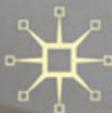


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# The Politics of Economic Regionalism

Explaining Regional Economic Integration  
in East Asia

Kevin G. Cai



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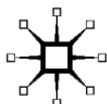
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# **The Politics of Economic Regionalism**

**Explaining Regional Economic Integration in East Asia**

Kevin G. Cai

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Printed and bound in Great Britain by  
CPI Antony Rowe, Chippenham and Eastbourne

*For my wife, Yanling, and my sons, Jeffrey and Justin*

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# List of Abbreviations

ABF	Asian Bond Fund
ABMI	Asian Bond Markets Initiative
ACC	Arab Cooperation Council
ACM	Arab Common Market
ACU	Asian Currency Unit
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
ALADI	Latin American Association for Development and Integration
AMF	Asian Monetary Fund
AMU	Arab Maghreb Union
ANZCERTA	Australia-New Zealand Closer Economic Relations Trade Agreement
ANZUS	Australia, New Zealand, United States Security Treaty
APEC	Asia-Pacific Economic Cooperation
APO	ASEAN Plus One
APT	ASEAN Plus Three
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
ASEM	Asia-Europe Meeting
AU	African Union
BSEC	Black Sea Economic Cooperation
CACM	Central American Common Market
CACO	Central Asian Cooperation Organization
CAEU	Council for Arab Economic Unity
CAN	Andean Community of Nations
CARICOM	Caribbean Community
CCASG	Council of Cooperation between Arab States of the Gulf
CEFTA	Central European Free Trade Agreement
CEPD	Council for Economic Planning and Development
CEUCA	Customs and Economic Union of Central Africa
CIS	Commonwealth of Independent States
CMEA	Council for Mutual Economic Assistance
CMI	Chiang Mai initiative
COMESA	Common Market of Eastern and Southern Africa
COREPER	Committee of Permanent Representatives

DMZ	Demilitarized Zone
DR-CAFTA	Dominican Republic-Central American Free Trade Agreement
EAC	East African Community
EAEG	East Asian Economic Grouping
EAFTA	East Asia Free Trade Area
EAS	East Asia Summit
EASG	East Asian Study Group
EAVG	East Asian Vision Group
EC	European Community
ECB	European Central Bank
ECCAS	Economic Community of Central African States
ECGLC	Economic Community of the Great Lakes Countries
ECJ	European Court of Justice
ECLA	Economic Commission for Latin America
ECOWAS	Economic Community of West African States
ECSC	European Coal and Steel Community
EEA	European Economic Area
EEC	European Economic Community
EFTA	European Free Trade Association
EMU	Economic and Monetary Union
EPU	European Payments Union
EROA	Economic Recovery in Occupied Areas
ESCB	European System of Central Banks
EU	European Union
Euratom	European Atomic Energy Community
FDI	foreign direct investment
FKI	Federation of Korean Industries
FTA	free trade agreement/free trade area
FTAA	Free Trade Association of the Americas
GATS	General Agreement on Trade in Service
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GDP	gross domestic product
GNP	gross national product
G8	Group of Eight
G3	Group of Three
G20	Group of Twenty
IGOs	intergovernmental organizations
IMF	International Monetary Fund
IPNs	international production networks

ITO	International Trade Organization
LAS	League of Arab States
LDCs	least developed countries
MERCOSUR	Southern Common Market
MFN	most-favored-nation
MITI	Ministry of International Trade and Industry
MNCs	multinational corporations
MRU	Mano River Union
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organization
NGOs	non-governmental organizations
NIEs	newly industrializing economies
NTA	New Transatlantic Agenda
OECD	Organization for Economic Cooperation and Development
OEEC	Organization for European Economic Cooperation
OPEC	Organization of Petroleum Exporting Countries
OSCE	Organization for Security and Cooperation in Europe
PAFTAD	Pacific Trade and Development Conference
PBEC	Pacific Basin Economic Council
PECC	Pacific Economic Cooperation Council
RTAs	regional trade agreements
SAARC	South Asian Association for Regional Cooperation
SACN	South American Community Nations
SACU	South African Customs Union
SADC	Southern African Development Community
SEA	Single European Act
SELA	Latin American Economic System
SPC	South Pacific Commission
TEP	Transatlantic Economic Partnership
UMA	Arab Maghreb Union
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
VERs	voluntary export restraints
WAEMU	West African Economic and Monetary Union
WTO	World Trade Organization

# Preface

Economic regionalism has been a hot topic in academics for decades. However, the existing economic regionalism theories, while providing many insightful ideas, are mostly developed on the basis of the experience of European regional integration. As such, when applied to economic regionalism in many other areas, particularly in East Asia, the existing theories on the subject frequently become less relevant, increasingly out of line with the actual course of regional economic integration there. This work is therefore intended to construct an analytical framework that is capable of explaining the recurrent phenomenon of economic regionalism in the world economy in general and East Asian regional integration in particular. While the analytical framework developed in this book is seminal, it is built on the basis of many insightful thoughts of contemporary international political economy theories.

The analytical framework for economic regionalism developed in this book was originally derived from my doctoral dissertation that was completed in 1996. In the development of the analytical framework, I was greatly indebted to Professor Michael K. Hawes, my doctoral supervisor at Queen's University in Canada, for his helpful comments. I am also thankful to Professor Patrick James for his insightful comments on my analytical framework at a later time.

After years of work, this book was completed in June 2009 at University of Michigan at Ann Arbor. I would like to thank Professor Charles Shipan, the Chair of the Department of Political Science, for inviting me to this esteemed institution as a visiting scholar for summer 2009 and for providing me with office space and other logistical support, which helped me successfully to complete this project at Ann Arbor.

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Last but not least, I am deeply indebted to my wife, Yanling. As I frequently had to work for a long time on this book manuscript,

my wife had to take more care of the family. Hence, this book is dedicated to my wife and our two sons.

Kevin G. Cai

Ann Arbor, Michigan  
June 15, 2009

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# 1

## Introduction

This work is a study of the politics of economic regionalism with special reference to East Asia. Regionalism is a very important phenomenon in the contemporary global economic system, which is situated between multilateralism at one end and nationalism at the other in terms of attitude and policy orientation of nation-states. While regionalism might be manifested in different forms in different regions, it generally conveys an idea that nations and peoples in a specific international region express a common sense of identity and pursue a common objective of “greater coherence” through “structures, processes and arrangements ... in terms of economic, political, security, socio-cultural and other kinds of linkages.”<sup>1</sup>

It is with such understanding of regionalism that there has been the rise of a new wave of economic regionalism in the world economy since the mid-1980s. While political, economic and technological forces have been pushing globalization of national markets, these same forces are now also promoting growing regional economic integration. The current wave of economic regionalism started in Western Europe and then spread to North America, Latin America, East Asia and other areas. However, the movements toward regional integration differ greatly from one region to the other. They range from the politically motivated and institutionalized movement toward regional integration in Western Europe to the primarily market-driven and less institutionalized regional integration in East Asia. As Norman Palmer points out, “Well-developed, effectively functioning regional organizations are the most conspicuous concrete evidence of a high degree of regionalism; but regionalism may be well advanced even if it has not led to the establishment of major organizational forms. It may be evidenced primarily by an extensive pattern of cooperative political, diplomatic,

commercial, and professional contacts, relations, and associations.”<sup>2</sup> In a similar fashion, Fredrik Soderbaum identifies two types of regionalism, old regionalism and new regionalism. While old regionalism is dominated by states and regional intergovernmental organizations (IGOs), new regionalism involves state, market, civil society and external actors. Under old regionalism, regional cooperation is confined to clearly delimited sectors such as trade and security, but new regionalism involves regional cooperation in a variety of areas with strong sectoral linkages. Moreover, old regionalism is introverted and often protectionist in policy orientation, while new regionalism is extroverted and often directly linked with globalization.<sup>3</sup> Whatever the form or type of regionalism, however, the rise of regional economic integration since the mid-1980s is significantly influencing the nature and evolution of the world economy in the 21<sup>st</sup> century.

Since the 1950s, scholars have developed a number of theories to explain economic regionalism. However, different approaches within the existing literature concentrate on different aspects of the subject: some primarily focus on the functionalist mechanism created on the basis of mutual interests of nation-states, some others concentrate on economic-rationale explanations, and still others primarily look at the interactions of international politics and economics. While these theories provide many useful insights in one respect or the other of economic regionalism, they could hardly address the following two key questions simultaneously in a systematic fashion, the questions that are fundamental to the study of economic regionalism: (1) Why do nation-states make efforts to go regional? (2) Why does regionalism assume different forms in different regions? Some of the existing theories on economic regionalism attempt to answer the first question, while the others seek explanations for the second question. Moreover, most approaches in the existing literature are primarily designed to explore regionalism as exemplified in various organizational arrangements like trade blocs or preferential trade agreements under the cognition that analysis of economic regionalism in its institutionalized form should be taken for granted.

This book is intended to construct a systematic analytical framework that is capable of providing comprehensive explanation of not only the recurrent phenomenon of economic regionalism in the world economy but also economic regionalism that does not assume the form of formal regional organizations. In doing so, a comprehensive approach is adopted to incorporate factors at global (structural), regional and national levels into a unified framework. Such a comprehensive approach would allow

us to simultaneously address the two key questions on economic regionalism, namely, *why* regional economic integration happens and *how* it proceeds to *what* form.

While the analytical framework constructed in this work can be used to explain economic regionalism in general, it is applied in this book to the particular case of regional economic integration in East Asia. Through this analytical framework, the book explores a unique process and pattern of regional economic integration in the East Asian region. As the existing literature on East Asian regional integration, despite its high density, is far from systematic and theoretical, particularly as compared to the existing literature on European regional integration, this work is intended to offer a systematic and theoretical approach to the exploration of East Asian regionalism, hence contributing to the existing literature on the subject. As East Asia might well become the centre of gravity of the world economy with its continued dynamic economic growth, it is therefore very important for us to have a better understanding of the growing East Asian regional integration and its profound impact on the global political economy.

Moreover, the selection of East Asia as a case study of regional economic integration is not only because this is a most dynamic region in the world economy today, but also because East Asia is quite distinct in many important respects from other regions. According to Bruce Russett, an international region may be defined by a set of criteria, either individually or collectively. These criteria include: (1) social and cultural homogeneity, that is, a region is composed of states which are similar with respect to several kinds of internal attributes; (2) similar political attitudes or external behavior, as shared by the states in a region; (3) political interdependence, that is, the countries in a region are joined together by a network of supranational or intergovernmental political institutions; (4) economic interdependence, as identified by intraregional trade as a proportion of the nations' national income; and (5) geographical proximity.<sup>4</sup> According to the above criteria, East Asia is grouped as an international region primarily by social and cultural homogeneity (for much part of the region), economic interdependence and geographical proximity. Although political interdependence as Russett defines is very weak in East Asia today, common interests in maintaining a region-wide stable political environment do exist among the nation-states in the region. Also added to these conditions is the consciousness and sense of the mutual identity of the region by the peoples in East Asia. Furthermore, it is also important to point out that certain features of state-society relations are unique to

the region. These shared attributes of East Asian states clearly distinguish them from other international regions.<sup>5</sup> Finally, it is also important to note that although as an international region, East Asia is generally seen as being made up of two sub-regions, Northeast Asia (which covers Japan, the Korean Peninsula, China, Taiwan and Hong Kong) and Southeast Asia (which involves Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, Vietnam, Cambodia, Laos, and Myanmar), the region as a whole is profoundly influenced by Northeast Asia, particularly by two regional powers, China and Japan, in terms of politics, security, economics and culture.

The book consists of six chapters. The chapters following the introductory chapter are organized as follows:

After a review of major existing theoretical perspectives on economic regionalism, Chapter 2 develops an analytical framework for explaining economic regionalism. While the overall structure of this analytical framework is seminal, the approach is built on the basis of many insightful ideas of contemporary international political economy theories. This analytical framework is intended to explore economic regionalism in the world economy in general and a unique process and pattern of regional integration in East Asia in particular. The analytical framework developed in this chapter lays a theoretical foundation for discussion of economic regionalism in the following chapters.

Chapter 3 provides an analysis of the establishment and evolution of the postwar international economic order and its historical background. Attention is especially given to the fundamental changes in the international setting from the 1980s onwards. The major argument in this chapter is that the end of the Cold War, the relative decline of American hegemonic power and the rising trend of globalization have altered the very foundation of the postwar liberal international economic order. Consequently, a novel global political and economic system is emerging, which is now jointly influenced by the US, the European Union (EU), Japan, China and other national powers and various international players. It is against such a background that a new wave of regionalism has emerged and developed since the mid-1980s, concurrent with rising globalization.

Chapter 4 examines regionalism in the world economy in the postwar years. A major theme of the chapter is that while multilateralism is the most salient force in the postwar world economy, economic regionalism has consistently existed since the early 1950s. However, economic regionalism in the 1950s–60s failed to prevail, as multilateralism served the interests of major economies well and the US as

the hegemon restrained itself from any regional economic arrangement. After the mid-1980s, however, a new wave of regionalism emerged and developed vigorously in the context of fundamentally transformed global geopolitics and economics as a result of the end of the Cold War, relative decline of US hegemonic power and emergence of new economic powers, and rising trend of globalization. Consequently, the global economic order has been transformed with realignment between multilateralism and regionalism in a new era of the globalized world economy and post-hegemonic stability.

Chapter 5 explores a unique process and pattern of regional economic integration in East Asia since the mid-1980s and the driving forces at global, regional and national levels behind this process. Different from economic regionalism elsewhere, regional economic integration in East Asia since the mid-1980s emerged as an autonomous and un-institutionalized process characterized by rising intraregional trade and foreign direct investment (FDI) flows, which was primarily driven by market forces and economic imperatives, although encouraged by the governments in the region in varying degrees. Over time, however, regional integration in East Asia gradually involved a new dimension of increasingly institutionalized regional economic cooperation among states in the region, particularly in the wake of the Asian financial crisis of 1997–98. The evolution of East Asian regional integration from a market-driven autonomous process to growing institutionalized regional cooperation over a rising range of regional issues not only was a logical development of increasingly closer economic and other ties in the region, but also reflected the efforts of East Asian states to respond actively to the changing conditions of the global and regional economy brought about by globalization. The chapter specifically examines some most important government initiatives of institutionalized regional cooperation, including Asia-Pacific Economic Cooperation (APEC), the Association of Southeast Asian Nations (ASEAN), the ASEAN Plus Three (APT), the ASEAN Plus One (APO), and an increasing number of bilateral preferential arrangements in the region.

The concluding chapter provides a summary explanation of economic regionalism in East Asia by referring to the analytical framework developed in Chapter 2 of the book and assesses the prospect of growing institutionalized regional cooperation among East Asian states. The chapter finally speculates on how an East Asian grouping, if it eventually emerges, will bring impacts on global as well as East Asian regional politics and economics.

# 2

## Theoretical Perspectives: Constructing an Analytical Framework

Scholars have developed a number of theories to explain economic regionalism in the postwar years. While the existing theories provide some intellectual insights on economic regionalism in one respect or the other, they could hardly explain a unique process and pattern of regional economic integration in East Asia that has developed since the mid-1980s. The analytical framework that is developed in this chapter is intended to explore economic regionalism in the world economy in general and regional economic integration in East Asia in particular. While the overall structure of this analytical framework is seminal, the approach is built on the basis of many insightful thoughts of contemporary international political economy theories with respect to economic regionalism, incorporating global (structural), regional and national factors into a unified analytical framework.<sup>1</sup> As such, a review of major theoretic perspectives on economic regionalism is useful.

### 1. Major theoretical perspectives on economic regionalism

#### 1.1. Regional integration theory

The attempts to explain economic regionalism in theoretic terms in the postwar years started with the emergence of regional integration in Western Europe. The general body of literature lumped under the rubric of regional integration theory includes functionalism and its modified version, neofunctionalism. The logic of functionalism, which was first developed by David Mitrany, rests upon the premise that nation-states, as presently constituted, are incapable of solving increasingly complex economic and social problems of a border-crossing nature.<sup>2</sup> Functionalism therefore attempts to explore regional organizations to deal with these common economic and social problems.

These regional organizations are designed to pursue functional cooperation in specific technical and non-political sectors. According to functionalism, such functional cooperation would trigger a process of “spillover” with collaboration in one sector generating the need for collaboration in other sectors, thus resulting in the ever-widening circles of regional economic and social integration and eventually involving the political sector. Consequently, a web of regional interdependence would be formed, which would gradually remove layers of sovereignty from the state and redirect the sentimental attachments of individuals toward regional organizations. Based on the belief that mutual interests would draw nation-states together, functionalism is a theory of international cooperation, in sharp contrast to realist theory, which stresses competition and conflict as a principal feature of international politics.

Neofunctionalism modifies functionalism in several important respects. The primary modification is that neofunctionalism embraces federalist political objectives while maintaining a functionalist incremental strategy, a modification that makes neofunctionalism essentially a theory of supranational state-building and not just an approach to the management of international interdependence through a “working peace system.”<sup>3</sup> Another important revision concerns the role of politics in the process of regional integration. While technical, material and administrative factors are held to play a background role, politics is seen in neofunctionalism as the essence in the process of regional integration. The high politics/low politics dichotomy is abandoned.<sup>4</sup> The key actors are not the regional institutions of functionalists, but national and regional elites and interest groups. The political process occurs in the context of broad intergovernmental agreement about the need to integrate, and of “permissive consensus” in public opinion. The “spillover” concept is also modified in a way that the spillover process is no longer taken to be automatic and technically driven, but is contrived and negotiated by political actors seeking to maximize advantage. As it impinges more and more on sectors of high politics (which is related to state sovereignty), regional integration is expected to become more and more politicized, its process marked by periodic crises.<sup>5</sup>

Although regional integration theory correctly identifies the incremental nature of the integration process in terms of both the scope of integration and the motives of the actors, as Ernst Haas suggests, it pays insufficient attention to factors in the broader international setting that affect the regional integration process.<sup>6</sup> In other words,

regional integration theory focuses only on interdependence among the participants and tends to overlook the importance of events and actors external to the region under examination. To overcome this weakness of regional integration theory, Joseph Nye proposes that both external actors and events be included as a “process mechanism” within the evolution of integrative scheme, with the emphasis placed upon the role of the external actors.<sup>7</sup> Although events may act as a temporary stimulus, the role of actors, according to Nye, is continuous.<sup>8</sup> Nye cites the favorable impact of external actors upon the early efforts at regional integration in Central America. Moreover, the policies of major powers may have both intended and unintended effects upon the ongoing process of regional integration.<sup>9</sup> At a more general level, interest groups and elites may become interested in regional integration if increased benefits are perceived as a result of a stronger international position *vis-à-vis* external actors through increased regional cooperation.<sup>10</sup> This process mechanism, Nye concludes, has a strong perpetual character. He notes: “The way that regional decision makers perceive the nature of the external situation and their response to it is an important condition determining agreement on further integration. There are a variety of relevant perceptions, such as a sense of external threat from a giant neighbor, loss of status felt by the Europeans and Latin Americans as a result of bipolarity, and simple demonstration effects (‘everybody’s doing it’).” And, furthermore, “Agreement on the nature of the external situation and on what the regional organization should do to deal (or not deal) with it is the favorable condition that makes an integrative response to the process mechanisms more probable.”<sup>11</sup> Although Nye aptly identifies the important role that the external actors and events play in the initiation and process of regional integration, his concepts are still basically constructed within the same analytical framework of conventional regional integration theory by simply modifying some variables and adding others.<sup>12</sup> He fails to address the issue of why nations go regional in the first place.

## 1.2. Customs union theory

About the same time as the emergence of regional integration theory, Jacob Viner developed in 1950 a pure economic model – customs union theory – to explain regional free trade arrangements.<sup>13</sup> By introducing the concepts of “trade creation” and “trade diversion,” Viner attempted to address the welfare effects that result from changing trade flows following the formation of a customs union. Trade creation occurs when a customs union, by removing tariffs on intra-union

trade, shifts members' demand from domestic production to lower-cost output from a union partner; trade diversion appears when a customs union, through tariff preferences for union members, shifts demand for imports from a low-cost non-union source to a higher-cost union member. The establishment of the union, according to the theory, improves welfare if trade creation predominates and worsens it if trade diversion prevails. Although Viner also looked at the effects of administrative costs, economies of scale, effects of effective tariffs, and terms of trade effects, he was primarily concerned with the production effects of customs unions, that is, the impact of customs unions on the location of production. Viner's theory was later modified and broadened by Franz Gehrels (1956),<sup>14</sup> Richard Lipsey (1957),<sup>15</sup> and Paul Collier (1979),<sup>16</sup> who introduced into their models other welfare effects, such as consumption effects and terms of trade effects, in addition to production effects. Lipsey's 1960 survey article was an important summary of the developments of customs union theory in the 1950s, though research on the welfare effects of changing trade flows continued thereafter.<sup>17</sup>

After Lipsey's 1960 survey paper, economists shifted their research emphasis from the economic effects of customs unions to the question of why customs unions are formed in the first instance. Such a change, according to Melvyn Krauss, "reflects both a theoretical and institutional imperative: the former being a response to the failure of traditional international trade theory to explain why policies other than free trade or modified free trade are followed by governments; the latter, to the recent interest in economic integration on the part of the world's developing countries as a means for accelerating their rate of economic progress."<sup>18</sup> The issue was tackled by C. A. Cooper and B. F. Massell (1965),<sup>19</sup> Harry G. Johnson (1965),<sup>20</sup> Melvyn B. Krauss (1972),<sup>21</sup> Gunnar Floystad (1975),<sup>22</sup> Roma Dauphin (1978, ch.2),<sup>23</sup> Eitan Berglas (1979),<sup>24</sup> and others, who attempted to search for both economic and non-economic rationales for forming a customs union.

One of the most frequently cited economic rationales behind the creation of a customs union is the economies-of-scale effects.<sup>25</sup> These economies of scale, if realized, could result in lower unit cost. In addition, the reduction of barriers to trade (and to movements of labor and capital) can bring mutual benefits to all participating countries by eliminating inefficient centers of production. Large-scale enterprises, to be efficient, require high levels of production. High levels of production, in turn, require mass consumer markets. The formation of a regional trading bloc serves to create this mass consumer market.<sup>26</sup>

Another economic rationale for the formation of a customs union is economic development, especially in developing countries. As Cooper and Massell argue, the rationale of customs unions among developing countries is that “two can do what one cannot” in achieving industrialization. The underlying presumption is that developing countries seek to avoid dependence on the West in pursuing industrialization. However, given their weak position in the world economy, developing countries could achieve economic independence only through grouping with other developing neighboring countries rather than individually.<sup>27</sup> This is also true with the concept of infant industry protection. As the market in most developing countries is too small to allow an efficient scale of production of a new product, a customs union might provide sufficient demand for this new product until the domestic producers are ready for global competition. However, none of the customs unions and free trade areas among developing countries has been successful so far, largely because of the structural weaknesses of most developing countries.

Although the economic approaches provide some insights into the economic consequences of customs unions, they ignore a very important fact, that is, the chain reaction effect. As regional trading blocs operate by lowering and eventually eliminating tariff and non-tariff trade barriers between member states, these measures are in effect discriminatory against non-member states. In response, non-member states would logically take countervailing measures most probably by forming their own customs unions. This would therefore offset the benefits that the members of the first union could obtain. Furthermore, as many authors argue, the economic effects of the formation of customs unions are either weak or undetermined enough to be neglected.<sup>28</sup>

As such, some theorists attempted to introduce a political dimension into the analysis of customs unions. Among the authors who explored this issue, Cooper and Massell provide widely accepted explanation. There could never be an economic case for any customs union, they claim. Their argument is that customs unions, especially the European Economic Community (EEC), were created for political not economic reasons,<sup>29</sup> though, as Hirschman points out, at least initially the political support for forming a customs union comes primarily from those who expect to benefit from trade diversion.<sup>30</sup> This is also true with the Council for Mutual Economic Assistance (CMEA), which was established by the Soviet Union for exactly political and military considerations.<sup>31</sup> However, this argument, though good at explaining the formation of some customs unions in the 1950s–60s, especially the

EEC and the CMEA, is obviously unable to explain the new regionalism that emerged and developed from the mid-1980s onwards.

### **1.3. Contemporary theories of international political economy**

Though not dealing with regionalism *per se*, contemporary international political economy theorists provide many useful thoughts with respect to economic regionalism. A central issue in international political economy is the interaction of international politics and economics. However, the search for answers to how international politics and economics interact and affect one another divides scholars along several major theoretical lines: economic nationalism, liberalism, and Marxism. Each perspective represents a distinct theoretical tradition within the field of international political economy.

#### *Economic nationalism*

Rather than a coherent and systematic body of economic and political theory, economic nationalism conventionally refers to certain measures of public policy and administration in such areas as trade and commerce, investment, finance and welfare that have historically been seen and characterized as nationalistic.<sup>32</sup> The essence of economic nationalism is to pursue national economic interests through (1) shielding the national economy against outside influences and (2) aggressive and discriminatory policies against foreigners.<sup>33</sup> According to economic nationalism, international economic relations should be determined by political factors and economic interests can be pursued by political means. As nationalists regard power and wealth as two complementary national goals, international economic relations are therefore viewed as being fiercely competitive and conflictual. As such, economic nationalism tends to emphasize the real or potential costs over benefits of international economic exchanges. In its historical development, economic nationalism has assumed different forms (mercantilism, protectionism, and new protectionism) at different times and in different countries, basically reflecting the changing structure of the world economy as a whole and the changing norms and practices of nation-states. Under these different forms of economic nationalism, specific policies and practices have also evolved in response to changes in governmental objectives and economic thinking. Nationalist economic policies and practices could be those of purely defensive and self-strengthening nature, say, autarky and self-sufficiency,<sup>34</sup> the protection of domestic production through tariff or non-tariff barriers, economic development through industrialization, a favorable balance of trade, a balance of payments surplus, a favorable

position in international division of labor, and primacy of domestic employment and welfare; they could also be those more aggressive measures, such as dumping, export subsidies, various forms of “beggar-my-neighbor” policies,<sup>35</sup> and security of overseas economic resources and markets through various means. Nation-states usually pursue economic nationalism to safeguard national economy and security against external economic and political forces and to secure and even expand economic interests overseas.<sup>36</sup> This finding is illustrated by the political and economic development and the evolution of theoretical thinking since the 16<sup>th</sup> century.

As the earliest manifestation of economic nationalism, mercantilism is a collection of ideas on economic policy characteristic of the period of pre-industrial capitalism from the late 16<sup>th</sup> to the early 18<sup>th</sup> century, responding to the Commercial Revolution and the expansion of international trade throughout the period. Aiming at building national strength through increasing wealth, mercantilism relies upon a strong state and the extensive regulation of economic activity. Under the body of ideas termed as “mercantilism” are two essential propositions: (1) the wealth of a country consists of the quantity of precious metals (gold in particular) in circulation or in hoards within its borders; and (2) the way to increase that wealth is to secure a surplus in balance of payments usually identified with a balance of trade, by policies of import substitution and export promotion.<sup>37</sup> The classical mercantilists therefore advocate the growth of national wealth by achieving continuing inflow of money in the form of gold through policies designed to create a continuing balance-of-payments surplus.<sup>38</sup> An additional way to increase wealth is the acquisition of colonies, which is considered necessary to provide convenient sources of raw materials and secure markets at little expense to the mother country. Since one country’s gold gain almost always means a gold loss to one of its trading partners, not all nations could achieve their ambitions at the same time – a fact that makes trade rivalries among nations highly intense. The mercantilist doctrine was later criticized by Adam Smith in *The Wealth of Nations* (1776) with his famous principle of specialization and division of labor, which was then extended by David Ricardo in the principle of comparative advantage. According to Smith and Ricardo, what makes a nation rich is not money but the accumulation and efficient utilization of productive resources and trade is a matter of mutual advantage. As such, production and international trade should be completely free.

Following the Industrial Revolution, the idea of industrial nationalism gained a stronger hold upon popular thinking than at any time since

the days of mercantilism.<sup>39</sup> The philosophical groundwork of economic nationalism of this brand is best reflected in infant industry theory. Like an infant, according to this theory, the burgeoning industries in late-comer countries are exposed to a harsh environment of international economic competition and therefore need special care from the government before they could become mature and self-supporting. It is no accident that two of the foremost theorists of industrial nationalism – Alexander Hamilton and Friedrich List – were respectively from America and Germany, two then industrially backward countries facing fierce competition from “mature” nations of England and France. Although the infant industry argument was first developed by Hamilton to justify protecting US industry and agriculture against British competition, it was List who developed the theory most systematically in his 1840 book, *National System of Political Economy*. List advocated government protection of national market as a means to enable a nation to catch up economically with stronger foreign competitors. Once the national economy was properly established, the system of protection could be replaced by a system of universal free trade. List’s theory provided intellectual defense of nationalist protection in the interests of wealth creation in a competitive capitalist world economy. His argument was later adopted by many developing countries in the 1950s–60s, which, after obtaining political independence, sought to achieve economic independence through protection of domestic industries and the pursuit of nationalistic development policies.<sup>40</sup>

Largely due to the Great Depression of 1929 and the subsequent collapse of the international monetary system, the 1930s witnessed the introduction of a new phase of economic nationalism, concerned primarily with protection of domestic employment and welfare, in addition to balance of payments surplus. Consequently, a purposive – rather than merely a regulative – state emerged as a dominant political form throughout the capitalist world, a state that regarded it as its duty to secure for the population not merely their rights to physical security and property but also to social welfare. After World War II, economic nationalism became further sophisticated. In addition to full employment, the purposive state was also concerned with economic growth, increase in productivity, and high living standards. As a result, nation-states became more tempted to adopt nationalistic fiscal, monetary and trade policies to export unemployment to other economies and to safeguard their own industries and social welfare. From the 1970s onwards, the economic nationalism (neoprotectionism or neomercantilism as is called by some scholars) in the industrial world was

reinforced by the consistent economic decline, rapid technological innovations, and increasingly effective challenges posed by a group of successful developing countries. Accordingly, governments shifted their policies from the traditional way of protection from imports *per se* to the fiscal subsidization of new import-competitive industries and high-tech export industries; they also began to look to the creation of supranational protected market areas rather than protection of the home market.

Behind economic nationalism there is a consistent theme of pursuing national economic independence, which is in sharp contrast to liberals' emphasis of interdependence of national economies. Historically, nationalists have pursued economic independence in various ways. An extreme way to achieve economic independence is autarky, which deliberately rejects all external economic relationships. In the modern times, such extreme cases are rare. More often than not, economic nationalism of this orientation, in pursuing economic independence, takes the form of self-sufficiency with limited economic intercourse with a limited number of foreign countries. Both autarky and self-sufficiency are actually inward-looking approaches to development. The purpose of this domestic-oriented strategy could be the formation of an integrated national economic system that could achieve economic development while escaping from or lessening uncontrollable and at times unpredictable external forces or constraint.<sup>41</sup> The examples of such extreme pursuit of independence, however, are quite few in modern times.

Moreover, the formation of supranational trading blocs may also be seen as manifestation of modern economic nationalism.<sup>42</sup> Given the growing interdependence in the world economy, which no country could escape from without considerable cost, protection of domestic markets through traditional mercantilist measures clearly becomes an inadequate resort. As a result, regional trade blocs are created as a supplementary approach to the protection of domestic markets against external competition. Bilateralism also reveals such features of economic nationalism.

#### *Liberalism – interdependence theory and hegemonic stability theory*

Liberalism is theoretically wide-ranging. Originating in the writings of Adam Smith and other classical writers, liberalism emerged in the 17<sup>th</sup> century as a response to, and critique of, authoritarianism and paternalism in the political sphere and mercantilism in the economic sphere. Liberalism assumes that politics and economics are separate spheres of human society and that market – in the interest of efficiency,

growth and consumer choice – should be kept free from political influence. Though not anarchists and at the very least recommending a minimal state that protects lives, defines property rights, and enforces contracts in the market, early liberals believed in the general rule of *laissez faire* and wanted to preserve self-regulating market process. They were confident that the enforcement of strict constitution and the elimination of monopoly and special-interest legislation would guarantee peace and material process within all societies and for all social classes. This theoretical thinking, which was later termed as classical liberalism, is embodied in orthodox economics.<sup>43</sup>

By the end of the 19<sup>th</sup> century, a new style of liberalism, called neoliberalism, began to compete with classical liberalism and became a dominant form by the first half of the 20<sup>th</sup> century.<sup>44</sup> Neoliberalism continued to speak of individual freedom and liberty, but advocated an expanded role of the state in the marketplace. Unlike classical liberals, neoliberals were not overly concerned with the danger of a powerful state turning into tyranny. They were confident that, as long as democratic forms of government were maintained, the political system would attract and select reasonable leaders to manage power in a humane and responsible manner.

Both liberalisms share the same fundamental goal of promoting individual self-development; they differ only on the means to be employed. In both versions, the most general underlying proposition is that the market and price mechanism is the most efficient means for organizing domestic and international economic relations, and brings maximum welfare for human beings. At the global level, liberalism advocates free trade among nations on the basis of comparative advantage and believes that free trade would help achieve rapid economic growth and good distribution for all nations. As such, liberals denounce any trade restrictions as irrational and harmful. On the other hand, liberals believe that the development of the international division of labor would maximize general welfare and thus raise the costs of conflict. Consequently, any attempt to advance the national interest by force becomes increasingly irrational, and the maintenance of a market order, and the commitment by states to its progressive liberalization, is therefore the best security policy. Generally speaking, liberalism emphasizes opportunities rather than constraints. Historically speaking, however, it is usually the most powerful states that are in favor of free trade, while later comers in the international economic competition seldom see the rationality of free trade as so apparent.

Since the late 1960s, largely stimulated by the postwar growing international economic ties, characterized by the formidable size and growth

of trade, investment, and other forms of economic exchanges among nations, the concept of international interdependence has received special attention within the liberal school. Although the notion of interdependence is not a new one in international relations theories, it was not until the late 1960s and early 1970s that efforts were made to develop propositions about its trends and political effects. The book by Richard Cooper, *The Economics of Interdependence*, published in 1968, is considered to be the starting point, thereafter interdependence became the theoretical focus of liberalism.<sup>45</sup>

Most notably, the concept of interdependence is systematically explored by Robert Keohane and Joseph Nye as mutual sensitivity and vulnerability in their book, *Power and Interdependence*. Seeing political realism as no longer able to depict adequately many aspects of the current reality, Keohane and Nye paint a picture of complex interdependence. In contrast to the state-centric realist perspective, complex interdependence draws attention to the role of non-state actors (such as international organizations and multinational corporations (MNCs)/banks) in shaping the contours of contemporary world politics and economics. It also challenges the realists' view of the centrality of military power in states' foreign policies, arguing instead that on some issues military power is irrelevant.<sup>46</sup> In essence, it is the belief of the liberal interdependence literature that trade and economic intercourse are a source of peaceful relations among nations, because the mutual benefits of trade and expanding interdependence among national economies tend to foster cooperative relations. No nation-state in the contemporary world can afford the costs of disrupting economic interdependence. This mutual vulnerability of necessity limits and moderates the economic and political struggle among nation-states. On the contrary, in the interest of world efficiency and domestic economic welfare, the nation-state's control over economic affairs continually gives way to multinational corporations, to world free market, and to other international institutions better suited to the economic needs of mankind. As this process is going on, nation-states will eventually become obsolete.

It is true that the world is increasingly interdependent. However, as Waltz points out, interdependence is a relation among equals.<sup>47</sup> In the contemporary world, the prevailing story is inequality in terms of national strength and power and of national political, economic and military capability and competence. There are unmistakably great differentials in vulnerability, dependency, influence, and coercive capacity among nation-states. The interdependent world has not radically

altered the position of developing countries *vis-à-vis* developed ones under the existing international political and economic order. A world of nations marked by great inequalities can hardly be truly interdependent. As Keohane and Nye notice, power derives from patterns of asymmetrical interdependence between actors in the issue areas, which would then be used by them in their dealings with one another.

Just due to the existence of inequalities among nation-states in power and capacity, the gains from international exchanges are actually distributed unequally among them. Under the existing international economic order, many developing countries mainly, or even exclusively, produce and export raw materials while industrialized countries specialize in producing manufactures and capital goods. This international division of labor is an obstacle to the economic development of many developing countries, since those producing raw materials are subjected to deteriorating terms of trade *vis-à-vis* the industrialized countries. Thus, contrary to the belief of the liberal literature that the consequences of increased participation in international trade and economic exchanges are more or less equal to all parties, growing interdependence never affects every state in the same way, and neither does it raise the same welfare in all the countries trading with each other. Moreover, an expansion of the market would often favor those countries that have already possessed developed industries, for countries with a relatively small industrial basis fall behind when competing with the larger and more developed industries. In the meantime, the weak position of developing countries becomes further worsened by their increasing dependence on developed countries for capital, technology, know-how, management skill and market in their economic development. Thus, for many developing countries it is the degree of dependency, rather than interdependence, that constitutes their primary concern. Thus, the patterns and qualities of interdependence are more important than quantities and growth rates. Economic nationalism is likely to occur exactly in situations typified by asymmetrical patterns of interdependence, unequal exchange, unidirectional flows, and attempts by the strong to penetrate the weak politically, economically, culturally and socially. Apparently, while liberals may envision absolute gains for national economies from participating in international trade and economic exchanges, they are unable to solve the problem of those gains being unequally distributed among them. It is precisely the issue of the distribution of relative gains that causes tensions among nations.<sup>48</sup>

Another important concept of neoliberalism is "public goods." Public goods refer to the goods and services "the consumption of which by an

individual, household, or firm does not reduce the amount available for other potential consumers."<sup>49</sup> That is to say, public goods cannot be simply limited to those who are willing and able to pay for them. This implies that public goods have to be supplied by the government and/or by those private sectors subsidized by the government, which can then force consumers to pay for them through taxation, otherwise these goods tend to be undersupplied. Among public goods in the domestic setting, for example, are national security, highways, monetary stability, law and order, and so forth.

At the global level, public goods, which provide political and economic conditions for, and aspects of, a liberal international economy, include the provision of international security,<sup>50</sup> a stable international monetary system, and an open international trade system based on the most-favored-nation (MFN) principle of non-discrimination and unconditional reciprocity.<sup>51</sup> The existence of these public goods makes the movement of goods, services and capital relatively free and predictable. The concept of public goods is based on the argument that international economic relations through market are a positive-sum game, which would bring increased economic welfare, for all the nations involved, although increased welfare might be unequally distributed. Moreover, according to liberals, such positive-sum interactions generate a rationale for international economic cooperation among nation-states.

In international economic relations, the supply of public goods is said to be problematic, for there is no world government that exists to perform the role of extracting taxation from those who benefit from a stable liberal international economic order. This gives rise to the "free-rider" issue, an issue that frequently threatens an open world economy. To solve this problem, economic liberalism is fused with political realism to introduce hegemonic stability theory.<sup>52</sup> According to this theory, a liberal world economy, in which the rules of the market are enforced over the particular national interests of individual nation-states, requires the leadership of a hegemonic power. As individual states usually have the temptation to cheat and exploit others and to benefit from international public goods without paying their "fair" share toward providing it, a hegemonic state is needed to perform a managerial or policing role in international economic relations and to supply international public goods.<sup>53</sup> In so doing, the hegemonic power may either supply international public goods freely (the benevolent hegemon) or get other states to contribute to the supply of these goods through threats and/or inducements (the coercive hegemon).<sup>54</sup>

For a liberal international economic order to be created and maintained, hegemonic leadership is seen as a necessary but not sufficient condition, since the hegemon itself must be committed to the value of liberalism. As both Katzenstein and Ruggie note, the domestic social and economic structures of the hegemon (and of other societies as well) are important preconditions for its commitment to a liberal international order.<sup>55</sup> In addition, there must also be a balance of interests between the hegemon and other major economies if the legitimacy of hegemony is to be maintained. If the hegemon is to have the necessary support of other major economies, a considerable degree of ideological consensus between them is required.<sup>56</sup> The hegemon can encourage but cannot compel other major economies to follow the rules and norms of an open world economy. The hegemon assumes the leadership role in a liberal economic order; at the same time it should be constrained by the need to maintain this order as well. On the other hand, other major economies must also have an interest in the liberal international relations. They accept the rule of the hegemon because of its prestige and status in the international political system.<sup>57</sup> The hegemonic system would be greatly weakened if other states begin to view the actions of the hegemon as self-serving and contrary to their own political and economic interests, or the hegemon believes that other states are cheating or that the costs of leadership begin to exceed the perceived benefits.<sup>58</sup> As Gilpin points out, hegemony, liberal ideology and common interests are three prerequisites that must be available for the emergence and expansion of the liberal market system.<sup>59</sup>

In performing its leadership role in a liberal world economy, the hegemonic power usually designs and creates international regimes, which Krasner defines as the "implicit or explicit principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations."<sup>60</sup> The regime prescribes legitimate and proscribes illegitimate behavior in order to limit conflict, ensure equity, or facilitate agreement.<sup>61</sup> The duty of the hegemonic power is to prevent cheating and free riding, enforce the rules of a liberal economy, and encourage the others to share the costs of maintaining the system. The gold standard of the 19<sup>th</sup> century and the postwar Bretton Woods system and General Agreement on Tariffs and Trade (GATT) system are such examples of economic regimes in which the hegemon establishes and enforces the rules of a liberal market regime and suppresses the ever-present tendencies toward economic nationalism.<sup>62</sup>

Historically, there have been only two examples of a liberal world economy with hegemonic leadership.<sup>63</sup> The first was the era of the *Pax*

*Britannica* between the end of the Napoleonic Wars and the outbreak of World War I. The liberal international order that provided the framework of economic relations between the major powers prior to World War I was largely due to the British economic power and to the policing of world trade routes by the British navy. Great Britain, committed to the ideology of liberalism following the political triumph of the middle class, used its influence to usher in the age of free trade. In the meantime, recognizing benefits of trade the major powers generally accepted the values of liberalism and opened their borders to the world market through negotiations on tariff reductions.<sup>64</sup> Similarly, the establishment and maintenance of the post-1945 liberal international economic order depended crucially on the dominance and leadership of a new hegemon, the US, in the world economy. GATT and the International Monetary Fund (IMF), which embodied liberal principles, were established and maintained primarily by the US with the support of its allies. In the meantime, the US-led North Atlantic Treaty Organization (NATO) provided a secure and stable environment for the development of global economic relations. By playing the leadership role, the US assumed almost unilaterally international obligations to the maintenance of the world economic and political order. During both the *Pax Britannica* and the *Pax Americana*, the global market and international economic interdependence expanded.

Just as the existence of a hegemonic power with its overwhelming economic and military strength is the key to the establishment and maintenance of a liberal international economic order, this economic order would get weakened if there is decline of the hegemon.<sup>65</sup> If this situation appears, the free-rider issue would become a serious problem again. However, although the liberal international economic order might erode with the decline of the hegemonic power, other factors such as the force of inertia, the absence of an alternative, and the residue of common interests and purposes among the dominant powers would help maintain the system.<sup>66</sup> As Keohane cogently argues, the norms of the regimes themselves inhibit proscribed behavior.<sup>67</sup> As states learn their benefits, regimes are more easily maintained than created.<sup>68</sup> On the other hand, if a regime is brought down, considerable costs would be incurred. This explains why the 19<sup>th</sup> century trade and monetary regimes continued to survive long after British hegemony began its decline<sup>69</sup> and why the post-1945 trade and monetary regimes was largely maintained despite the relative decline of American hegemony that started as early as the late 1960s.

On the whole, the postwar world economic system based on the hegemonic leadership of the US and on the rejection of the principles of

economic nationalism supported the basic ideas of liberalism. The exceptional record of growth and prosperity after World War II was largely attributed to the favorable world political and economic order defined and maintained by the US, and to the lowering or elimination of tariffs, the banning of quantitative import quotas, the achievement of currency convertibility, the liberalization of the movement of capital and labor, the control of cartels and the promotion of competition, and to the success of integration in the world economy. The record of economic growth and trade in the 1950s–60s had no parallel in previous economic history.<sup>70</sup> Despite the prevalence of liberalism, however, economic nationalism continued to exist in various forms in the postwar years. As Gilpin points out, "... economic nationalism is likely to be a significant influence in international relations as long as the state system exists."<sup>71</sup>

#### *Marxism – dependency theory and world system theory*

Marxism is a rich theoretical tradition, representing a particular viewpoint of the combined disciplines of philosophy, history, economics, sociology, and political science. As far as the capitalist world economy is concerned, however, Marxist historical-materialism and imperialism arguments are of most importance. Emerging in the mid-19<sup>th</sup> century as a radical reaction to economic nationalism and liberalism, Marxism asserts that economics drives politics and that economic relationships in society define and give rise to class conflict and determine the distribution of wealth. These basic themes of Marxism were later developed and applied by dependency and world system theorists in their study of international political economy.

Marx defined capitalism in terms of relations between the working class and the capitalist class. The capitalist development, according to Marx, is determined primarily by each country's historical condition and internal structure, especially by the nature of the dominant mode of production. According to classical Marxism, capitalist development is an inevitable worldwide process, spreading from the centre to other parts of the world, and this process brings other areas into a similar process of capitalist development. It is in this sense that the process of capitalist expansion can be seen as positive to these areas, because it results in changes toward new mode of production and helps to replace the old pre-capitalist mode of production by domination of a capitalist mode of production. In his analysis, however, Marx, following the Hegelian tradition, distinguished between the subjective motivations for capitalist expansion and its objective historical results. On

the one hand, he condemned this expansion as the most brutalizing and dehumanizing that history had ever known, but on the other, he argued that it is necessary if the backward societies are to develop. It is in this sense that Marx argued in *Capital* that the backward country suffers not only from the development of capitalist production, but also from the incompleteness of that development. It is also in this sense that Marx claimed that the country that is more developed industrially only shows, to the less developed, the image of its own future. As such, colonialism and the expansion of capitalism into pre-capitalist areas of the world are considered desirable and progressive. Lenin held on to this evolutionary perspective in his analysis of capitalist development in Russia, though the process is full of contradictions due to its backwardness.<sup>72</sup> In his later works on imperialism, Lenin further modified the classical Marxism by claiming that capitalist development in the colonies is prevented by the colonial bonds.

After World War II, a different type of analysis emerged in the Marxist literature on development and underdevelopment. In Paul Baran's 1957 book, underdevelopment is seen as a continuous process rather than as an original state to be overcome by development, and capitalist penetration and an ever-growing "economic tribute" that the core countries are able to extract from the periphery is considered to be the principal cause of underdevelopment in the latter. Baran thus completed the series of revisions in Marxism about imperialism with regard to its historical progressivity, becoming the "father" of the dependency school.<sup>73</sup>

Baran's argument was echoed by Latin American historical-structural theorists represented by Raul Prebisch of the Economic Commission for Latin America (ECLA). Prebisch sought the causes for Latin American underdevelopment outside the continent, and found them in the system of international free trade. According to Prebisch, the world economy is composed of two poles (center and periphery) and that the structures of production in each differ substantially with the center specializing in the production of industrial goods while the periphery in primary products. This international division of labor, in Prebisch's view, causes the deterioration of the periphery's terms of trade in favor of industrialized countries. Through this analysis, Prebisch came to the conclusion that the underdevelopment of Latin America is due to its reliance on exports of primary products. He also claimed that a continued emphasis on the export of primary products would inevitably lead to further deterioration of the periphery's terms of trade. By this analysis, Prebisch criticized liberalist trade theory,

which, according to Prebisch, supports the existing international division of labor, a structure that only benefits the center. As such, Prebisch proposed import-substitution policy for less-developed countries.<sup>74</sup>

Baran's theory and ECLA structuralism were taken up and extended by other third world scholars in the late 1960s, which were later grouped into what is called the dependency school. While dependency theory is very diverse and complex, some ideas that are common to most dependency theorists can still be discerned. These ideas include: (1) underdevelopment is intimately connected with the expansion of the industrialized capitalist countries; (2) development and underdevelopment are different aspects of the same universal process; (3) underdevelopment cannot be considered as the original condition in an evolutionary process; (4) dependency is not only an external phenomenon but is also manifested in different ways in the internal (social, ideological and political) structure. Furthermore, according to dependency theory, dependence of the periphery on the core is not seen as temporary or accidental, but as a structural feature of world capitalism. This is reproduced through a process that concentrates capital accumulation and technological innovation in the core. These financial, technological and trade advantages are the sources of the periphery's dependence on the core. Such advantages enable core states to exploit peripheral countries. As this involves draining resources from less-developed countries, the core-periphery divide is maintained or even increased.

Under this general view of the capitalist economy within the dependency school, there are variations in the assessment of the severity of the systemic impact of structural dependency on the periphery. Andre G. Frank was most radical and pessimistic. In his view, the development of the core implies a process of underdevelopment of the periphery. As such, peripheral states have very limited external autonomy. On the other hand, however, Henrique Cardoso suggested that some "dependent development" may occur in the periphery, with a complex relationship emerging between the state, foreign and local capital. However, the structural condition of dependency still persists, and the insertion of the peripheral political economy into the capitalist world economy works to the advantage of core capital, although in Cardoso's view more external autonomy is possible for peripheral countries than allowed by Frank.

As dependency theory was later refuted by the successful experience of newly industrializing economies (NIEs) and the unsuccessful experiments of delinking and self-reliance strategy of many developing countries, some scholars then modified dependency theory and developed a

new approach, the world system theory.<sup>75</sup> Derived from the center-periphery model of dependency school, world system theory draws on realist ideas in analysis of what is called the “international state-system.” According to the world system approach, the history and operation of the international political economy can only be understood as a structural whole – the world system, in which various parts of the structure are functionally and necessarily related. The world system is composed of three hierarchically ordered tiers of states: core, semi-periphery and periphery. Historically, only two types of world system have ever existed, that is, world empire and world economy. The capitalist world economy, which is the modern world system, has been in existence since the 16<sup>th</sup> century. From then onwards, this system incorporated a growing number of previously more or less isolated and self-sufficient societies into a complex system of functional relations based on international division of labor. The result of this expansion is that a small number of core states have transformed a huge external area into a periphery. During the process, the structural mechanism of the capitalist world economy leads to transfers of surplus from the periphery to the core, bringing simultaneously capital accumulation and development in the core and economic and political underdevelopment in the periphery. Once in existence, the core-periphery division is maintained by core states that manipulate the workings of the system to suit their needs through conquest and monopoly.

The essence of this structure is the international division of labor in which core states take a role as industrial producers, peripheral states specialize in the production of raw materials, and semi-peripheral states are somewhere in between, which are experiencing an increase in the relative importance of industrial production. This international division of labor favors the core and places the core in a dominant position over the periphery. On the other hand, as an intermediate and functionally important tier semi-peripheral states may turn either into core states or lose their status as such, disappearing out into the periphery, depending on their performance in global competition. According to world system theory, development is basically a matter of changing the structural position from a peripheral to a semi-peripheral one, a possibility that is open to comparatively few states.

Unlike the world empire whose existence rests on a central political power, the capitalist world economy is unified by international market relations with a succession of dominant core states playing a hegemonic leadership role. The rise and fall of hegemonic powers represent

the cyclical movements of the world system, movements that are basically influenced by economic long waves. Like realist writers, world system theorists analyze the rise and decline of hegemonic powers and come to similar conclusions regarding their historical dynamics and effects. For both schools, the rise and fall of hegemonies are seen in cyclical terms, and hegemony is seen as having implications for order and stability in international economic relations.

What mainly distinguishes world system writers from their dependency counterparts is a concern with historical dynamics and different explanation of the patterns and processes of change. World system authors specifically allow for some upward and downward mobility within the world system, and use the term semi-periphery to cover intermediate states that are relatively more developed, and have more external autonomy than others in the periphery. Both approaches are, however, rather deterministic in the sense that they identify a relatively fixed set of historical structure, whose foundation was laid in place in the 16<sup>th</sup> century. From this period onwards, the core-periphery divide became the key structural characteristic of the world system.

Obviously, both dependency theory and world system theory deviate greatly from the mainstream of the Marxist tradition. While classical Marxists emphasize the class conflict in terms of production relations, these two approaches, as a response to the failure of capitalist development in many developing countries, focus their analysis on the exchange relationships between industrialized countries and developing countries and on the capitalist world system. In their view, capitalism is not defined mainly by a specific relation between classes in a nation-state and by the exploitation of working class by capitalist class, but by production for profit in a world system of unequal exchange and by exploitation of the periphery by the core. International economic and political system is dominated by capitalist international division of labor. Largely because of this deviation, some argue that dependency theory and world system theory are not of the Marxist tradition at all. Furthermore, whereas classical Marxists focus on conflicts between core states, dependency and world system writers tend to assume a significant degree of cooperation between these states, particularly when one core state is able to assert its dominance over others. World system theorists assume that the level of conflict between core states varies over time, and when power is more dispersed within the core, conflict is more likely. Moreover, in this latter case more direct forms of political control over the periphery tend to predominate, whereas in the case of a hegemonic order open trade and even decolonization are

more likely. Despite all these differences, however, these schools of thought do share an interest in the way the global system of capitalism shapes and influences the nature as well as the behavior of states, classes, firms and individuals. It is in this respect that their notions of structure are similar, and are in contrast with the individualist concepts of structure that are used in economic nationalism and liberalism.

### *Gilpin's realist approach*

In discussing the definition of state interests in international relations, economists of liberal persuasion and political scientists in the realist tradition tend to have very different views with the former inclined to assume the pursuit of wealth as the national goal (i.e. maximization of real economic welfare for the nation) while the latter emphasizing the pursuit of power as the national goal (i.e. the achievement of national security). Accordingly, liberalism implies that all nation-states care only about *absolute gains* from trade and are indifferent to the gains achieved by others; by contrast, realism suggests that every nation-state values *relative gains* (political advantage) above all. In the real world, however, every nation-state can be legitimately assumed to have a keen interest in both goals. According to Robert Gilpin, international political economy can be seen as "the reciprocal and dynamic interaction in international relations of the pursuit of wealth and the pursuit of power."<sup>76</sup> The theoretical issue, therefore, is to build a clear, systematic model that is able to simultaneously address these questions: how do both goals fit together functionally in the preference orderings of different governments, how much does any given state care about absolute versus relative gains, to what extent are these interests regarded as substitutes rather than as complementary, what are the trade-offs between them, and how and why do these trade-offs change over time?<sup>77</sup>

Based on the critique of the three major theoretical perspectives – liberalism, economic nationalism, and Marxism, Gilpin developed a synthesized perspective of international political economy with respect to the interaction of international politics and international economics. In his 1975 article "Three Models of the Future," Gilpin pointed out, "Throughout history, the larger configurations of world politics and state interests have in large measure determined the framework of the international economy."<sup>78</sup> This approach emphasizes the critical importance of the framework of international political relations and the pursuit of national interests in structuring and regulating the market relations of states. From this perspective, it is not difficult to ascertain

the systematic causal linkages between the postwar capitalist liberal economic order and its two paramount preconditions: the paramount postwar concern with national security and the hegemonic power of the US. According to this analysis, national security consensus provides the vital underpinning of support for international cooperation in more economic and technical areas. "National security justified international cooperation in economic and functional areas and support for the United Nations, alliances, foreign aid, and extensive military involvements around the world... National security symbolism helped to construct a favorable global environment for transnational economic actors... National security was an ambiguous symbol, but it was also a force."<sup>79</sup> On the other hand, its unchallenged predominance of military and economic power enabled the US to define and sustain almost alone a universal and liberal system of trade and monetary relations, which then provided a secure and stable environment for the development of global economic relations. Thus, the foreign economic policies of major capitalist countries were complementary, and the international political economy basically reflected the international political reality and served well the national interests of all these economic powers.

It is also following this line of reasoning that Gilpin argues that the future of the liberal world economy becomes greatly threatened due to profound changes in world politics and economics. Among the major changes are the end of the Cold War and the decline of American hegemonic power with the rise of other capitalist economies. All these changes in the international setting are causing national governments to reorient their foreign economic policies and to reconsider regional arrangements as a possible policy choice.<sup>80</sup> Implied in this argument is that the development of these international conditions will likewise affect the process of regionalism in terms of depth and width. In this sense, it can be well argued that national economic interests and political choices are ultimately shaped and influenced by the constraints and opportunities of the international political and economic structure. However, as a system-level (or structural-level) analysis that concentrates exclusively on external environment – analogous to Waltz's "third" image,<sup>81</sup> Gilpin's theory of international political economy basically ignores the internal characteristics and dynamics of regionalism. The weakness of Gilpin's international political economy theory may be made up by integration theory and customs union theory in one way or another. As such, these theoretical perspectives are complementary.

The insights of all the theoretical perspectives discussed in this section provide a theoretical background for an analytical framework that is to be developed in the following section.

## 2. Constructing an analytical framework

In *War & Change in World Politics*, Robert Gilpin identifies economic nationalism and empire as opposite phenomena.<sup>82</sup> Pure economic nationalism is nothing but economic autarky. In the modern world, such extreme cases are rare. More often than not, such domestic-oriented economic nationalism takes the form of self-reliance with limited economic intercourse with a limited number of other countries, as in the post-revolutionary Soviet Union and Mao's China. Most frequently in modern world history, economic nationalism takes the form of mercantilism, statism or protectionism, as recurrently appeared from the Commercial Revolution of the 16<sup>th</sup> century through the mid-20<sup>th</sup> century. These can be seen as kind of "relaxed" economic nationalism in the sense that nationalism of this nature is more or less away from its pure model. On the other hand, a world empire is characterized by a single unified world market and a unipolar power structure under a universal government. A real world empire has never existed in human history. However, a "relaxed" empire once existed in ancient China and in the Roman Empire period in the sense that these empires were largely limited in geographical scope. As such, pure economic nationalism and real world empire are two extreme cases in opposition, which are rare or non-existent in modern history. The economic life in the modern world is mostly situated somewhere between these two extremes. In the post World War II years, the two major identifiable economic phenomena have been multilateralism and regionalism. Multilateralism was the dominant form of international economic activities for the first three decades after World War II. In the 1970s multilateralism experienced a severe blow and began to weaken. Since the mid-1980s, regionalism has gradually grown as a viable force in the world economy alongside multilateralism.

As a growingly important force in the world economy, regionalism since the mid-1980s, which is called "new regionalism" by many scholars,<sup>83</sup> can be divided into two forms, hard-closed regionalism and soft-open regionalism. Hard-closed regionalism refers to institutionalized and discriminatory regionalism, which is usually the result of political agreements among national governments involved. The EU, North American Free Trade Agreement (NAFTA), ASEAN are the very

cases of such negotiated regionalism. On the other hand, soft-open regionalism is an autonomous process of regional integration that is primarily driven by market forces. This process of regional integration is uninstitutionalized and non-discriminatory, though it may be encouraged and supported by governments in the region. Generally speaking, *hard* regionalism often goes together with *closed* regionalism, whereas *soft* regionalism with *open* regionalism.<sup>84</sup> The locations of various world economic phenomena identified above are illustrated in Figure 2.1.

There then comes the issue of how multilateralism and regionalism can be defined and measured. Multilateralism, by definition under GATT/the World Trade Organization (WTO), refers to the notion of non-discrimination, which means that nations treat all other GATT/WTO members equally in applying regulations and restrictions to trade and foreign investment. This notion is embodied in the MFN principle.<sup>85</sup> On the other hand, economic regionalism is generally defined as preferential arrangements and/or ties in economic affairs among a group of nations located in the same geographic area.<sup>86</sup> However, due to different degrees of these regional arrangements and ties, regionalism can be subdivided into two forms: hard-closed regionalism and soft-open regionalism. Hard-closed regionalism is institutionalized and discriminatory, thus relatively distant away from multilateralism.<sup>87</sup> Soft-open regionalism, on the other hand, is uninstitutionalized and generally non-discriminatory, hence relatively closer to multilateralism.<sup>88</sup> (See Figure 2.1)

To determine whether the world economy is multilaterally-oriented or regionally-oriented, a most appropriate and convenient approach is to compare the portion of world trade as under the GATT/WTO principle of non-discrimination and the portion of world trade as within the preferential trade arrangements. These preferential trade arrangements all share the feature of discrimination, through tariff and non-tariff barriers, in favor of trade among their members and at the expense of non-members.<sup>89</sup> On the other hand, the comparison of intraregional and interregional trade flows is also an important method of measurement. Investment flows are another important indicator in measuring multilateralism and regionalism. Moreover, multilateralism and



Figure 2.1 Patterns of World Economic Order

regionalism can also be identified by looking at the frequency at which individual governments settle their foreign economic issues through multilateral or regional/bilateral mechanisms. This approach suggests how individual governments attribute importance to multilateral versus regional/bilateral mechanisms in settling their economic disputes.<sup>90</sup> This in an important way helps to explain whether multilateralism or regionalism is dominant in the world economy.

Furthermore, to determine whether regionalism is hard-closed or soft-open, the level of institutionalization, the degree of discrimination and the degree of openness to countries outside the region are the appropriate criteria. There are at least three levels of regional institutionalization that can be conceived: high-institutionalization, semi-institutionalization, and non-institutionalization. A highly institutionalized form of regionalism exists when official regional institutions are formed to govern such matters (but not necessarily all of these matters) as foreign affairs, security, trade, investment, finance, monetary issues, industry, agriculture, service, labor, movement of people, environment, legal issues, and so forth on a regional basis (such as the EU, NAFTA, ASEAN, and so on). Decisions reached in these institutions are normally compulsory to all member states. A semi-institutionalized form of regionalism exists where official or semi-official organizations are formed for consulting or coordinating, rather than for governing, on various matters as mentioned above, but not necessarily on all these matters, such as APEC. The policy recommendations or decisions made in these organizations are normally "suggestive" as opposed to compulsory. Finally, non-institutionalized regionalism is the loosest form of regionalism with respect to the level of institutionalization. There are no established official or semi-official regional organizations. Regional integration, which is primarily in the economic sphere, is largely driven by market forces and conducted mostly by corporate actors, though accepted, guided and encouraged by governments, as what was happening in East Asia after the mid-1980s.<sup>91</sup> However, official or semi-official organizations might sometimes be formed on an *ad hoc* basis to coordinate on selected issues. The degree of discrimination can be identified by looking at the scope and level of formal governmental preferential arrangements or informal tacit preferential practices with respect to trade, investment, finance, monetary matters, labor, and so on among regional economies. The degree of openness of regionalism can be judged by observing whether the policies and practices of governments toward non-member countries or countries outside the region are inclusive or exclusive. It is important to point out that these three criteria are usually related to one another – high level

of institutionalization often leads to high degree of discrimination and strict requirements for new membership, and *vice versa*.

Multilateralism in the postwar years was established and maintained through the political leadership of the US and the general commitment of major capitalist economies to liberalism. This multilateralism was institutionalized in a liberal trading system (under GATT) and a US dollar-centered monetary system (under the IMF and the World Bank), which jointly constituted the postwar liberal economic order. The essence of this international economic order was the emphasis on the liberalization of trade and payments. In the meantime, American military preponderance provided a secure and stable environment for the development of global economic relations. By playing a leadership role, the US unilaterally assumed the obligation of maintaining the world economic and political order. Within a period of about three decades, major Western economies played the game basically within this liberal framework. However, it is important to point out that the postwar multilateral order was not a perfect one for two main reasons. First, for political and strategic considerations, the US adopted relatively more liberal economic policies while tolerating illiberal policies and practices of its junior allies for quite some time.<sup>92</sup> Secondly, the postwar multilateralism was confined only to the capitalist world in geographical scope, while socialist economies were largely excluded. Despite this, however, the major features of postwar multilateralism could still be discerned.<sup>93</sup> So the location of postwar multilateralism can be found somewhere left to the point of perfect multilateralism. (See Figure 2.2) This imperfectness explains why there were still some regional arrangements even in the zenith of postwar multilateralism.<sup>94</sup>

Due to uneven development among nation-states, American power began to show signs of decline by the early 1970s, whereas the other capitalist economies were gaining growing power. This was especially true of Japan, Germany and some East Asian NIEs. The relative decline of American power seriously undermined its ability and willingness to continue to perform the leadership role as in the 1950s–60s in maintaining a liberal international economic order. At the same time, with the eroding liberal economic order combined with the negative

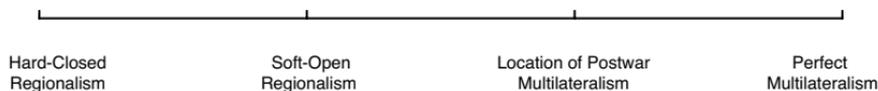


Figure 2.2 Postwar Multilateralism

effects of increasing interdependence of national economies in the age of globalization,<sup>95</sup> the ideology of liberalism gradually weakened as a guide to national economic policies, which in turn further eroded the liberal international economic order. This constitutes the background in which regionalism has been gaining momentum since the mid-1980s.

From the above discussion arise two fundamental questions on economic regionalism: Firstly, why do nation-states move toward regionalism? And secondly, why does regionalism take different forms in different areas? To help address these two questions, an analytical framework is designed in this section, which will enable us to pursue multilevel (from the global structural level to regional and national levels) analysis of the subject. By incorporating many insightful ideas of international political economy theories discussed in the previous section, this multi-level analytical approach will allow us to comprehend the phenomenon of growing economic regionalism that is becoming increasingly complex and multi-facet in a changing international context and that is assuming growingly multiple forms in its existence. In this process, factors at global/structural, regional, national levels closely relate and interact in a dialectic way, jointly playing a crucial role in promoting and shaping regionalism. The analytical framework developed in this section, therefore, is capable of providing a systematic and comprehensive explanation of ongoing regionalism in the world economy in general and East Asian regionalism in particular.

The analytical framework of economic regionalism is built on a set of assumptions with respect to global/structural, regional and national factors as follows:

Assumption 1: The emergence of economic regionalism is in the first place generated by external and internal imperatives as perceived by national decision-makers, elites and interest groups.

Assumption 2: The subsequent development of economic regionalism with respect to speed, level and form depends on specific conditions existing at the regional and national levels in the region.

Assumption 3: Usually there are chain reaction effects, that is, regionalism in one region may lead to regionalism elsewhere as a general or defensive reaction, strengthening this trend further.

Assumption 4: Economic regionalism often evolves gradually, step by step, from a low level of regional arrangements to higher levels, and involves more and more economies around.<sup>96</sup>

Assumption 1 could explain the emergence and development of all the major regionalist moves, such as the EU, NAFTA, and APEC, for

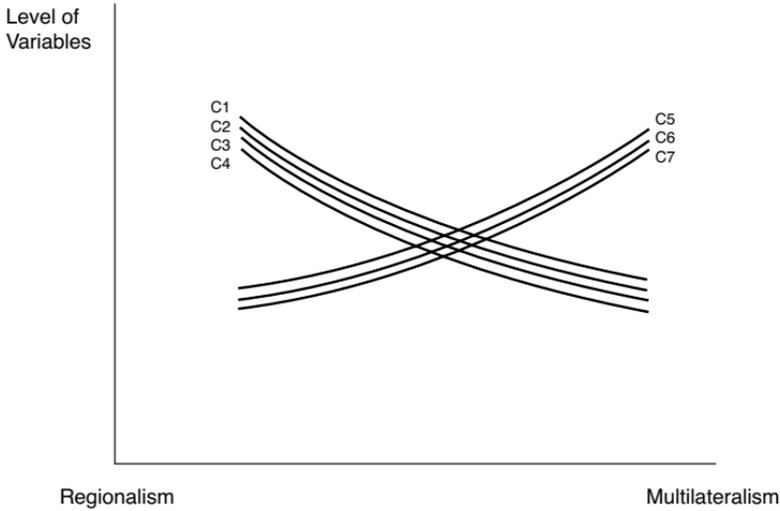
they have all been related to a transformed international and domestic environment resulted from political, economic and technological changes at both global and national levels. Assumption 2 explains why there is difference across the world in terms of forms of regionalism, as regional and domestic conditions in different regions vary. Assumption 3 explains why moves toward regionalism occur one after another – the European integration was followed by NAFTA, which then stimulates the regionalist tendency in Latin America, East Asia and other areas, regardless of their forms. With Assumption 4, the economic regionalism in East Asia can be seen as still being at an early stage, and its future development will be determined by a set of factors at global, regional and national levels as identified in Assumptions 1–3. Implied in all these assumptions are the rational and deliberate calculations by national decision-makers, elites and interest groups of the benefits and costs of specific moves toward a specific form of regionalism under specific external and internal conditions.

#### *Regionalism vs. multilateralism*

Based on the assumptions outlined above, it is possible to identify some important variables that may define a world economic order on a regionalism-multilateralism continuum. These variables include: (1) chain reaction effects of regionalism; (2) degree of positive and negative effects of international interdependence and globalization; (3) regional political, economic, cultural and social ties of major regions; (4) level of global hegemonic power; (5) complementarity of national economic structures within regions; and (6) prevalence of norms of multilateralism and working of international regimes. An analytical graph may help better understand the correlations between these variables as represented by a number of curves and the existence of a specific economic order. (See Figure 2.3)

C1 explains that regionalism in one region may produce chain reaction effects, that is, causing other regions to follow suit by taking counter-vailing measures.<sup>97</sup> An illustrative example in this respect was the formation of NAFTA, which is widely seen as a direct reaction to the deepening integration of Western Europe.

C2 shows that negative effects of international interdependence and globalization, or to use Keohane and Nye's term, *asymmetrical interdependence*,<sup>98</sup> may discourage multilateralism and encourage regionalism, or even cause a nation to resort to nationalism, that is, autarky. The calls for South-South cooperation and delinking of developing countries from the capitalist world economy in the 1960s–70s, for example,



- C1: Chain reaction effects.
- C2: Negative effects of international interdependence and globalization.
- C3: Regional political, economic, cultural and social ties of major regions.
- C4: Complementarity of economic structures within regions.
- C5: Global hegemonic power.
- C6: Positive international interdependence/globalization.
- C7: Prevalence of norms of multilateralism/working of international regimes.

*Figure 2.3* Regionalism vs. Multilateralism

were probably derived from such asymmetrical interdependence between developed and developing countries.

C3 tells that close political, economic, cultural and social ties among the countries within a region are conducive to regionalism. The EU is the very case in point.

C4 indicates that complementary economic structures among the economies within a region would promote regionalism, as illustrated by NAFTA.

C5 shows that when the level of global hegemonic power is high, which implies that the hegemon is willing and able to provide a stable political and security environment and maintain a relatively liberal international economic order, the world economy is likely to be more multilateral. By corollary, an extreme form of hegemonic power, namely, imperialist power, might lead to a world empire. On the contrary, when hegemonic power declines, the hegemon would become less willing and able to support a liberal international economic order and there might be a trend toward regionalism, or even nationalism.<sup>99</sup> The

impact of the British hegemonic power in the 19<sup>th</sup> century and early 20<sup>th</sup> century and its subsequent decline during the interwar period on the world economy seems to be a relevant example in this respect.

C6 tells that positive effects of international interdependence and globalization may promote multilateralism.<sup>100</sup> The prevalence of multilateralism in the postwar years may largely be explained by the positive effects of international interdependence and globalization among capitalist economies.

C7 indicates that multilateralism would be upheld if there is a high level of prevailing norms of multilateralism and effective working of international regimes. By contrast, eroding norms of multilateralism and decline of international regimes would push the world economy toward regionalism or even nationalism. The evolution of multilateralism and regionalism in the postwar period can largely be explained by the correlation as indicated in C7.

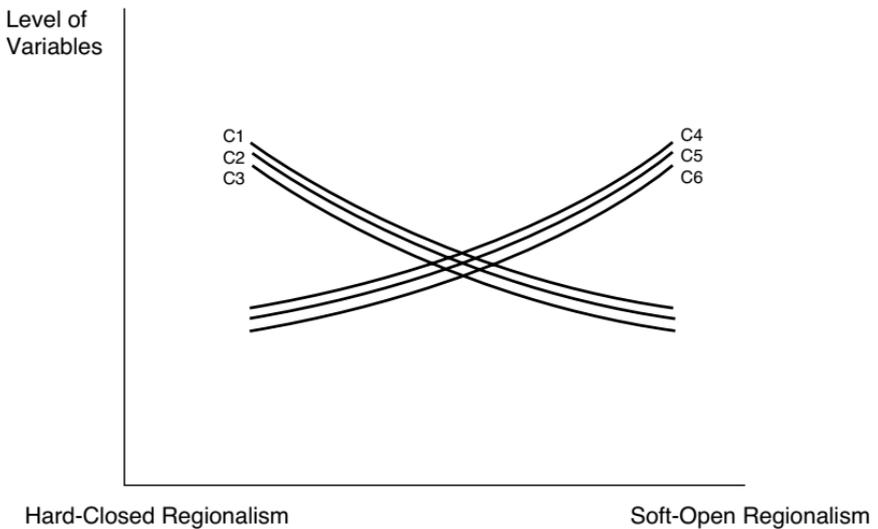
Obviously, the existence of an actual world economic order in a specific historic period is determined by the interactions of all those variables. No single variable alone is able to determine the actual location of this order on a regionalism-multilateralism axis, though some individual variables might be more decisive than others.<sup>101</sup>

Using the above analytical framework, it is not difficult to find why a new wave of regionalism in the postwar years emerged in the 1980s. It may even help us tell the possible trend of the world economy within a particular context of international environment. We can find that regionalism emerged in the 1980s largely as a result of the declining hegemonic power of the US, which itself was caused primarily by Cold War politics and uneven development among major economies. It was also the result of a series of chain reactions, starting from Western Europe, through North America, to East Asia and other regions. From Figure 2.3, we can also tell that as a result of the interactions of various variables, the movement toward economic regionalism is taking place simultaneously with the movement toward globalization of the world economy. These two tendencies constitute a dialectical process, reflecting that national economies not only need to participate in the world economy but also must take appropriate measures (for example, "regional arrangements" in this instance) to improve their competitiveness in world markets.

#### *Hard-closed regionalism vs. soft-open regionalism*

Despite its huge momentum, regionalism apparently does not assume the same form in all the regions of the world. Particularly, whereas

economic regionalism in Western Europe is most highly institutionalized and discriminatory, it is uninstitutionalized and non-discriminatory in East Asia. Then how can this difference in the form of regionalism be explained? A graph may provide a clearer picture of the variables at global, regional and national levels as represented by a number of curves that define a hard-closed regionalism or a soft-open regionalism. These variables include: (1) dependence on intraregional trade; (2) competition from outside the region; (3) regional political trust and consensus, historical connection, cultural proximity, shared ideology and value, and sense of common identity and mutual interests; (4) external political, security and economic linkages beyond the region; (5) competitiveness of regional economies; and (6) political suspicion, political and ideological diversity within the region. (See Figure 2.4)



- C1: Dependence on intraregional trade and other economic exchanges.
- C2: Competition from outside the region.
- C3: Regional political trust and consensus, historical connection, cultural proximity, shared ideology/value, and sense of common identity and mutual interests.
- C4: External political, security and economic linkages beyond the region.
- C5: Competitiveness of regional economies.
- C6: Political suspicion, political and ideological diversity within the region.

Figure 2.4 Hard-Closed Regionalism vs. Soft-Open Regionalism

C1 shows that heavy dependence on trade and other economic exchanges within the region is likely to encourage regionalism in its hard-closed form. On the other hand, a high level of dependence on economic ties with the countries outside the region makes hard-closed regionalism difficult, as is indicated by C4.

C2 illustrates that growing/strong economic competition from economies outside the region would make regionalism hard and closed. Similarly, if regional economies are less competitive in the face of competition from other economies, they tend to form hard/closed economic blocs, as is shown by C5.

C3 tells that hard-closed regionalism is more likely if there are strong political trust and consensus, historical connection, cultural proximity, shared ideology and value, and sense of common identity and mutual interests among the countries in a geographical area. On the contrary, the bitter historical memory, lack of political trust, and political and ideological diversity in the region all make it difficult to achieve hard-closed regionalism, as C6 explains.<sup>102</sup>

C4 explains that strong political, security and economic linkages with the countries outside the region make it difficult to form a hard/closed regional bloc.

The variables discussed above in Figure 2.3 and Figure 2.4 are linked by a complex web of interrelations, from which a synthetic analytical framework for explaining regionalism can be deduced:

Firstly, regionalism is first of all caused by both external and internal imperatives, important among which are the decline of hegemonic power, imperative of improving national economic competitiveness in the global economy, eroding norms of multilateralism, and rising regionalism elsewhere.

Secondly, the form of any regionalist scheme is then largely determined by existing regional and national conditions within the region. These conditions include regional political trust and consensus, historical connection, cultural proximity, shared ideology and value, complementarity of economic structures, existing ties, and sense of common identity and mutual interests, as well as the level of support from national decision-makers, elites and interest groups.

Thirdly, due to different regional and national conditions among regions, and also due to different external connections of different regions, regionalism may take different forms in different areas, hard and closed in some regions while soft and open in others.

Finally, as *change* is a constant feature of world history, global, regional and national conditions might be evolving over time. As a

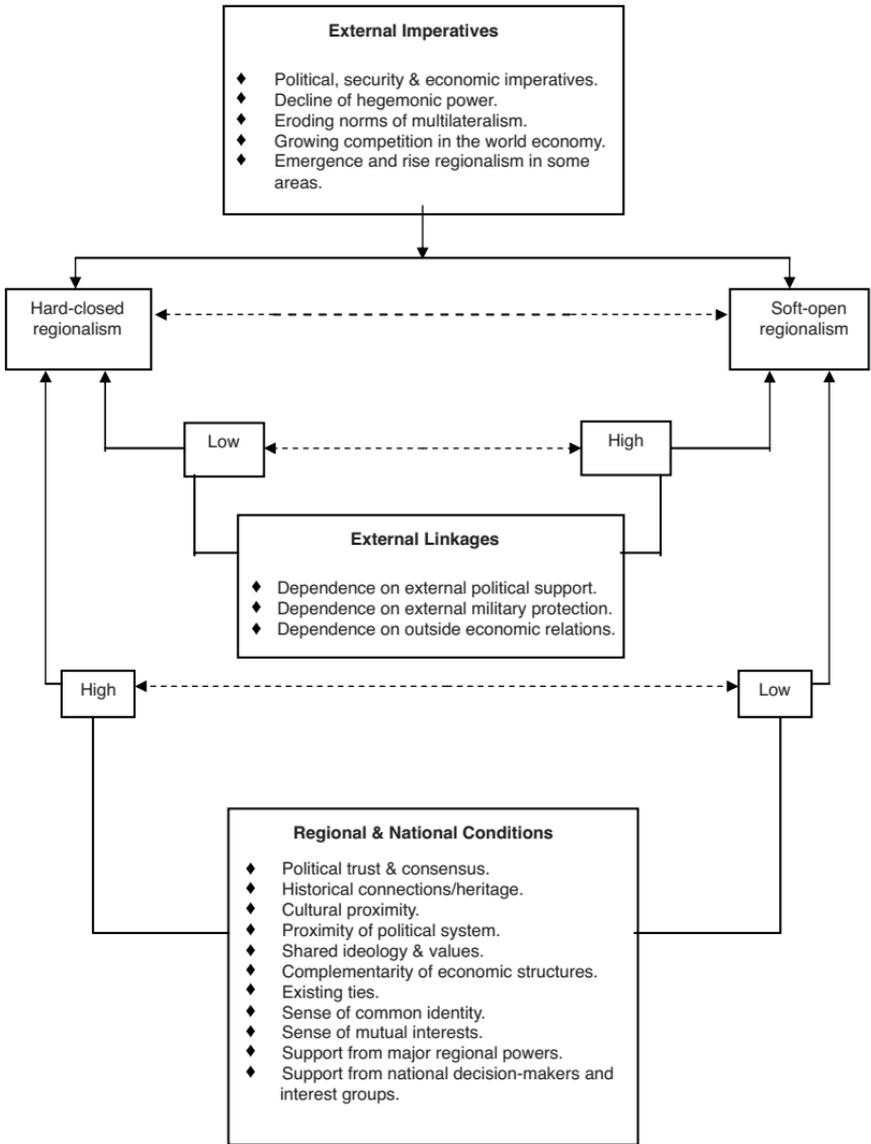


Figure 2.5 Analytical Framework of Economic Regionalism

consequence, a soft-open regionalism might evolve into a hard-closed one, or the other way round.

This analytical framework can be translated into a graphic model as shown in Figure 2.5.

It is important to note that while this analytical framework provides an established model of analysis of economic regionalism, the variables that are listed in the framework are not exclusive. As research on the subject deepens and broadens, it is likely that more important variables may be identified and added to this model, thus making this model even more comprehensive and powerful in explaining economic regionalism.

Whereas the analytical framework of economic regionalism developed in this chapter can be used to explain economic regionalism in general, it is intended to explain the particular case of East Asian integration in this book. Moreover, this analytical framework is capable of explaining not only economic regionalism but also foreign economic policies of national governments with respect to economic nationalism, regionalism and multilateralism. As such, this analytical approach should not only contribute to our overall understanding of regionalism in the world economy, but also provide a useful addition to the study of foreign economic policies of national governments.

# 3

## The Evolution of the Global Economic Order since 1945

The global economic order has been evolving since 1945, reflecting changes both in the larger setting of global politics and economics and in national interests as perceived by decision-makers of nation-states.<sup>1</sup> According to Robert Gilpin, an international economic order is largely determined by the larger configurations of world politics and state interests.<sup>2</sup> In the postwar years, the establishment and evolution of the liberal international economic order were substantially defined by two most important and significant conditions of the international setting and its evolution, namely Cold War politics and American hegemony, until around the end of the 1980s. Since the early 1990s, however, the global economic order has been increasingly shaped and defined by the trend of globalization. With this general understanding in mind, this chapter examines the evolution of the specific international environment of the world economy since 1945.

### **1. Cold war politics, American hegemony and the postwar liberal international economic order (mid-1940s–60s)**

World War II brought profound political consequences in post-1945 international relations, as particularly reflected in the introduction of the Cold War and the American hegemony. These political consequences of the war, in turn, dramatically affected the world economy in the postwar years.

In the first instance, the military outcome of the war brought a politically and economically alienated great power – the Soviet Union – into the heart of Europe, the development that caused profound political impact on international relations. Because of different war objectives, political suspicion and ideological conflict among the allied powers, the

temporary occupation line in Central Europe between the allied forces as a result of military victory over the axis powers soon turned into a demarcation line of Cold War politics, dividing the wartime allies into two conflicting blocs – the American-centered capitalist West and the Soviet-headed socialist East.<sup>3</sup> The communist victory in China in 1949 and the Korean War of 1950–53 had the effect of extending the Cold War from Europe to the Far East.<sup>4</sup> Cold War politics thus established a political bond among the capitalist countries as against a perceived threat to their national security from the Soviet bloc. Postwar foreign policies (in both political and economic spheres) of these countries were basically framed within this context, and low politics was therefore subordinated to high politics of the Cold War.

On the other hand, the outcome of World War II had considerably rewritten the political map of world powers. As a result of the war, the former major powers in world politics were either defeated or considerably weakened. Western European countries and Japan suffered unprecedented physical, as well as human, destruction. On the other hand, the US had emerged from the war with its power not only intact but enhanced. Having the monopoly over atomic weapons, holding almost half of the world's monetary reserves and two-thirds of the world's gold supply and possessing half of the world's manufacturing capacity, the US thus occupied the predominant position in world politics and economics. Under such circumstances, the US was the only power that was capable of providing capital and military protection desperately needed by other capitalist countries for their economic reconstruction and national security. As such, with its preponderant military and economic power, the US became a new hegemon. Added to this physical qualification for a hegemonic power was American leaders' political will of discarding isolationism that characterized its foreign policy after World War I and clear ideological conception of the kind of international society they wished to construct.

As a consequence, because of a perceived threat from the Soviet Union, Western powers subordinated their potential conflicts over economic matters to the need for political unity against such a threat. With its preponderance of military and economic power, the US committed itself to the security of its allies through a series of collective security arrangements (including NATO; Australia, New Zealand, United States Security Treaty (ANZUS); and American-Japanese bilateral mutual defense treaty) and implemented huge recovery aid programs for Western Europe through the Marshall Plan and for Japan through the Economic Recovery in Occupied Areas (EROA), while these allies supported the

leadership position of the US in world politics and economics.<sup>5</sup> It was against this historical background that capitalist countries reached a consensus on the kind of economic order they were going to establish for the postwar period, an economic order that was to be characterized by multilateral, non-discriminatory, increasingly competitive and freely trading features.<sup>6</sup> In this process, the experience of the 1930s (the fear of economic instability, unemployment, protectionism and currency speculation, and ultimately the fear of war) also provided, at the level of both theoretical insight and political will, the main source for defining and bolstering the essential features of the emerging postwar economic order. Defined and maintained almost alone by the US, this postwar liberal world economic order was then to provide a framework for the development of economic relations among capitalist countries in the postwar years.

In analyzing what motivated the US to assume the responsibilities of world leadership, there is an "opportunity cost" argument.<sup>7</sup> According to this argument, the key to understanding Washington's motives in promoting international stability lies with the perceptions of US leaders about the military and political costs that would come from dissolution of the world order. The experience of the depression and the war convinced US leadership that US prosperity and security depended on prosperity abroad and on eliminating or blocking the acts of hostile and aggressive states. If the US should not act to prevent these from happening, international economic conflict would devour any chance for free economy and economic growth in the US, while control of the resources in Europe and Asia by a hostile power would certainly bring a garrison state in the US and another world war. Thus, the benefits of a liberal world order derived from the unacceptable costs that could be foregone with its presence.<sup>8</sup> In this view, therefore, the US decision to take the leadership role was purely defensive in nature.

Whereas the US indeed wanted to avoid any disturbance in a new world order, Washington's concern was apparently more than the "opportunity costs" of the disturbance of the world order. It is obvious that the liberal international economic system was designed to promote specific US national objectives and to protect specific US interests. The assumed identity of interests between the US and the system at large emerged very early after the end of the war. One of the major postwar objectives of the US was to promote the open market philosophy in the world economy. To achieve this objective, Washington pursued two policies during and immediately after the war. The first was the policy of anti-colonialism, which was designed to dismantle

the 19<sup>th</sup> century colonial system established by the European powers, and British power in particular, thus opening the commercial opportunities on a non-discriminatory basis for US business. In 1941, the Atlantic Charter committed the US and Britain to free trade as well as free choice of government; the 1942 Mutual Aid Pact committed Britain to ending discriminatory practices exemplified by the Imperial Preferences system; by mid-1942, Treasury Department officials had drawn up detailed plans for postwar free trade and monetary regimes. Indeed, in all the major documents of World War II, the Americans insisted on including amongst the allied war aims a commitment to the end of preferential trade arrangements.<sup>9</sup>

The second policy of the US related to the choice of an exchange rate system. It was generally agreed at the time that it was undesirable to return either to the gold standard or to the monetary system free for all of the 1930s. It was believed that the unpredictability of the latter had helped to prolong the economic depression and poison the political atmosphere. The Americans were determined to choose a system that would prevent other countries from devaluing their currencies against the dollar as a means to shut US products out of their own market.<sup>10</sup> The US-proposed dollar exchange standard, in which all the major currencies were fixed in relation to the dollar, which was itself pegged to gold at \$35 an ounce, was partly designed to secure this specific US national interest.<sup>11</sup>

Following the Bretton Woods Conference of 1944 and a series of negotiations that led to the signing of GATT in 1947, the construction of the postwar economic order was finally completed on the basis of the broad commitment of the major economies to multilateral ideas and institutions. These ideas were embodied in a stable pattern of liberal rules in international finance and trade to regulate international economic relations, which included (1) convertibility of currencies, (2) reduction and eventual abolition of tariffs and quantitative restrictions on imports and direct subsidies for exports, and (3) non-discrimination as embodied in the MFN principle. These rules were then institutionalized in a liberal US dollar-centered monetary system and a liberal trade system, which were designed to supervise their implementation, negotiate steps toward further liberalization, settle disputes, authorize retaliatory measures against recalcitrant members, and provide aid to help them cope with the costs of adjustment.<sup>12</sup>

Under the monetary system were two Bretton Woods institutions, the IMF and the International Bank for Reconstruction and Development (commonly known as the World Bank). The IMF was established

to work toward and help preserve currency convertibility and the free flow of capital through a mechanism of managing exchange rates and payments imbalances among nations. The resulting system of fixed exchange rates was built around the US dollar, in which the US dollar was fixed in value to gold at \$35 per ounce, while other states fixed their currencies to the dollar and pledged to intervene in foreign exchange markets to keep values within a narrow band around the fixed rate. As was seen from this arrangement, the functioning of this system of exchange rates was crucially based on the stable supply of the US dollar. On the other hand, the IMF was also designed to provide short-term loans for countries experiencing a current account deficit in their balance of payments. The loans would typically be used to support the fixed value of the country's currency and were usually contingent on adoption of a national policy designed to reverse the deficit. The World Bank was established to provide long-term capital for postwar reconstruction and economic growth, thus supplementing private capital for international investment. Over its first decade, the World Bank played only a marginal role in the actual postwar reconstruction process. But since the late 1950s and early 1960s, it has played an increasingly important role in providing aid for developing countries. By supporting a revival of private capital markets, and underpinning the convertibility of major currencies, these two institutions were intended to encourage the freest possible movement of goods and services among capitalist economies.

The postwar trading system was embodied in GATT, which was designed, (1) most importantly, to serve as a negotiating forum for the multilateral reduction of tariffs and other barriers to trade, (2) to supervise compliance with the code of fair trade practices, and (3) to determine whether members were injured by the failure of any member state to meet its obligations and what retaliatory actions they could take.<sup>13</sup> GATT reflected a commitment by its member states to establish a schedule of tariff rates and a set of trade principles designed to produce uniformity and predictability in international commercial relations. The basic principles of GATT included *non-discrimination*, *reciprocity* and *transparency*, among which the principle of *non-discrimination*, embodied in the MFN rule, was of most importance. The aim of MFN was to ensure that any trade concessions or barriers were applied in a non-discriminatory fashion among all GATT members. Since GATT was initiated in 1947, its most publicized accomplishment was the outcome of rounds of trade negotiations conducted under its aegis. Through a series of rounds of negotiations in the 1950s and 1960s, tariffs were substantially reduced,

especially on manufactured goods. By the time the sixth round (1964–67) of tariff-reduction negotiations (the so-called Kennedy Round, which had by far stood out as most significant) was finished, the remaining tariffs on most industrial products had been reduced to 10% or less, and quantitative restrictions had been banned on the bulk of international trade.<sup>14</sup> As a result of these achievements of GATT, multilateralism had been greatly promoted.

The postwar liberal international economic order so formed proved to be a great success. As there was a stable liberal monetary system and barriers to trade and monetary flows were progressively reduced and in many cases abolished during the 1950s and 1960s, trade flourished and the international capital market expanded dramatically in these two decades. In this process, world trade grew substantially faster than world gross national product (GNP) throughout the postwar period. During the 1950s, world trade grew at an annual average of 6.4% while world GNP increased at an annual average of 5.2%, and the corresponding annual averages for the 1960s were 9.2% and 5.6%. Trade therefore once again became an engine of growth, as it had been in the 19<sup>th</sup> century but had ceased to be during the interwar years; and many economies were becoming more and more dependent upon foreign trade to help increase and sustain their levels of production and consumption. The result was record growth of trade and production in the 1950s and 1960s that had no parallel in previous economic history.<sup>15</sup> This unprecedented and almost uninterrupted prosperity was quite widespread in geographic terms, especially among industrialized countries.

In the meantime, international financial markets, though somewhat delayed, were finally integrated after the Western European nations restored currency convertibility in January 1958, following their monetary reserves having been sufficiently replenished as a result of rising production, expanding exports, and favorable balances of payments. By the end of the 1960s, short- and long-term capital was moving freely among the Organization for Economic Cooperation and Development (OECD) countries, US FDI was growing substantially, European and Japanese FDI was beginning to become significant, and the Euro-currency market – which was to witness spectacular growth during the 1970s – had emerged. Added to this liberalization of the movement of goods and capital that contributed to the postwar prosperity was the free movement of labor, the control of cartels and the promotion of competition, as advocated by major economies in the postwar years.<sup>16</sup> As a result, national economies were becoming increasingly interdependent.

As hegemonic stability theory acutely indicates, behind this remarkable success of the postwar international economic order lay the willingness and ability of the US hegemon to perform the leadership role and bear a considerably large share of costs in maintaining this order. In general, the US played the hegemonic role in four ways. First, it provided massive economic aid both directly for many countries and indirectly as the main financial contributor to the IMF, the World Bank, and other international lending and grant-giving agencies. Secondly, it assumed a huge economic burden of military spending to maintain the security of the Western world and global stability. Thirdly, it kept its economy substantially more open than those of its trading partners and competitors and allowed its currency to be overvalued relative to theirs.<sup>17</sup> As the US market was by far the largest in the world, relatively free access on non-discriminatory terms to the expanding US market was a major factor in stimulating the steady export-led growth of the other members of the system in the postwar years. In the meantime, other economies also benefited enormously from the increasingly overvalued US dollar in both the US market and the markets of other countries, especially in the 1960s. Fourthly, it maintained a persistent balance of payments deficit, as the US dollar was central to the operation of the gradually restored international financial system. Not only was the major portion of world trade dominated in dollars but the dollar soon came to form the major portion of the monetary reserves that the OECD nations and other countries were slowly rebuilding during the 1950s and 1960s as their production and exports increased.<sup>18</sup>

As the US had sufficiently higher productivity in many industries than other countries for much of the postwar period, US companies were able to maintain their competitive advantage both at home and abroad. Even in these sectors where the US competitiveness was relatively low, the short-term adjustment costs had a marginal impact on the whole US economy in terms of the effects on US employment and incomes. As such, the US was able and willing to pay the price of maintaining a liberal international economic order in exchange for the benefits that derived from greater security and from liberalized international economic relations and the faster economic growth of an increasingly integrated world economy. The benefit in the latter area was especially important, for free trade surely favored the most productive and low-cost nations with their exports expanding more quickly relative to others. Furthermore, the nation with the world's key currency also received special benefits by avoiding the need to adjust its domestic economy for balance of payments deficits. As the dollar

functioned as a key currency and was accepted as an international currency for payment for goods, the other nations actually bore some of the costs of the operation of the international economic system.<sup>19</sup>

On the whole, within a period up to the early 1970s, the economic order established in the immediate years after World War II basically reflected the international political reality and served well the national interests of major capitalist economies. And the foreign economic policies of these countries were largely complementary. US foreign aid and direct investment first financed the recovery of Western Europe and Japan and then played a leading role in financing the development of the newly industrializing economies. On the other hand, a more or less free world market and a relatively stable payments system largely benefited US exporters, and the recovery and development of other economies helped the US to win political allies in its global competition with the Soviet Union. In the meantime, as national economies were basically complementary, reflecting the comparative advantage of the world economy at the time, the liberal norms and rules as embodied in various regimes of the postwar economic order were well respected and taken as guidance for national economic behaviors. Of fundamental importance, however, was that US mighty military power provided a secure and stable international environment for the development of global economic relations and rapid economic growth. The postwar extraordinary performance of the world economy was primarily attributed to this favorable world political and economic order.<sup>20</sup>

## **2. *Détente*, the relative decline of US hegemony<sup>21</sup> and the erosion of the liberal international economic order (1970s–80s)**

By the late 1960s and early 1970s, however, the liberal international economic order that was established in the immediate postwar years began to show the signs of erosion. The process of this erosion continued through the 1980s. On surface, this erosion seemed to have been the result of growing divergences, starting in the 1960s, on economic, monetary, political and military matters between the US and its allies. In substance, however, it had derived from the very changes in world politics and global economic power distribution. As such, the erosion of the postwar liberal international economic order should be understood in the context of the historical evolution of the postwar world politics and economics.

In any analysis of the postwar international political economy, it is important to point out that in essence the postwar liberal international economic system that had been designed and led by the US was largely self-liquidating. The very success of this system would inevitably pave the way for changes that would eventually transform it. This system brought more than two decades of high rates of economic growth and rising living standards for its core and associate members by providing secure and favorable international environment for development. Over time, the economic success of the members of the system were not only increasing their capabilities and improving their relative positions *vis-à-vis* the US but also helping to resurrect their sense of national identity and self-confidence. On the other hand, to support and maintain the functioning of this system, the US played a leadership role that would gradually consume its capabilities. This process would inevitably lead to a crisis of the system, particularly when the political consensus among the core members of the system was disappearing.

Generally speaking, starting in the late 1960s there were some major developments that led to the erosion of the liberal international economic order. Among these developments were the changing perception of Cold War politics among Western allies as a result of the *détente* between the two superpowers; the continuing decline of US power, which gradually undermined its ability and willingness to play the leadership role; growing competition in the world economy following the recovery of Western European countries and Japan and the emergence of NIEs; and eroding norms of multilateralism due to the slowdown in the economic activity and the persistent high level of unemployment throughout major economies.

The political *détente* of the 1970s occurred in the context of the Soviet achievement of nuclear parity with the US and the parallel expansion of Soviet naval and other conventional military capabilities by the end of the 1960s. The US and the Soviet Union initiated *détente* in order to reduce the risk of war between them by escalation, accident, or miscalculation.<sup>22</sup> Although *détente* of the 1970s did bring a thawing atmosphere in world politics and relax Cold War politics to some extent, the US and its allies still viewed the Soviet Union as an utmost threat to their national security and the Western allies still depended on US military protection. On the other hand, while the Western unity remained as against the perceived Soviet threat and the Western allies continued to follow US leadership, Washington's political influence had been gradually diminishing among its allies over time. This was partly due to the declining credibility of US political resolve and military capability

to protect its allies with its loss of nuclear superiority over the Soviet Union. This was also due to an increasing capacity and propensity among those allies for independent political action for their own political and economic interests following their economic achievements and restoration of their sense of national integrity and self-confidence. This was reflected in West Germany's initiative of *ostpolitik* and the efforts of the European Community (EC) to speak with one voice in foreign affairs. As a consequence of this development, there was growing disagreement among Western allies over an increasing number of issues in world politics, including *détente*, which in turn brought impact on the world economic order.

In comparison with its diminishing political influence, the relative decline of US economic power was even more visible. Although the absolute indicators of US economic capabilities had grown substantially during the postwar period, the corresponding economic capabilities of other nations, especially their competitiveness in foreign trade, had increased faster. As a consequence, they had been able to narrow the gap between their economic positions and that of the US – a gap that had helped to make the US hegemonic role possible.

One major indicator of the declining economic power of the US was that the asymmetry between the US economy and the world economy had steadily become less marked and less significant. Whereas in 1950 US GNP was two-fifths of world GNP, its proportion declined to roughly a third by 1970 and a quarter by 1980. As late as 1960, US FDI accounted for more than three quarters of the world total stock but, by 1980, it had fallen to less than two quarters.<sup>23</sup>

The drop of the US share of total world exports was equally dramatic, from 16.4% in 1950 to 13.5% in 1970 and 10.8% in 1980. Particularly, the US share of world exports in manufactures continued to drop as a result of further loss of competitiveness by many US industries and the big overvaluation of the US dollar during the first half of the 1980s, while the shares of Japan and West Germany had been growing. Although the US share of world agricultural exports rose until 1980, it too declined thereafter due to the overvaluation of the dollar, the increases in the heavily subsidized agricultural exports of the EC and other producers, and the improvements in cereal production in India, China, and other Asian countries.<sup>24</sup> Perhaps most significant in the trade area is that by the early 1970s the US experienced the first foreign trade deficit in a century.

In the international monetary system there was also a major redistribution of the shares of world monetary reserves between the US and

other countries. Whereas in 1950 half of the world monetary reserves of gold and convertible currencies was held by the US, its portion of the total dropped to less than a third by 1960, to a sixth by 1970 and to only 6% by 1980. The dollar continued to constitute the largest portion of the currency component of the monetary reserves of other countries, but the proportion declined from 75.6% in 1970 to 66.7% in 1980.<sup>25</sup>

The decline of US power could be viewed as an inevitable development as world history evolves; it could be attributed to the nature and functioning of the postwar political and economic system itself; it could be attributed to imperialist inclinations in its foreign policy – spending much of its resources and energy on military preparations in confrontation with the Soviet Union during the Cold War era, maintaining a presence in the third world and fighting two “hot wars” on the Asian mainland (Korea in the early 1950s and Indochina in the 1960s through the early 1970s) had exhausted itself; and it could also be viewed as a natural outcome as other major economies had finally recovered from their war destructions, thus bringing about growing competition in the world economy.<sup>26</sup>

Indeed, largely thanks to the favorable external environment in the postwar years, other Western countries underwent remarkable growth during the postwar years. Following the completion of their postwar reconstruction, Western European countries soon recovered their international trade capabilities and Japan emerged as a major trading nation. As a consequence, the location of economic power was steadily changing during the 1950s throughout the 1960s. Starting in the 1960s the patterns of international trade and economic power were subject to further substantial transformation. In this process, four major developments stood out as most significance, namely, the influence of European integration on the direction of trade, Japan’s transformation into an economic superpower, the entry of new competitors into international markets for industrial products, and the oil price changes.

For both political and economic reasons, Western European countries started their endeavors toward integration in the early 1950s. With the enlargement of the EC during the 1970s and 1980s to include all Western European countries except Norway, Sweden, Switzerland, and Austria, they had collectively become the largest exporter as well as the largest importing market in the world and, after the US and Japan, the third largest source of capital for both portfolio and direct investment. As a result, a growing amount of trade had been diverted to within the EC.

Japan's economic performance was even more spectacular. Adept at borrowing and improving the newest and most efficient product and process technologies, Japanese companies had been stimulated and assisted by their government to undertake export drives targeted at manufacturing markets in the US and the EC. Japan's exports had moved progressively up the technological scale from textiles to steel to automobiles and shipbuilding to consumer electronics and, in the 1980s, to computer-controlled machine tools and other high-technology capital goods. In consequence, Japan's share of total world trade in manufactured goods had been steadily rising, from less than 8% in 1965 to over 11% in 1980.<sup>27</sup> By the 1980s, Japan had surpassed Western Europe as the second largest source of capital for external direct and portfolio investment after the US and. By 1985, Japan had surpassed the US to become the largest exporter of capital.<sup>28</sup>

The so-called NIEs comprise four East Asian economies – South Korea, Taiwan, Hong Kong, and Singapore, which were following in Japan's footsteps, as well as several Latin American nations that succeeded in developing manufacturing industries for export, notably Brazil and Mexico. During the 1970s, the NIEs concentrated their efforts on exports by producing those labor-intensive and standard goods of static or slowly changing technologies, in which they enjoyed their comparative advantage in their abundant, readily trained, and low-cost labor forces over their high-wage competitors in North America, the EC and, most recently, Japan. Over the decade of the 1970s the share of four East Asian NIEs in the world's manufactured exports more than doubled, and increased by more than 70% between 1980 and 1988. The rapid expansion of East Asian NIEs' manufactured exports had a significant impact on the sales of almost all categories of industrial goods in practically all major markets. With a combined population of only about 70 million, they accounted for some 70% of all exports of manufactured goods from developing countries.<sup>29</sup> In the 1980s, the East Asian NIEs began to produce higher-tech goods for export, and countries in South and Southeast Asia (e.g., India, Malaysia, and Thailand) and Latin America (e.g., Colombia) were also moving to join their ranks.

The declining power of US hegemony was also reflected in its loss of control over the world energy market as shown in the oil crisis of the 1970s, when the Organization of Petroleum Exporting Countries (OPEC) countries were able to take advantage of temporary political and economic conditions favorable to the exercise of monopoly power by an exporters' cartel to triple the real world-market price of oil in

1973–74 and to double it once again in 1979–80. These moves greatly enhanced their economic positions in the world economy, especially those of the biggest exporters, whose multiplied foreign-exchange earnings were much too large to be spent on imports of goods and services. The resulting OPEC current-account surplus, which mounted to a peak of \$106 billion in 1980, was largely invested in the financial markets of the OECD countries, partly in their governments' securities but mainly as short-term deposits in the big US, European, and Japanese banks. In turn, the banks "recycled" these huge funds as higher-interest loans to their own governments and private-sector enterprises and to governmental and private-sector borrowers in the oil-importing nations.

In the postwar years, the legacy of Keynesianism of the 1930s and the commitment to high levels of employment and other social objectives merged to form a relatively coherent national policy in Western countries. However, as the unprecedented economic growth of the 1950s and 1960s was being replaced by the "stagflation" of the 1970s (the combination of a low rate of economic growth, mass unemployment, and double digit inflation) and by even slower economic growth of the 1980s, domestic objectives were increasingly in conflict with the international policy objectives, and national governments were facing increasingly strong pressures for protectionism, brought about by the domestic community and labor unions that were hurt by foreign competition. As a result, governments were becoming growingly prone to adopt nationalistic fiscal and monetary policies, pursue highly competitive export-led growth strategies, and safeguard their own industries and social welfare programs. As a consequence, there was growing erosion of norms of multilateralism among major economies and a marked shift in economic thinking toward trade liberalization and market forces.

With all these developments, the conditions that sustained the liberal world economic order for the first two decades after World War II had either been transformed or weakened throughout the 1970s–80s. Consequently, the liberal international economic order had been gradually eroding. This erosion was well illustrated in the breakdown of the Bretton Woods system of fixed rates and the shift to a system of flexible exchange rates. Largely due to the effects of its steadily declining economic power, combined with the defects of the postwar international monetary system itself, by the late 1960s the US was running a large current-account deficit that was mainly financed by the willingness of other countries to accumulate dollar assets in their monetary

reserves. In order to eliminate this persistent US balance of payments deficit and the resulting drain of gold from its monetary reserves, on 15 August 1971 the US President Nixon announced the New Economic Policy, which officially devalued the dollar for the first time in the postwar years, dropped the gold standard, and imposed a temporary 10% surcharge on all imports. Nixon's New Economy Policy was followed by the Smithsonian Agreement of December 1971, which temporarily realigned exchange rates. By the end of 1973 the international monetary system had been officially radically transformed, which eliminated a fixed rate between the dollar and gold (whose price was thereafter free to fluctuate in accordance with supply and demand) and fixed rates of exchange for other currencies in terms of dollars. With these changes, the Bretton Woods system of fixed rates was to be replaced by a system of flexible exchange rates.

Technically speaking, Keynesian economic policies had also contributed to the breakdown of the Bretton Woods system. In the short term, Keynesian demand management brought about an era of relatively non-inflationary full employment with rapid real growth and modest payments imbalances (with the end of the 1950s as its golden age). In the longer term, however, the sustainability of this prosperity was quite questionable. At the domestic level, maintenance of high levels of employment through active demand management finally stimulated accelerating inflation. At the global level, there was a similar problem. The growth in dollar reserves that had been generated by the US continuing payments deficit without being converted into gold was necessary if world economic expansion was to be maintained. Other nation-states needed growing reserves as trade expanded if a given degree of trade liberalization was to be maintained, and there was no other significant source of reserve growth. However, if the short-run dollar liabilities of the US continued to expand while its gold assets remained constant or even shrank, it was only a matter of time that the US would eventually be unable to maintain its commitment to sustain the \$35 gold price. When that point of time came, central banks would logically rush to convert dollars into gold, just as had happened to Britain in 1931. Thus, the Bretton Woods system had a built-in dilemma at the very time of its birth, dubbed the *Triffin Dilemma*, which implies that either the US would succeed in curing its payments deficit, in which case world growth would be strangled by the emergence of a progressively more acute liquidity shortage, or the US deficit would continue, in which case a crisis of confidence would sooner or later be inevitable. The system as constituted was inherently incapable of solving simultaneously the *liquidity problem* (how to ensure

that reserves grow at an appropriate rate) and the *confidence problem* (avoiding crises of confidence).<sup>30</sup>

In comparison with the breakdown of the postwar monetary system, there seemed to be no comparable crisis in the international trade area. However, as the process of economic development redistributed power among nations, there had been growing competition in the world economy. Starting in the late 1960s, there was a growing tendency of new protectionism in most industrial countries. Quite different from the tariff protection of the past, new protectionism assumed the form of "managed trade," which mainly rested on quota restrictions. As a result, the number of bilateral or multilateral agreements involving import restrictions, or so-called voluntary export restraints (VERs), increased considerably, and the menu of issues being negotiated lengthened. Such agreements, covering broad sectors or specific products, were voluntary in name only. This trend implied a *de facto* cartellization of international trade for the products and areas concerned. A more concealed form of protectionism was found in various export subsidies provided by numerous governmental and administrative obstacles to imports. As national governments were becoming increasingly prone to view the rise of imports as a direct threat to domestic employment, the list of sectors claiming special treatment and protection was getting longer and longer: including agricultural products as well as major industries, such as steel, textiles and clothing, shipyards, chemicals, consumer electronics, and automobiles. All these developments challenged the principle of multilateralism and the credibility of GATT.

Under such circumstances, there was growing strain and acrimony between major economies, especially between the US and the EC, and between Japan and its OECD partners, over various issues, including agriculture, trade in services, high-tech products, the protection of intellectual property, investment, exchange rates, macroeconomic policy, and even the shares of military burden between the US and its allies. Also, there was a vague feeling, shared by US officials, businessmen and scholars, that Western Europe and Japan had benefited more than the US from the postwar international economic order, thus there was need for a more aggressive policy to defend US interests at home and abroad. In the meantime, in contrast with the system of general preferences in favor of developing countries, there was a growing tendency to discriminate against the exports of the most successful developing countries, despite the fact that they still accounted for only a small share of trade in manufactures.

In analysis of the erosion of the liberal international economic order, however, it is also important to point out that the effects of the erosion resulting from the changed conditions in the world economy were to some extent counterbalanced by the effects of increasing interdependence of national economies in the postwar years. In particular, the system of fluctuating exchange rates and highly integrated financial markets had resulted in a more rapid and drastic transmission of inflationary and deflationary pressures among national economies in a world of growing interdependence. As a result, the value of rules that reduce uncertainty in the world political economy was still highly appreciated by national governments. Thus, although the process of erosion continued, some major elements of liberal world economy were maintained. Under the system of floating rates established in 1972, theoretically speaking, national governments were free to intervene in the operation of the foreign exchange markets. However, this new system had many points of similarity with the dollar exchange standard. As free convertibility of currencies was maintained, the existing monetary system was still partly liberal. It did not lead to competitive devaluation – the principal argument advanced in 1944 for the commitment to a fixed exchange rate regime.<sup>31</sup> There was no evidence to show that the volume of international trade had been significantly affected by the switch-over to the managed flexible exchange-rates system. Finally, this system “cushioned” domestic economic policy more effectively than its predecessor and reduced speculative pressure while facilitating a certain level of “voluntary” adjustment, even on the part of surplus countries, particularly the US and Japan, which showed willingness to accept currency revaluation occasionally. Thus, the emergence of the managed flexible exchange-rates system was best seen as a modification of the regime to achieve the objectives of the Bretton Woods regime – described by John Ruggie as “embedded liberalism.”<sup>32</sup> Moreover, though US hegemony was declining, the US dollar still served as the major transaction currency, the key currency, and the reserve currency of the international monetary system.

In the area of international trade, the Tokyo Round (1973–79) continued tariff liberalization.<sup>33</sup> In the meantime, negotiations moved on to tackle non-tariff barriers to trade (such as the standardization of customs procedures and the strengthening of anti-dumping codes). The Uruguay Round (1986–93) continued these matters, along with the areas of agriculture and services. The agreement reached at the Uruguay Round decided that the World Trade Organization be established to replace GATT in 1995. In brief, although increasing attention was

being focused on the rise of protectionism, in both absolute and historical terms there was still an astounding degree of freedom of trade and of foreign investments in the world economy during the 1970s–80s. Freedom of movement of goods, services and capital still prevailed among principal trading nations.

In the last analysis, it is clear that national economies all benefited greatly from the growing opportunities for expanding their external economic relations created by the postwar liberal economic order, as barriers to international trade and payments were steadily reduced, and in many respects, abolished, during the postwar period. Indeed, after the tariff reductions and other changes agreed to in the Kennedy Round of GATT negotiations in the 1960s went fully into effect, the world market economy was closer to the free-trade ideal than at any time in history and national economies had become more interdependent than ever known. Then in the 1970s and 1980s, despite some setbacks, including the rise of unemployment and of economic uncertainty, trade and production continued to grow. The credit for today's unprecedented prosperity and for the resilience of economic structures can be largely attributed to the lowering or elimination of tariffs, the banning of quantitative import quotas, the achievement of currency convertibility, the liberalization of movement of capital and labor, the control of cartels and the promotion of competition.

From the point of view of the national economies involved, however, this development had ambivalent effects. On the one hand, it continuously opened up new opportunities for trade, thereby greatly stimulating economic growth and rising employment and incomes. On the other hand, it meant that the global economy was becoming increasingly competitive, with comparative advantages shifting more rapidly between national economies as their relative factor costs changed and technological innovations were disseminated much faster than in the postwar period. Thus, the more integrated the global economy became, the more the participants would experience the adverse short-term effects of the adjustment process on employment and incomes even as they were reaping the short- and long-term benefits of the gains from trade. The adjustment was always painful and difficult. Only in a dynamic or growing economy that the constant adjustments required by international trade and foreign competition can be accomplished relatively smoothly with less social tensions and political opposition. But most nation-states, especially developed countries, became increasingly unwilling and unable to endure the unfavorable short-term impact of the adjustment and all the more eager to maintain and

expand their exports. As such, the revival of protectionist pressures could be linked to difficulties of adjustment at both the national and international levels.

In sum, the period of the 1970s and 1980s witnessed three major changes in the world economy and the global economic order. The first was the continuing decline of US power, which undermined its ability and willingness to continue its commitment to the maintenance of the postwar international liberal economic order. In the meantime, the position of the US economy also changed relative to the world economy, thus making the US significantly more dependent upon the latter and, hence, more susceptible to the adverse short-term effects of the adjustment process. The second was the greatly increased importance in the world economy of the EC, Japan, and the NIEs, as well as of the OPEC countries whenever oil supply and demand conditions were in their favor so that they could exert their monopoly power. The third was the period of rapid economic growth of the 1950s–60s being succeeded by a prolonged world recession. The problem of the erosion of the liberal international economic order was therefore largely a problem of how to reconcile short- and long-term benefits of a liberal international economic order and short-term effects of the adjustment process on national economies and domestic societies caused by international economic competition.

### **3. Post-Cold War politics, globalization and a new world economic order (1990s–)**

By the end of the 1980s and early 1990s, fundamental changes had taken place in international politics. The Cold War, which emerged from the ruins of World War II, had come to a final end as a result of the dramatic transformation in Eastern Europe and the Soviet Union.<sup>34</sup> With the end of the Cold War and the disappearance of the Soviet threat, the political benefits of the Western unity no longer assumed priority and the concern over economic costs increased, thus weakening the political bonds of Western allies. This development, together with the continuing decline of US power, collapsed the very foundation on which the postwar liberal international economic order was constructed and maintained. Consequently, the post-Cold War period witnessed significant transformation in international politics and economics in three major respects.

In the first place, with the breakdown of the Soviet Union and the end of the Cold War, the prominence of security issues has declined,

while economics is becoming growingly salient in international relations.<sup>35</sup> In the process of this transformation, wealth and power are no longer primarily related to the possession of territory and raw materials, while trade, capital and technology have replaced traditional territorial expansion and military might as the key to national wealth and power.<sup>36</sup> As Harry Gelber summarizes the argument: "Perhaps for the first time in the history of social man, sheer size of territory, resources, and population is of declining economic and, in some ways, even military importance. Economic and military power is increasingly determined by science, technology, know-how, entrepreneurial flexibility, and innovative skills."<sup>37</sup> Under such circumstances, there has been escalating economic competition among nation-states in the post-Cold War era.

Secondly, as low politics is moving to the top of the global agenda and the international position of individual nation-states is deriving increasingly from their economic prowess rather than their military capability, the political map of world powers has been redrawn. As a result, whereas the relative power and influence of the US is falling, those of Europe, Japan, and, more recently, China are rising.<sup>38</sup> Consequently, the world economy has been moving away from a system that was previously predominated by the US to a system that is growingly influenced jointly by the US, the EU, Japan, and a rising China, although the US, despite its relative decline, remains the world's largest single economy and continues to possess superior overall capabilities.

Thirdly, in a world of growing economic interdependence and increasing competition, comparative advantages are shifting more frequently among nation-states, particularly with the rise of new industrial powers in the world economy. In response to changing comparative advantages, nation-states have to timely make adjustment of their economic structures to remain competitive. However, the economic adjustment is no easy job, given its complexity, scale, social effects and the clash between domestic autonomy and international norms it would bring with it. It is precisely the very difficulty of adjustment that has brought growing new protectionism in the form of various non-tariff barriers, including such measures as national regulations, safety standards, anti-dumping provisions, countervailing duties, VERs, gentlemen's agreements, and so forth. All these protectionist practices are posing new challenges to the liberal international economic system.

Despite the dramatic transformation in global politics and economics and the collapse of the postwar US-predominated global economic order, however, as regime theories aptly indicate, the existing global economic

regimes would likely continue to stay. This is because all the major economic powers have a high stake in the maintenance of the main elements of the economic regimes created under the previous US-predominated liberal economic order, as these liberal economic regimes could still provide a useful framework for much needed multilateral cooperation among them in the context of economic interdependence. In other words, no major economic power today could possibly afford the complete collapse of the existing liberal international economic regimes while continuing to maintain the well-beings of its people. As such, maintaining the existing international economic regimes is a logical choice for major economic powers, as according to Robert Keohane, it is much easier to maintain the existing regimes than to create new ones.<sup>39</sup> Furthermore, there is also considerable institutional opposition to protectionism that comes from institutional inertia both in international organizations and national governments, in both of which there is strong belief in the irreversibility of economic interdependence and global economic liberalization. This inertia can be found in the decision-making process at both national and international levels on trade, investment, monetary, and other economic matters.

More significantly, the forces that help continue to maintain the existing liberal international economic regimes have been particularly further strengthened by the rising trend of globalization, a process that coincided with and accompanied the process of the transformation in postwar global politics and economics in the course of the 1970s–80s and thereafter.<sup>40</sup> As a matter of fact, rising globalization has largely been the result of the rapid economic growth and technological advancement in the world economy in the postwar years, which had been achieved primarily due to the postwar liberal international economic order of the 1950s and 1960s. On the other hand, rising globalization is also a further evidence of decline of US hegemony that was starting in the late 1960s and early 1970s throughout the 1980s, and the consequent emergence of what Gillian Youngs calls “complex hegemony” by the first decade of the 21<sup>st</sup> century.<sup>41</sup>

As a major manifestation of globalization, national economies have been increasingly integrated among themselves through trade, finance, production, and a web of treaties and institutions. International trade, which has grown more rapidly than global production in almost every year since World War II, has now become a major source of economic growth and contributed to a large share of gross domestic product (GDP) in virtually every country. Equally significant, cross-border financial flows have grown even more rapidly than trade flows over the past four

decades. FDI, which has grown most rapidly among capital flows, is of particular significance in promoting globalization in the sense that it underscores the enormous and increasing role of MNCs in global trade, and especially in global production. As a result, different stages of the production process are now carried out in different parts of the world, depending on the comparative advantages of production locations. The rapid rise of FDI has also contributed to the rapid growth of international trade with an estimated one-third of merchandise trade today being derived from shipments among the affiliates of MNCs. Globalization has also brought increased harmonization of economic institutions and growth of global treaties. A growing web of treaties ties nation-states together through multilateral, regional, and bilateral obligations. Globalization has proved a catalyst for internationally agreed-upon rules of behavior in trade, finance, taxation, investment, and many other areas, thus prompting the rise of the WTO and other international institutions.<sup>42</sup>

Whereas globalization is primarily driven and shaped by increasing international economic interdependence through flows of goods, capital and people and spread of technology, it is also reinforced by and manifested in growingly stronger political ties among sovereign nation-states and closer social and cultural ties among peoples through the development of international law and expansion of international treaties, proliferation and rising influence of non-governmental organizations (NGOs), rising number of international interactions among various non-governmental actors, and rising movement of peoples and communications across national borders.<sup>43</sup> By the end of the 1980s and early 1990s, globalization had become a prevailing force that was bringing profound impact on world politics, economics and society at multiple levels.

A most significant consequence of globalization is that the world has been turned into a "global village" and world politics has been transformed in a way that is eroding the sovereign power and autonomy of individual nation-states and makes national borders increasingly irrelevant on an expanding number of issues. As a result, while the nation-state still remains as the most important form of political communities in world politics today, its sovereignty and autonomy has been increasingly eroded in a range of important areas.<sup>44</sup>

Firstly, growing economic interdependence is depriving nation-states of their sovereign power and autonomy in the age of globalization. National economies were once separated by high transport costs and artificial barriers to trade and finance, but they are now linked in an increasingly comprehensive and dense network of economic inter-

actions, which involves almost every aspect of the world economy, including production, consumption, resources, capital, technology, markets, information, and so forth. Particularly, national markets are being increasingly displaced by international markets in the age of globalization. Almost all countries have realized that national markets are simply too small to permit an efficient level of production in most areas of industry and even in many areas of services. Efficient production must be geared instead toward world markets. As nation-states are increasingly dependent on external economic ties for their own economic growth, social welfare and even domestic political stability, the globalization of national economies and markets has therefore undermined the power of individual states to control what happens within their borders. People's livelihoods now heavily depend on the events that are happening far beyond their national borders. In the meantime, whether jobs exist and what levels of wages are paid is frequently determined by policy decisions made by other states, by IGOs (as the IMF, the WTO, and so forth), and by transnational organizations. As such, nation-states are now highly dependent on the external forces, which are beyond their own control, for the economic well-beings of their citizens.

Secondly, as national economies have become so interdependent in the age of globalization, there is a rising number of important and urgent global issues, such as pollution, epidemics, natural disasters, drug trafficking, terrorism, pirating, and so forth, that affect nation-states more or less indiscriminately but that could only be effectively dealt with through multilateral cooperation and joint actions by nation-states, and that there is an increasing number of national policy objectives that could be achieved only through international cooperation. The imperative need for such multilateral cooperation, compromise and joint actions also help push the world economy toward multilateralism and erode state sovereignty and autonomy.

Thirdly, state sovereignty and autonomy is similarly weakened by the global revolution in information technology, as reflected in internet, facsimile machine and TV among others. In this respect, television and internet are particularly powerful and effective in breaking down national frontiers. As a result, nation-states have decreasing ability to control the movement of capital, ideas, and people entering and leaving their territory. Economically, speculators can now move huge sums of money almost instantly from continent to continent, thus making the state growingly powerless in management of the national economy, as illustrated by the Asian financial crisis of 1997–98.

Politically, repressive governments could no longer effectively prevent free flow of information and ideas through radio broadcasts, television, and internet. This development, combined with higher standards of living, wider education, improved communication, travelling and studying overseas, and consumption of foreign products, makes many citizens politically conscious. As a result, repressive states are increasingly unable to control their own citizens.

Fourthly, the prerogatives of nation-states are further challenged in various ways by the proliferation of non-governmental actors in the world arena, including IGOs, NGOs, MNCs, international social movements, religious movements, and even terrorist groups. IGOs and NGOs challenge the sovereignty of nation-states; MNCs challenge nation-states' economic independence; international social movements challenge various policies of nation-states; terrorists challenge the security of the citizens of nation-states. Non-governmental actors collectively form a global civil society, conducting many activities beyond the control of nation-states.<sup>45</sup> On the other hand, in the domestic setting, global trend of liberalization has also led to the growing decentralization of government power toward the people at sub-national or even local levels, which are increasingly asserting their claims to cultural, economic and political autonomy. Together, non-governmental actors bring a multi-centric world, in which political communities at the sub-national level, regional level, and global level have been gaining growing importance in global politics and economics, which is in sharp contrast to the state-centric world of sovereignty-bound nation-states.<sup>46</sup>

Consequently, there has been fragmentation of political authority in the course of integration of the global economy, which has caused a sea change in the role of the nation-state, relative to both local and sub-national governments on the one hand, and multinational political institutions on the other. It is in this sense that globalization has become the single most important source of political integration in contemporary global politics in terms of governance in the post-US hegemony era.

Under such circumstances, the global economic order has been substantially transformed since the late 1980s and early 1990s from the previous one that was constructed on the basis of the US hegemony into a new one that is primarily driven and shaped by globalization. While the new international economic order is still in the process of taking shape, some of its most important features have already been quite evident. The most significant feature of the new economic order

seems to be the enlargement of the playing field, which has been bringing the shift of power distribution both among nation-states and between state and non-state actors. To use the words of Benjamin Cohen when he refers to the IMF, which is relevant to other international institutions as well, the global economic system is experiencing a greater diffusion of power both among states and between states and societal actors in the age of globalization.<sup>47</sup> Particularly, the emerging new economic order is no longer dominated and managed by a single hegemon, but rather jointly influenced by an expanding group of major powers, including the US, the EU, Japan, China, and other players through a multi-polar structure that is frequently referred to as "global governance." The concept of global governance first appeared in the mid-1990s in the context of rising need for international cooperation and coordination in handling imperative global issues in the age of globalization. Rather than a top-down, hierarchical structure of global authority, global governance, according to Margaret Karns and Karen Mingst, refers to "the cooperative problem-solving arrangements and activities that states and other actors have put into place to deal with various issues and problems. They include international rules or laws, norms or 'soft law,' and structures such as formal international intergovernmental organizations (IGOs) as well as improvised arrangements that provide decisionmaking processes, information gathering and analytical functions, dispute settlement procedures, and operational capabilities for managing technical and development assistance programs, relief aid, and force deployments. In some instances the rules, norms, and structures are linked together in ... international regimes to govern a particular problem such as nuclear weapons proliferation, whaling, trade, food aid, transportation, ozone, or telecommunications."<sup>48</sup> Coming with the concept of global governance is reemergence of the concept of "global public goods" in the age of globalization.<sup>49</sup>

In the meantime, as global governance now provides a new structure to accommodate conflicting interests of nation-states through institutional cooperation and policy coordination,<sup>50</sup> the new global economic order is moving from "power oriented" to "rule oriented" in the process of globalization.<sup>51</sup> As a result, rule-setting through bargaining, tradeoffs and compromises primarily among major powers becomes increasingly a crucial issue for global governance.

On the other hand, in the age of globalization the universal norms and practices of multilateralism on the basis of negotiations, bargaining and tradeoffs between nation-states continue to be advocated to function as the basis of the new liberal international economic order.<sup>52</sup>

According to Harold James, the power of globalization rests not simply on material prosperity, but on the ability to communicate and share ideas as well as goods across large geographical and cultural distances. By referring to natural law theories, James concludes that a sustained dialogue between apparently rival traditions of thinking can lead to agreement on shared norms and values.<sup>53</sup> Largely because of this continued belief in universal norms of liberalism, the liberal multilateral system, albeit being now run through a multi-polar structure of global governance, is still considered as the best option for international economic relations by major economies. As such, despite growing nationalistic competition, most of the economic and political ties among major powers remain intact and the major economic powers still resort to makeshift arrangements to maintain liberal international economic relations. This may well be illustrated by the development in both the international monetary area and the international trade area. For example, although the Bretton Woods system of fixed exchange rates broke down in 1973, the major powers still followed the principle that national policies should properly be subject to international scrutiny and avoid great fluctuations of exchange rates, for there was the consensus that international monetary cooperation was in the interest of all. Precisely because of this consensus, the post-Bretton Woods international monetary system was still quite manageable as it was under the postwar system of fixed exchange rates. In the international trade area, despite growing protectionism, members of GATT and its successor after 1995, the World Trade Organization (WTO), still subscribed, to a considerable extent, to the principles of non-discrimination, liberalization and reciprocity. The successful completion of the Uruguay Round negotiations (1986–93) and its resultant establishment of the WTO is the very proof. It seems that all major economies have a common interest in pursuing cooperation and policy coordination for the common good.

In the age of globalization, while the world economic order is organized through a multi-polar structure with power more diffused, however, power is still not equally distributed and newly emerging powers have increased their capacity for action but not necessarily their influence.<sup>54</sup> As a matter of fact, the US continues to maintain a dominant position in the global economy, although retreating from the hegemonic role in the postwar years, but showing signs of strains, particularly in such key sectors as banking and finance.<sup>55</sup> It is in this sense that the attitude of the US to the rules of global governance is very crucial for the setting of new rules of global governance. As such, whereas the US does not necessarily have a

capacity of unilaterally creating new rules of global governance, it is still powerful enough to effectively veto any new rules that it dislikes.<sup>56</sup> On the other hand, however, it also becomes clear that global governance is also increasingly influenced by the EU as the largest economic bloc with a monetary union involving half of its members, China as a rising economic power with its manufactured exports, huge trade surplus, huge foreign exchange reserves, and holding of huge amounts of US bonds, and possibly India with its rapid economic growth.<sup>57</sup>

By the first decade of the 21<sup>st</sup> century, with the diffusion of power, global governance, which is still in the process of construction, has been characterized by a multi-polar structure that involves the long established institutions like the United Nations (UN), the IMF, the WTO, the World Bank, but also such new institutions like the expanded Group of Eight (G8) + 5.<sup>58</sup> There are also new proposals for strengthening and advancing global governance. One such important proposal comes from the former prime minister of Canada, Paul Martin, who has proposed the creation of L-20, which refers to a summit gathering of the leaders of twenty important states from all major world regions. According to Martin, L-20, which would build on the G8's strengths of informality and flexibility and provide a valuable complement to the UN, would constitute a significant advance in global governance.<sup>59</sup>

In a further analysis, while globalization has been bringing fundamental impacts on economic growth, distribution of income and wealth, structure and organization of production, patterns of trade and finance, and political institution, these impacts vary among different individuals and social groups in both developed and developing countries and among different national economies, particularly between developed and developing countries and between open economies and relatively closed economies.<sup>60</sup>

In the first place, whereas globalization has been promoting faster growth of the world economy as a whole through rapid growth of global trade and capital flows and internationalization of production process, the gains in economic growth are not shared equally by national economies. Generally speaking, export-oriented economies have experienced rapid economic growth, while the more closed economies with high tariffs have had slower growth. Moreover, those economies that primarily rely on the production of natural resources face lower long-term growth with their manufacturing sectors uncompetitive.

Secondly, while rapid economic growth derived from globalization has helped substantially improve the living standard in a very large portion of the world population in both developed and developing

countries, not all countries have benefited equally from this growth and not all people, even in those countries of fast growth, have had their living standard improved. As a matter of fact, globalization has contributed to rising income inequality both among and within countries. Particularly, globalization has not only further widened the gap in wealth between rich and poor countries, but also contributed to a sharp increase in income inequality between developing countries. While some developing countries have achieved very rapid economic growth and become NIEs, other developing countries have remained stagnant, drifting to the bottom of the global development scale and becoming the world's least developed countries (LDCs). On the other hand, in the domestic setting, there has been rising inequality in both developed and developing countries. In developed countries, workers in labor-intensive sectors have been losing jobs due to cheap goods imported from developing countries, while in developing countries skilled workers have been losing jobs when skill-intensive manufacturing goods are imported from developed countries. Besides, globalization is also responsible for reduced income for workers, exploitation of child labor and women in poor countries, and the flow of migrants from the poor developing countries to better-off countries. Furthermore, while globalization has helped lift millions of people in many countries out of poverty and achieve substantially increased living standards that many of them had never imagined in the recent past, most of the LDCs and the majority of their population remain marginalized in the global economic development and benefit so little from the huge wealth that has been brought about by globalization. As a result, there are still nearly one billion people who live in chronic poverty, particularly in LDCs, despite the great affluence that globalization has brought to the majority of the world's population.<sup>61</sup>

Thirdly, while globalization has contributed to rapid global economic growth thanks to a liberal global economic order institutionalized in GATT/WTO, the IMF, the World Bank, and other international organizations, for many developing countries, however, such an organizational framework of multilateralism is perceived as compromising their sovereignty to set their own priorities and economic policies. Moreover, many developing countries are concerned about a consolidated trade pattern in the process of globalization that has put them in a permanent inferior position as a supplier of raw materials and/or low-value-added labor-intensive manufacturing products in the international division of labor. Similarly, developing countries are also worried about the growing dominance and greater monopolistic power of MNCs

of developed countries that has put them in a dependent status in the globalized process of production.

Fourthly, globalization has brought with it macroeconomic instability. In the process of globalization, there has been dramatic rise of international capital flows in the form of portfolio investment, bank loans, bond lending, derivations (swaps, options, forward transactions, and the like), reinsurance, and other financial instruments. Both developed and developing countries have increasingly opened their capital markets to foreign investment. While trade in financial assets would generally benefit individual nation-states as merchandise trade does, it would also likely bring financial instability. Both the debt crisis of Mexico of the 1980s and the financial crisis of East Asia of 1997–98 have shown that unfettered financial flows from developed economies to developing economies without proper supervision can create profound destabilization in these emerging markets. Consequently, these crises have forced decision-makers of many developing countries to have second thoughts on rapid liberalization of international capital flows under the pressures of developed economies. Furthermore, globalization has also contributed to macroeconomic imbalances in the world economy, particularly as China, Japan, Russia, and East Asian and oil-exporting countries have accumulated huge international reserves, while the US and most countries in Central and Eastern Europe have run large current account deficits.<sup>62</sup> While macroeconomic imbalances have partly contributed to the financial crisis that started in the US in 2008, globalization has helped spread this financial crisis to other parts of the world very quickly.<sup>63</sup>

The varying impacts of globalization on national economies, both positive and negative, have therefore been prompting nation-states to adopt various policies to enhance the benefits of globalization for their own nations while minimize its negative consequences. One of such important policies adopted by many nation-states is, while continuing to advocate the general principle of liberal international economic relations and multilateral collaboration, to promote regional economic integration, particularly at a time when the existing multilateral framework of global governance fails to address some most imperative issues of global consequences and to push global economic liberalization further, such as a new world economic order, global warming, energy crisis, global financial crisis, reform of the global financial system, paralysis of the Doha Round of multilateral trade negotiations within the WTO, and so forth.

# 4

## Regionalism in the World Economy since the 1950s

While multilateralism is the most salient force in the postwar world economy, economic regionalism has consistently existed since the early 1950s. As a matter of fact, provided certain strict criteria are met and a procedure of notification is followed, regional trade agreements (RTAs) in the form of customs unions and free trade areas are openly sanctioned by GATT and its successor the WTO through three sets of rules, which include Article XXIV of GATT,<sup>1</sup> the Enabling Clause,<sup>2</sup> and Article V of the General Agreement on Trade in Service (GATS).<sup>3</sup> According to these rules of GATT and the WTO, if a free trade area or customs union is formed, duties and other trade barriers should be reduced or removed in substantially all sectors of trade in the group. Non-members should not find trade with the group any more restrictive than before the group is set up. The major rationale for the permission of regional preferential trade arrangements is that the regional integration would bring trade creation effects for the world economy as a whole. More significantly, RTAs, according to this rationale, could serve as a supplemental, practical route to the universal free trade that GATT and the WTO advocate as the ultimate goal, as complete removal of trade barriers on a worldwide basis would not likely be achieved in anytime soon largely due to huge political obstacles. As such, deeper regional integration could be first achieved within those areas where political conditions permit faster movement toward free trade, which would then spill over to the world economy as a whole over time. In this view, therefore, regional integration would contribute to the building of the multilateral trading system rather than threaten it.<sup>4</sup>

In 1995, the WTO Secretariat published a study on the issue of economic regionalism, entitled *Regionalism and the World Trading System*, which further confirmed the positive effects of regionalism on inter-

national trade relations. According to the conclusion of this study, "regional and multilateral integration initiatives are complements rather than alternatives in the pursuit of more open trade." The report observes that regional agreements allowed groups of countries to negotiate rules and commitments that go beyond what was possible at the multilateral level at the time. In turn, some of these rules paved the way for the Uruguay Round agreements, for example in services and intellectual property protection. Some regional groups reached agreements on environmental standards, investment and competition policies. These three issues were mentioned in the final Uruguay Round agreement and are now being discussed in the WTO.<sup>5</sup> Such a positive observation of the complementarity of regionalism and multilateralism most recently led to a new notion of "multilateralizing regionalism" in a 2007 study for the WTO.<sup>6</sup>

On the other hand, however, despite the strict criteria and the positive tune of GATT and the WTO regarding regional RTAs, in the eyes of many people the provision that permits the setting-up of regional preferential trade arrangements still looks a bit at odds with the most salient principles of equal treatment and non-discrimination for all trading partners as advocated by GATT and the WTO. As such, there have long been debates on the nature and impact of regionalism on the multilateral trade system. Particularly, according to critics, the relevant rules of GATT and the WTO regarding RTAs have been frequently abused since the formation of the EC in the 1950s.

Such debates have become even more heated in the past two decades, as regionalism has increasingly become a prominent feature of the multilateral trading system since the late 1980s. According to the WTO's statistical data, there have been rising number of RTAs since the early 1990s. By December 2008, there were some 421 RTAs that had been notified to GATT and its successor the WTO, 124 of which were notified to GATT and 297 to the WTO. Of all these RTAs, 342 were notified under Article XXIV of GATT, 29 under the Enabling Clause, and 68 under Article V of the GATS. Of all the 421 RTAs that had been notified to GATT and the WTO, 230 are still in force today. The total number of RTAs that are scheduled to be implemented by 2010 could be as high as 400 if those RTAs that are in force but have not been notified, those signed but not yet in force, those currently being negotiated, and those in the proposal stage are all included. Of all these RTAs, FTAs and partial scope agreements account for over 90%, while customs unions account for less than 10%. Among the best known RTAs of today are the EU, the European Free Trade Association (EFTA), NAFTA, the

Southern Common Market (MERCOSUR), the ASEAN Free Trade Area (AFTA), and the Common Market of Eastern and Southern Africa (COMESA).<sup>7</sup>

Realizing the significant implications of proliferation of RTAs on international trade relations, on 6 February 1996 the WTO General Council created the Committee on Regional Trade Agreements, whose major responsibility is to examine regional free trade groups and assess whether they are consistent with WTO rules. In the meantime, the committee is also responsible for examining how regional arrangements might affect the multilateral trading system, and what the relationship between regional and multilateral arrangements might be.<sup>8</sup>

## **1. Economic regionalism in the postwar world economy**

Economic regionalism emerged very early in the postwar years, and proceeded even in the zenith of multilateralism during the 1950s and 1960s. A most illustrative example of economic regionalism in the postwar years was European integration. The initiative of European integration appeared in the immediate postwar years and was initially supported by the US. For both geopolitical and economic considerations, the US initiated in 1947 an aid program in the name of the Marshall Plan for the reconstruction of Western Europe. However, the US aid was conditional on the effective cooperation among European governments and the progressive liberalization of intra-European trade and payments. Both the Organization for European Economic Cooperation (OEEC), which was later transformed into the OECD with the entry of non-European, Western industrialized countries, and the European Payments Union (EPU) were the result of the US pressure on the European recipients of the Marshall Plan aid. The aim was to achieve a more effective use of the money provided under the Marshall Plan and also to promote the economic and political integration of the old continent in the face of the threat from the Soviet Union.<sup>9</sup>

In the meantime, certain innovative leaders in France, West Germany, Italy, and the Low Countries also made efforts to promote European regional integration. Realizing that European integration could not be achieved overnight through a simple political action, they adopted a functional incremental strategy to eventually achieve their federalist objective – the establishment of a European federation.<sup>10</sup> In practice, this would be a process of identifying specific sectors where European nations could perceive national interests in creating organizations to

work together and then, through a mechanism of ramification or spillover, generating collaboration in more and more other sectors, finally involving more sensitive sectors, say, the political sector.

The persistent efforts of these countries first led to the establishment of the European Coal and Steel Community (ECSC), an institution that was designed to integrate the sectors of coal and steel, two sectors with strategic importance for both economics and military. The ECSC, established by the Treaty of Paris in 1951, originally derived from a French initiative, the so-called the Schuman Plan of 1950.<sup>11</sup> It was believed that sustained peace in Europe could be achieved if steel and coal, two commodities that were essential for war, were to be put under the control of a supranational body, which would be beyond control by any single nation-state. In the meantime, an intergovernmental Council of Ministers was established to safeguard national interests, especially of smaller states. A supranational Court of Justice would enforce the law and a supranational Assembly of National Representatives would loosely involve the citizens of Europe. As such, the supranational institutions designed to run the ECSC were protofederal in character. Despite its apparently limited economic objectives, the ECSC was directly linked to the national interests of its members and highly political in character. The French wanted to ensure that a vital element of West Germany's economic recovery took place under the control by a common European body, while for the Germans the ECSC provided them with a way back into the international community as an equal partner. Similar national interests and political calculations were also behind the decision of the other four countries (Italy, the Netherlands, Belgium, and Luxembourg) that joined the ECSC. Meanwhile, the ECSC was also directly related to Cold War politics of a perceived Soviet threat to Western Europe. In effect, the establishment of the ECSC laid the foundations of Franco-German reconciliation, which later developed into close cooperation, thus providing the cornerstone and the main driving force of regional integration in Europe.<sup>12</sup>

With the success of the ECSC, new plans were put forward for greater European integration. In 1957, the same six Western European countries signed the Treaty of Rome to create two new Communities, the EEC and the European Atomic Energy Community (Euratom), which became effective in 1958. Both bodies continued to hold federalist objectives, functionalist measures and national interests with a continuing geopolitical backdrop of the strategic aims of building a Western European bulwark against the Soviet Union, counterbalancing the US and binding West Germany into European institutions.

In the following years, the three communities combined were referred to as the EC.<sup>13</sup> However, as far as economics is concerned, among the three Communities of the EC, the EEC was by far the most important and far reaching in terms of scope and instruments. The primary goals of the EEC included the elimination of tariffs and quantitative restrictions and the suppression of any form of discrimination based on nationality; the establishment of a common tariff and commercial policy against non-member countries; the internal free movement of goods, services, people, and capital; and the establishment of a common policy on agriculture and transportation. After its establishment, the EEC quickly moved toward the accomplishment of its major goals: in December 1961, all quantitative restrictions on trade in industrial goods among member countries were abolished; in July 1967, a common agriculture policy was enunciated; in July 1968, a common market was established that provided for the free movement of goods and labor and a common external tariff.<sup>14</sup> In the meantime, the EC also developed preferential trading links with many parts of the developing world through the Yaounde Convention of 1964 and the Lome Convention of 1975. Thereafter, however, the EC entered a long period of stagnation. It is important to point out that despite its economic elements, regionalism in Western Europe in the 1950s–60s was largely motivated by political and strategic considerations of maintaining peace in Europe, containing Germany, and improving the ability to counterbalance two superpowers – the US and the Soviet Union. Economic integration, although important in itself, was often seen as a means to achieve a more fundamental objective of geopolitics.<sup>15</sup>

Largely triggered by the development of Western European integration, Britain promoted an alternative model of European regionalism that was loosely linked by free trade arrangements for industrial products. Such loose free trade arrangements would suit British interests by opening up a larger European market for its industrial goods while, at the same time, permitting the continuation of its preferential trade arrangements with the Commonwealth. The resultant EFTA, established in May 1960, involved Switzerland, Austria, Portugal, Denmark and the Scandinavian countries, which shared the British dislike of the EC's supranational institutions and broad political ambitions. They did not want either to be confined in a common market structure with common external tariffs, common foreign trade policy and other common policies that were decided within common European institutions. But soon after the EFTA came into force, Britain applied for EC membership, only to be blocked by France.<sup>16</sup>

Inspired by European integration, interest in free trade areas and customs unions soon spread to many developing countries in Latin America, Central America, Africa, and elsewhere during the 1960s. Nevertheless, unlike European integration of the 1950s–60s that was primarily driven by geopolitical considerations, the proposed regional arrangements in those other areas were largely motivated by the economic rationale of achieving national development and economic independence through regional import-substituting industrialization and collective self-reliance. And due to both external and internal constraints negotiations to achieve regional arrangements either did not lead to successful conclusion of agreements or, the agreements, if signed, could not be successfully implemented with the arrangements soon collapsing.<sup>17</sup>

On the other hand, entering the 1970s, despite the expansion of EEC membership with Great Britain, Denmark, and Ireland joining the EEC in 1973, European integration came to a sudden standstill in the context of the fall of the US dollar, the collapse of the postwar fixed exchange rate system, the oil crisis and worldwide economic recession. In the meantime, the membership enlargement of the EEC made the conclusion of agreements more complicated and difficult.<sup>18</sup> Member states had little incentive to promote economic cooperation at the European level, since each state was struggling to maintain its own economic prosperity.

The failure of economic regionalism of the 1950s–60s to prevail was largely due to two major factors. First, as multilateralism served the interests of the major economies well during the 1950s–60s, there seemed to have no economic rationale for national economies, especially major economies, to pursue regional alternatives. Secondly, as the key power in the world economy and the chief defender of multilateralism, the US had long been suspicious of discriminatory trade arrangements, and had restrained itself from any such attempt. The US support of European integration derived primarily from political and strategic considerations. And with the passage of time and changes in economic circumstances, the US was in fact becoming increasingly concerned with the trade diversion effects derived from the various integration initiatives of the EC.

## **2. Revival of economic regionalism after the mid-1980s**

Around the mid-1980s, there was a vigorous revival of regionalism in the world economy, again with Western Europe as the forerunner, but

in the meantime spreading rapidly to other major regions as well, especially to North America, Latin America, Africa, East Asia and elsewhere, as reflected in NAFTA, MERCOSUR, the South African Customs Union (SACU), AFTA, APEC, the Gulf Cooperation Council (GCC), and so forth. This new wave of economic regionalism, which is referred to as “new regionalism” by many scholars, occurred in a changed global setting of the declining prominence and eventually the end of Cold War politics, the relative decline of US hegemonic power, and the rising importance of economics in international relations.<sup>19</sup> Consequently, in contrast to regionalism of the 1950s–60s, regionalism after the mid-1980s was driven primarily by economic forces. Particularly, this new wave of regionalism became a truly worldwide phenomenon that involved all major economies, notably the US.<sup>20</sup>

The new wave of regionalism started with the 1986 Single European Act (SEA) of Western Europe. Enlarged by the addition of Greece in 1981, and Spain and Portugal in 1986, the EC began to move again around the mid-1980s at a very rapid pace. Aimed at revitalizing the process of economic integration in Western Europe, the SEA amended the Treaty of Rome and set the deadline of 31 December 1992 for the achievement of a truly unified market with the free movement of goods, services, people, and capital within the EC through the removal of remaining quotas and tariffs and non-tariff barriers. The SEA was intended not only to create a single market, but also to set new objectives for common policies across a wide range of fields, including monetary union,<sup>21</sup> social and regional policy, foreign policy, security, environmental policy, research and technological development. Moreover, the Community’s supranational institutions were to be reinforced by introducing a system of majority voting, significantly increasing the status of the EC’s bureaucratic apparatus (the European Commission), and increasing the role of the European Parliament. Particularly significant, the SEA reflected a broad political ambition of creating a European Union of undoubted confederal character.

By the end of the 1980s and early 1990s, there was fundamental transformation of global politics with the end of the Cold War following the collapse of the communist bloc in Eastern Europe and the breakdown of the Soviet Union. An immediate impact of the end of the Cold War for Europe was German unification, which aroused the concerns of European countries, notably France, that an already economically dominant Germany would become even more capable of dominating the European economy. As such, further European integration was strongly pushed as a safeguard against German dominance.<sup>22</sup> It was under such

circumstances that the EC was transformed into the EU in 1993 under the Treaty on the European Union (Treaty of Maastricht) that was signed in January 1992. Under the Treaty of Maastricht, which was far-reaching in content and structure, the EU sought to deepen European integration by granting uniform rights to all citizens of EU member states, reinforcing the EU's supranational institutions (the European Parliament, the European Council, and the European Court of Justice (ECJ)) and setting new objectives for common policies across a wide range of areas, including monetary union, social and regional policy, foreign policy, security, environmental policy, research and technological development.<sup>23</sup> The most significant decision of the Treaty of Maastricht was to create an Economic and Monetary Union (EMU) that was to merge national macroeconomic policies. The EMU would not only adopt a single currency but also pursue a single monetary policy for all participating countries with a timetable set for implementing the EMU by 1999. On the other hand, however, there were opt-out clauses for those member states that were not ready for the participation in the EMU. On 1 January 1999, the process of creating a single European currency formally started, which eventually led to the introduction of the euro on 1 January 2002. Thereafter, the euro replaced the national currencies as the only currency within the EMU of 15 EU members (out of 27).<sup>24</sup> In the meantime, through the Treaty of Amsterdam (1997), Treaty of Nice (2001), and Reform Treaty (2007), the EU was further reformed and strengthened with respect to the EU's citizenship, role on the international stage, institutions, membership expansion, proposed constitution, and future development. Clearly, the EU reflected a wider political ambition of creating a European Union of undoubted confederal character.<sup>25</sup>

According to Stanley Hoffmann, if the EC was originally designed as a reaction to high politics – to strengthen national security and power by increasing the ability of member states to speak with one voice in world affairs, then from the mid-1980s on its main policy goal was not high politics but the competitiveness of Western Europe in the world economy.<sup>26</sup> This major policy shift, first embodied in the Single European Act of 1986, was apparently intended to build a European economy which was “big enough” to compete with the US, Japan and newly industrializing economies in an increasingly competitive world.<sup>27</sup>

By the first decade of the 21<sup>st</sup> century, the economic and political climate in Europe has radically changed and the EU differs considerably from the European integration that began in the 1950s. While European integration was initially conceived as a way to safeguard

peace and enable economic recovery among six Western European countries, the development in Europe after the mid-1980s represented a qualitative shift in the historical process of European integration. What was at stake was the creation of a European economic system as a superstructure built on top of already densely knit national economies. The main issues now revolved around the regulation of markets, the development of common policies at both microeconomic and macroeconomic levels, and the restructuring of European industry and the services sector, involving increased cross-border cooperation among firms. More significantly, the EU has developed into one of the world's most formidable trading blocs. With the addition of three new members in 1995 (Austria, Finland, and Sweden), ten in 2004 (Malta, Cyprus, Estonia, Latvia, Lithuania, Poland, Hungary, Czech Republic, Slovakia, and Slovenia) and two in 2007 (Bulgaria and Romania), the EU now has 27 member states, which involves much of the European continent with a total population of 500 million and GNP that accounts for about 30% of the global GNP. Although its future with respect to political integration is still in flux,<sup>28</sup> the EU has become an unequivocal player in global politics and economics.<sup>29</sup> Obviously, in the new wave of regionalism in the global economy, the EU is unique in terms of its distinctive historical, cultural, and societal features that underpin the process of European regional integration and its unique institutional structure. Clearly, this was a most illustrative case of *hard/closed* regionalism.<sup>30</sup>

Of particular significance in the new wave of economic regionalism after the mid-1980s was the conversion of the US to economic regionalism by concluding the US-Canada Free Trade Agreement in 1989, followed by its expansion into NAFTA in 1994 that brought Mexico in. As a predominant economic power, the US used to be a key defender of multilateralism throughout the postwar years. But due to its continuously declining political and economic power, Washington was not able to push multilateralism with the same force as it had been prior to the 1980s. Consequently, starting in the late 1980s the US moved to pursue regional arrangements with its neighbors in the context of transformed global politics and economics in the post-Cold War era. The decision to create NAFTA clearly represented "a new chapter in American foreign economic policy."<sup>31</sup> While there were multiple forces behind its formation, NAFTA was concluded primarily as a response to the deepening integration of Europe and growing competition from East Asia in the global economy. According to R. Grinspun and M. Cameron, "NAFTA is a strategic response by the United States to

global trends such as the increasing economic threat arising from an expanded and unified Europe and a more assertive Japan."<sup>32</sup> This perspective is also shared in a report by the Canadian government, in which it is noted that "[r]egional responses to the internationalization of economic activities in Europe and Asia, as well as in America's, have presented Canada with a direct challenge. The free trade agreement (FTA), that is, the Canada-US Free Trade Agreement, was the first response to that challenge. The Canada-US-Mexico negotiations built on that achievement."<sup>33</sup> As such, NAFTA first of all was seen as a defensive mechanism that would improve the competitiveness of the three countries in the world economy and strengthen the position of North America against threats of increased protectionism that might be brought about by regionalism elsewhere.

Furthermore, Washington's decision to pursue a regional strategy rather than continue to focus exclusively on multilateral options also derived from its dissatisfaction with the multilateral negotiations that were going on in the Uruguay Round at the time. The conclusion of NAFTA would help produce a demonstration effect to show to the EU that Washington had the capacity to negotiate free trade in a regional context if multilateral arrangements failed in the Uruguay Round of trade negotiations. Similar considerations were also behind Washington's support of APEC around the same time.<sup>34</sup> Hence, the new regional approach provided the US with a powerful bargaining chip in multilateral negotiations, which would enable Washington to use "the threat of a regional option in order to force concessions from Europe in bilateral or global negotiations."<sup>35</sup> On the other hand, it is important to note that the US decision to pursue regional arrangements was also based on the longer-term lesson learned from the very success of the EU, which helped change the long-held US belief in multilateralism as the dominant strategy and led US policy-makers to envisage a parallel track in which multilateralism and regionalism could coexist and change its own international economic policy so as to incorporate a preferential trading area into its portfolio.<sup>36</sup> Obviously, NAFTA reflected a new strategy that was designed to respond to the new challenges the US was facing in a changed global environment. It allowed the US to pursue a regional strategy which could help increase its leverage within the multilateral framework to which it had long been committed.<sup>37</sup> At the regional and bilateral levels, by bringing Canada and Mexico into NAFTA, the US also had both political and economic considerations. Both Canada and Mexico were America's important trading partners. Because the level of protectionism on bilateral trade was higher in both

Canada and Mexico than in the US, a free trade agreement would be likely beneficial to the US. Besides, natural resources in both of its neighbors and cheap labor in Mexico were also attractive to the US economy. Moreover, by bringing Mexico into NAFTA, Washington also wanted to support economic and other reforms in Mexico and help solve the problems of illegal immigration created for the US due to Mexico's much higher poverty levels.<sup>38</sup>

For Canada and Mexico, the conclusion of NAFTA could help both of them expand their limited domestic markets by gaining duty-free access to the huge US market in the face of Europe's deepening integration and increasing competition from East Asia. NAFTA could also help reduce their exposure to unfair US trade remedy laws through a unique NAFTA dispute-settlement mechanism for antidumping and countervailing duty cases. Besides, assisted by the regional liberalization process within NAFTA, Canada and Mexico would also be able to promote domestic reforms and increase the role of market forces in their respective economies, a domestic objective that both the Canadian and Mexican governments were committed to. Finally, at the time when NAFTA was being negotiated, there was increasing uncertainty over the fate of the Uruguay Round of multilateral trade negotiations. As such, both countries sought to reach a regional political agreement through NAFTA as a safe-valve in case that the multilateral negotiations should fail.<sup>39</sup>

Although important steps were taken later in the Miami Conference of 1994 and the Santiago summit of the Americas of 1998 to schedule an expansion of NAFTA into the Free Trade Association of the Americas (FTAA) for the whole Western Hemisphere from the year 2005 onwards, however, this plan failed to materialize largely due to the diverse objectives of the US and Latin American countries regarding the projected FTAA.

As an institutionalized regional arrangement, NAFTA clearly represents an alternative model as compared with the EU. While the EU is a system of regional governance, which is still in the process of evolution as seen in the contents of the European Constitutional Treaty, NAFTA is not in any way a form of governance. Besides, European integration was initially driven by the need to address the German question and to search for a system of interstate relations that would avoid another war, NAFTA was primarily driven by economic imperatives without fundamental political underpinnings. In terms of institutional structure, NAFTA is only a trade and investment union rather than a customs union.<sup>40</sup> As such, it does not have an external dimension in

the sense that there are no common external tariffs and no common foreign economic policy. Similarly, NAFTA does not negotiate with third parties as a unified body like the EU. Besides, the secretariat of NAFTA is not an equivalent to the European Commission; neither does it have such permanent institutions as the Council of Ministers, Committee of Permanent Representatives (COREPER), parliament (whether appointed or elected), and a court equivalent to the European Court of Justice. NAFTA has no equivalent to the supremacy of European Law over national law and no plans for a common currency or the integration of home and justice affairs. Furthermore, NAFTA submits business to national treatment rather than to reciprocity, that is, business is regulated by host country rather than home country rules; and NAFTA is not a signatory to international trade or environmental agreements.<sup>41</sup> More importantly, unlike the EU that is a highly integrated and institutionalized regional grouping, involving a whole range of economic areas and conducting policy coordination on a wide range of issues with even a clear political objective, NAFTA has no such an ambitious agenda and objective. The US rejection of Mexico's proposal for a deeper NAFTA clearly shows the very political limits of regionalism that Washington is prepared to pursue.<sup>42</sup> Finally, while the EU, through its institutional structure, is deliberately designed in a way that asymmetry between member states is minimized, NAFTA is dominated by the US in terms of trade patterns with both Canada and Mexico heavily dependent on trade with the US and having limited direct trade between themselves.

Behind the differences between Europe and North America in terms of level and scope of regional integration are fundamental differences in attitudes and approaches toward regionalism between the EU and the US. For the EU, regionalism is used to promote its international influence, whereas for the US regionalism is adopted to get access to or remain in control of different regions or prevent other powers from gaining international influence. Moreover, while regionalism is a preferred form of political organization for the EU, for the US regionalism is simply of an instrumental value.<sup>43</sup>

On the other hand, however, as a form of institutionalized regional integration NAFTA does go beyond just free trade arrangements and assume some similarities with the EU. Specifically, NAFTA has established a framework for greater regulation of intellectual property rights, public services, energy, labor conditions, and the environment, as well as a mechanism for dispute resolution. Particularly, according to Alberta Sbragia, the Commission for Environmental Cooperation, the

Commission for Labor Issues<sup>44</sup> and the institutionalization of dispute settlements are the three distinctive features of NAFTA.<sup>45</sup>

In a further analysis, NAFTA is particularly asymmetric in terms of level of economic development and the bringing of Mexico into NAFTA, like the middle-income Southern European economies incorporated into the EC, was significant in the sense that regional economic integration could now involve countries at very different levels of economic development, thus bringing profound impact on the future development of regional integration, as more and more middle- and lower-income countries would be attempting to join one of these regional groupings to secure their major markets in the developed countries.

The conclusion of NAFTA created a combined market area of over 360 million people with a total economic capacity of \$7 trillion and representing 20% of the world trade. Consequently, NAFTA became the largest free trade area in the world economy, surpassing the EU. The regionalist choice of the US is very important at the international level. Particularly, the shift of US economic policy in favor of regional arrangements substantially strengthened the global trend of economic regionalism and tilted the balance of forces away at the margin from multilateralism to regionalism.<sup>46</sup>

While the EU and NAFTA are the two most influential and significant regional blocs, there are also a rising number of other regional arrangements in Latin America, Africa, East Asia and elsewhere in the new wave of regionalism in the world economy. (See Table 4.1)

The most significant regional arrangement in Latin America is MERCOSUR, which was formed by Argentina, Brazil, Paraguay and Uruguay in 1991 after the signing of the Asuncion Treaty. MERCOSUR was created by its four founding members primarily to provide a regional economic platform of common external tariffs that could permit its member states to more smoothly go through a gradual process of economic liberalization and help them more effectively improve their economic competitiveness in the global economy in the context of the rising economic and security challenges brought by globalization. MERCOSUR, inspired by the European integration model, shows many similarities with the EU with its customs union, political objective and political function of stabilizing democracies of member states. The current process of regional integration in the southern cone of Latin America is possible largely because Brazil and Argentina, two regional powers, have agreed to build mutual confidence between them by abandoning their nuclear programs and their previous mutually suspicious and aggressive political culture, much like what France and

**Table 4.1 Major Regional and Interregional Arrangements**

<b>Region</b>	<b>Regional Arrangements</b>	<b>Year</b>
<b>Africa</b>	Customs and Economic Union of Central Africa (CEUCA)	1966
	South African Customs Union (SACU)	1969
	Mano River Union (MRU)	1973
	Economic Community of West African States (ECOWAS)	1975
	Economic Community of the Great Lakes Countries (ECGLC)	1976
	Economic Community of Central African States (ECCAS)	1983
	Southern African Development Community (SADC)	1992
	West African Economic and Monetary Union (WAEMU)	1994
	Common Market of Eastern and Southern Africa (COMESA)	1994
	African Union (AU)	2001
	East African Community (EAC)	2001
<b>Americas</b>	Central American Common Market (CACM)	1960
	Andean Community of Nations (CAN)	1969
	Caribbean Community (CARICOM)	1973
	Latin American Economic System (SELA)	1975
	Latin American Association for Development and Integration (ALADI)	1980
	Southern Common Market (MERCOSUR)	1991
	North American Free Trade Agreement (NAFTA)	1994
	Group of Three (G3)	1995
	South American Community Nations (SACN)	2004
Dominican Republic-Central American Free Trade Agreement (DR-CAFTA)	2005	
<b>Arab &amp; Maghreb</b>	League of Arab States (LAS)	1945
	Council of Cooperation between Arab States of the Gulf (CCASG)	1947
	Council for Arab Economic Unity (CAEU)	1957
	Arab Common Market (ACM)	1964
	Gulf Cooperation Council (GCC)	1981
	Arab Cooperation Council (ACC)	1989
	Arab Maghreb Union (AMU/UMA)	1989
<b>Asia</b>	Association of Southeast Asian Nations (ASEAN)	1967
	South Asian Association for Regional Cooperation (SAARC)	1985
	Central Asian Cooperation Organization (CACO)	1994

**Table 4.1 Major Regional and Interregional Arrangements – continued**

Region	Regional Arrangements	Year
Europe	BENELUX	1947
	European Community/European Union (EC/EU)	1957
	European Free Trade Association (EFTA)	1960
	Commonwealth of Independent States (CIS)	1991
	Central European Free Trade Agreement (CEFTA)	1992
	European Economic Area (EEA)	1994
	The Black Sea Economic Cooperation (BSEC)	1994
Oceania	South Pacific Commission (SPC)	1947
	Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA)	1983
	<b>Interregional Arrangements</b>	
	EU + Countries of Africa, Caribbean and Pacific Organization for Security and Cooperation in Europe (OSCE)	1975
	Asia-Pacific Economic Cooperation (APEC)	1989
	Asia-Europe Meeting (ASEM)	1994
	Free Trade Association of the Americas (FTAA)	1994
	The New Transatlantic Agenda (NTA)	1995
	The Transatlantic Economic Partnership (TEP)	1998

Sources: Primarily based on S. Santander, "Appendix: List of Regional and Interregional Arrangements," in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), pp.327–56.

Germany did at the beginning of the European integration in the early 1950s. However, compared to the EU that is characterized by its supranational institutional structure, MERCOSUR is a political institution of intergovernmental political cooperation with its member states continuing to assume prevailing state sovereignty. Despite its different institutional settlement as compared to the EU, MERCOSUR has a General Secretariat, a council of permanent representatives and an incipient process toward a parliament. Currently, there are ongoing debates within MERCOSUR on the future direction of regional integration in such areas as a single currency, macroeconomic coordination and the powers of a court regulating juridical and economical disputes. While most Latin American countries are in favor of a more autonomous Latin America, the direction of regional integration in Latin America largely hinges on the future strategy of the regional power, Brazil, which hesitates between

deeper MERCOSUR regionalism or revival of traditional Latino American regional integration in the form of a South American Free Trade Area including MERCOSUR and the Andean Community as reflected in the Brasilia Declaration that was signed by 12 Latin American states.<sup>47</sup>

Compared to that of Latin America, regionalism in Africa seems less successful in terms of institutionalized regional arrangements, largely due to Africa's economic underdevelopment, weak states, lingering consequences of the colonial and neocolonial legacies, division between different metropolitan references, and problems of border conflicts. Nevertheless, there still have been efforts in pursuing institutionalized regionalism in Africa as seen in the COMESA, the Southern African Development Community (SADC), and the Economic Community of West African States (ECOWAS) as a result of the growing fear of African marginalization in the new international environment, characterized by the two parallel trends toward globalization and regional blocs, and the growing external pressure by the international community and particularly by the EU's development policy.<sup>48</sup> However, if viewed from a more comprehensive perspective, as Fredrik Soderbaum suggests, regionalism in Africa represents a more complicated process that involves the interplay of both state and non-state actors and assumes both formal and informal forms of regionalization in the context of globalization.<sup>49</sup>

In East Asia, which is seen as one of the three major economic centers in the world economy today together with Western Europe and North America, regional integration, due to the unique national and regional conditions of the region, assumes a different process and pattern from those for Europe, North America and Latin America in the sense that regionalism in East Asia emerged as an autonomous process of rising intraregional economic ties driven by market forces, short of a formal regional grouping, although there is clearly the rise of institutionalized regionalism in Southeast Asia as a sub-region of East Asia (i.e., ASEAN). More recently, however, East Asian integration has been gradually moving toward increasing institutionalized regional economic cooperation among states in the region. The unique process and pattern of East Asian integration will be systematically explored in Chapter 5.

### **3. Multilateralism and regionalism in the age of globalization**

In a broader historical perspective, the emergence and development of economic multilateralism after World War II was largely based on the

tragic lessons that postwar leaders learned from the disastrous mercantilist competition derived from the aggressive nationalism and antagonistic imperialist blocs that had occurred in the interwar period, which led to not only the Great Depression of 1929 but more significantly to the devastating World War II. As such, there was a broad consensus within the capitalist world in the postwar years on the promotion of multilateralism and liberalism in the world economy, which then constituted the ideological basis of the postwar global multilateral economic order until the 1980s, despite the existence of some regional arrangements in some areas of the world largely due to geopolitics, particularly in Europe.

Since the late 1980s, however, the global economic order has been undergoing transformation as a result of the rising trend of globalization and the changed global geopolitics and economics characterized by the end of the Cold War and confrontational alliance politics, relative decline of US hegemonic power, emergence of new economic powers, and rising salience of geo-economics in international relations. Under such circumstances, there has been the vigorous resurgence of economic regionalism and the consequent realignment between multilateralism and regionalism in a new era of the globalized world economy and post-hegemonic stability. As such, the rise of new regionalism can be seen as part of the process of the transformation of the global economic order from the previous one that was predominated by the US hegemon to a new one that is increasingly influenced by an expanding group of major players that include the US, the EU, Japan, China, and other powers in the post-US hegemonic era.<sup>50</sup> As is discussed in Chapter 3, since all the major powers have a high stake in continuing to maintain liberal international economic relations, the emerging new global economic order, which is managed through a multi-polar structure of "global governance" in the context of globalization, continues to uphold the norms and principles of multilateralism. On the other hand, however, compared with the previous global economic order under the US hegemon when multilateralism was predominant despite some regional arrangements, the emergence of a new global economic order since the end of the 1980s has been a more complex process, which involves not only a strong tendency of continuing multilateralism but also a proliferating and vigorous movement toward economic regionalism in the era of globalization. The two concurrent forceful tendencies of multilateralism and regionalism are conflicting sometimes while complementary at other times. It is in this sense that new regionalism could be better understood only through observing

and analyzing the connections and interactions between regionalism and multilateralism in the context of globalization and the transformed global politics and economics.

The emergence of new regionalism can be seen as a logical development in the transformed environment of global politics and economics and rising trend of globalization. In the first place, the end of conflicting Cold War politics between the East and the West has transformed the rigid global structure of polarity and brought huge space for the emergence of autonomous regionalist groupings as part of the new global order and global governance in the post-Cold War era and in the age of globalization. From a pure economic perspective, in the context of the rising salience of geo-economics and increasing competition in the global economy, regionalism in the form of closer regional economic ties and preferential regional arrangements clearly provides nation-states in a region with economic advantages in lowering economic costs, improving economic competitiveness, and effectively handling common economic problems.<sup>51</sup> According to Pier Carlo Padoan's model, regionalism provides regions with the advantages of geographic proximity in global competition, which includes limited transfer costs, common policies, common social and environmental standards, and comparative advantage. Moreover, regional trade liberalization enables member states – especially the poorer – to enjoy some of the benefits of trade via larger markets and improved efficiency without having to be exposed to competition from outside the region.<sup>52</sup> Besides, as globalization brings market instability, regionalism can help provide more stable markets for member states of the regional group. Regional cooperation also enables national economies and companies to be internationally competitive in the global markets through regionally-based training, research, investment, public procurement and infrastructure, and the need to maintain legal and managerial control over companies.<sup>53</sup> Furthermore, regionalism helps strengthen the bargaining power of nation-states as a group *vis-à-vis* other powers in multilateral negotiations at such forums as the WTO, G8, and others. In case of an economic crisis or the collapse of the global multilateral system, regionalism, as a defensive strategy, could provide a final safe-haven for member states, which, if acting alone, might hardly survive.<sup>54</sup>

From a political perspective, as globalization has weakened the traditional state power in an increasing number of areas, such as finance, market, technology, society, and so on, new regionalism can be seen as an attempt by nation-states to partially regain state sovereignty over these areas through strengthening regional cooperation and

coordination and increasing collective bargaining power *vis-à-vis* extra-regional players. In other words, nation-states are attempting to revive political sovereignty by pooling authority at the regional level, both as a voluntary and original decision and as an imitation of regional arrangements of other regions. Moreover, in many areas of the world, new regionalism, through creating a supranational institutional structure, also helps limit the process of fragmentation and disintegration of nation-states brought about by ethnic fundamentalism and movements for national self-determination.<sup>55</sup> But on the other hand, however, regionalism, while strengthening the state power at the regional level against the other players at the global level, also helps weaken state sovereignty further by relegating some of state authority to a supranational institutional structure at the regional level.

In a further analysis, new regionalism is also a phenomenon that goes beyond an issue of mere international political economy and reveals multidimensional features, including not only politics and economics but also culture, social psychology, collective identity, and so forth.<sup>56</sup> According to Richard Higgott, regionalism can be a social construct, which is first informally built on shared cultural, historical and emotional affiliations rather than as a result of a rational choice of nation-states, multinational companies, and domestic interest groups. This is what Higgott calls “cognitive regionalism.”<sup>57</sup>

While it makes sense for nation-states in both economic and political terms to get involved in regional arrangements, new regionalism has indeed been bringing substantial impact on global politics and economics in general and the new world economic order and multilateralism in particular. A most controversial and important issue seems to be how and in which form new regionalism is compatible with multilateralism and globalization and whether it can support a new post-hegemonic multilateral world order and global governance. For some scholars, regionalism in the form of free trade areas will be potentially bringing damaging effects on the multilateral trade system and undermining trade liberalization. This is because the deepening of regional arrangements will inevitably provoke zero-sum conflicts between highly closed regional blocs in the global economy, which, in the worst scenario, would even lead to military conflicts as a result of rising concerns over national security by nation-states.<sup>58</sup> But for other analysts, due to complex interdependence in the post-hegemonic stability, new transnational institutions and regimes are able to mediate conflicts and make a positive-sum game possible and bring economic welfare more likely for a larger number of countries.<sup>59</sup> It is in this sense that according to E. Preeg, regionalism

in Western Europe and North America is a “desirable evolution potentially supporting a more multilateral liberal system.”<sup>60</sup>

The actual situation, however, is much more complex due to the dynamic interactions of regionalism with multilateralism and globalization. As Andrew Gamble indicates, new regionalism intersects with multilateralism and globalization in multiple ways.<sup>61</sup> It seems growingly clear that the emerging new world order is characterized by a comprehensive and multilevel governance structure, which involves governance at not only at the global level but also at the regional level.<sup>62</sup> As such, regionalized democratic governance can be seen as helping form part of global governance as embodied in a renewed multilateral system, and therefore contributing to an overall global governance structure. It is in this sense that regional governance established through regional arrangements can be seen as complementary to global governance and regional bodies could function as managers of the globalization process. The EU shows that regional governance is likely to strengthen the multilevel system of authority, rebalancing it in favor of public centrally coordinated governance.<sup>63</sup>

Besides, in a post-hegemonic world, there are institutional imbalances as a result of the global redistribution of power. Since the US as the single superpower can no longer unilaterally maintain an equilibrium between increasing demand and diminishing supply of international public goods as it did in the postwar years, neither has the global governance structure been well established yet to fully provide such public goods, regional arrangements therefore appear to help contribute to a new equilibrium between demand and supply by partially supplying international public goods in the context of globalization. It is in this sense that new regionalism can help contribute to multilateralism at the global level.<sup>64</sup>

Moreover, regionalism helps reduce the number of actors in multilateral negotiations at the international level, which makes these negotiations more manageable and more likely to succeed, because bargaining between a large number of nation-states is usually more difficult and less efficient than between a small number of regional blocs.<sup>65</sup> In the meantime, as political, economic and social differences among nation-states at the regional level are, generally speaking, less profound and broad than those at the global level, regional integration is likely more accommodating, and is therefore relatively easier for nation-states and national actors to make adaptation and adjustments, once regional agreements are reached, and have relatively long-term commitment to regional rules. Finally, regional arrangements are likely

more comprehensive in coverage, involving multiple areas such as trade, monetary, security, social policy, environment, and so forth, which could then serve as a model for global arrangements. As such, regional arrangements could function as the building bricks for the construction of a global governance structure.<sup>66</sup>

But on the other hand, however, it is also true that regionalism might lead to a less cooperative international system, as preferential trade arrangements and selective market access discriminate against the non-member states and therefore increase the likelihood of inter-regional conflicts between regional blocs. In the meantime, regionalism, while providing member states with protection against global instability, can consequently weaken the global multilateral system.<sup>67</sup> Furthermore, the rising wave of regionalism can also harm the atmosphere of multilateralism by giving the impression that regionalism is now the order of the day and therefore bring adverse psychological as well as actual effects on those nation-states that are not yet involved in any regional preferential arrangements, which, for fear of being isolated in the global economy, might rush to regional arrangements too, thus strengthening the trend of regionalism further. Particularly, the regional arrangements in the two major regions of the world economy, Western Europe and North America, though prompted by different motivations and historical circumstances, have caused great fear among other countries of the would-be diversion of trade and investment flows. They fear that if they remain outside of any regional bloc, they might eventually become economically isolated, and lose their traditional world markets.<sup>68</sup>

Indeed, as the circumstances at both the global and national levels have changed profoundly from those of the postwar years, it is neither realistic nor possible that multilateralism in the age of globalization would assume the same form of the 1950s–60s. To provide the basis for secure and liberal economic relations among nation-states in a transformed environment, multilateralism would have to be modified and supplemented by some other practices in international political economy.<sup>69</sup> In this process, it seems inevitable that new regionalism is emerging as an increasingly viable force in the ongoing formation of the new global economic order. Economic regionalism can be viewed as a process of reducing the economic significance of national political boundaries within a geographic area.<sup>70</sup> Rather than a sheer challenge to or the replacement of multilateralism, the new regionalism can largely be seen as supplementary to multilateralism. This is not only because that major economies still show enthusiasm about the principles and

norms of multilateralism, but also because that the current movement toward economic regionalism is largely confined within the existing liberal economic norms and multilateral system, in contrast to the exclusive and antagonistic economic and political blocs in the 1930s. In this respect, it is particularly important to note, for example, that almost all the existing regional preferential arrangements are officially claimed to be consistent with the relevant rules of GATT and the WTO. As such, the multilateral system as embodied in the WTO, the IMF, and other institutions is still considered as the best option for international economic relations by major powers and a growing number of trading nations. The successful transformation of GATT into the WTO and the continuing efforts of major powers to pursue multilateral arrangements on trade, finance and other areas under the framework of the WTO, the IMF, G8, G20, and other bodies have reinforced the process of multilateralism at the global level. Within such a backdrop, the current endeavors of nation-states to pursue regional economic arrangements can largely be interpreted as a tactical maneuver in achieving the objective of multilateralism, that is, to increase collective bargaining power in the multilateral negotiations at the global level, or even to set up a model of economic cooperation that can be followed by other countries under the global multilateral framework.<sup>71</sup> It is in this sense that new regionalism might be positive in promoting a multilateral system of global liberalization.<sup>72</sup> It is equally important to note that growing international interdependence and common interest in avoiding conflict remains a strong force that holds national economies together. The post-Cold War era has also witnessed the changing worldwide attitudes toward economic liberalization and democracy, which serves as an additional supporting force for global multilateralism.

In a further analysis, in a transformed environment of global politics and economics, new regionalism might well play a suitable role of linkage between economic nationalism and multilateralism. In a world of coexistence of eroding liberal economic relations and growing international interdependence, national economies are bogged down in a constant dilemma in their policy decisions with respect to economic affairs. On the one hand, in the face of growing competition in the world economy, it is more and more difficult for national governments to achieve constant adjustments required by shifting comparative advantages in international trade without excessive domestic social tensions and political opposition. On the other hand, however, national governments understand that sheer resort to nationalistic policy or delinking of national economies from the world economy would be

even more detrimental to their national interests. Under such circumstances, regional arrangements are adopted by national governments as an appropriate “mid-way” to solve the rising conflict between the growing economic nationalism and existing international norms of multilateralism. For the best, such a “mid-way” approach could improve the competitiveness of their economies and help occupy a favorable position in the international division of labor, while at the same time serving as a bridge to multilateralism; for the least, it could serve as a most convenient and immediate way to protect their domestic markets and industries, thus softening the consequences of economic nationalism.

In any analysis of new regionalism since the mid-1980s, it is also important to keep in mind that although its relative power has declined, the US remains a dominant economy in the world, let alone its military preponderance and global reach in almost every important respect.<sup>73</sup> In a wide range of areas, it continues to be the world’s most prominent actor, and continues to play a dominant and pivotal role in the world economy. The continuing function of the US dollar as the basis of the international monetary system, the universal desire for access to the huge US market, the inherent technological dynamism of the US economy, and America’s additional strength in both agriculture and resources – which Europe, Japan and China do not have – provide a cement sufficient to hold the world economy together and keep the US at its centre. Added to this overall capacity is Washington’s continuing commitment, at least nominally, to liberal objectives – even its adoption of regional arrangements through NAFTA is pursued as a means of achieving multilateral objectives. Moreover, many countries still have strong economic ties with the US, which are difficult to scuttle. This in an important way explains why it is not possible that current economic regionalism will assume the extreme form of antagonistic trade blocs of the 1930s.

While it seems unlikely that the current wave of regionalism would lead to a complete fragmented system as existed in the 1930s in the foreseeable future, it is still too early to anticipate how the global financial and economic crisis that started in 2008 will reinforce regionalism or globalization in the long run.

# 5

## Regional Economic Integration in East Asia

The postwar political economy of East Asia was initially structured under the aegis of the US, reflecting the political and economic conditions in the region at the time. For geopolitical considerations against communist influence in the region in the context of the Cold War, Washington adopted a strategy in East Asia that encouraged closer economic ties among its allies centered on Japan in the postwar years. The development of postwar economic relations between Japan and other capitalist economies in the region basically proceeded along this line.<sup>1</sup> By the mid-1960s, with the normalization of diplomatic relations between Japan and South Korea, the East Asian political economy had been solidly established. Thereafter, the major market economies in East Asia successively achieved economic miracles with Japan emerging as a new economic superpower and South Korea, Taiwan, Hong Kong and Singapore becoming NIEs. In this process, these economies became increasingly interdependent through growing trade and FDI flows among them. In the late 1970s China moved away from Mao's policy of self-reliance and began to participate in the regional and international economy.<sup>2</sup> The new orientation of China's policy not only changed the political and economic environment in East Asia and opened up new prospects for effective regional cooperation, but also vastly expanded the region's markets, natural resources and industrial potential. As a result, there has been rising economic integration truly region-wide in East Asia since the mid-1980s.

The rising regional economic integration in East Asia was echoing a novel pattern of relations between states in the region that began to develop during the 1980s. Coupled with growing economic ties, there were increasing political contacts, cultural exchanges, communication and tourism across the borders in the region. Most importantly, there

was rapprochement between the former political enemies in East Asia, although the level of rapprochement varied across the region. These interactions led to a growing web of cooperation, far more extensive than ever before. In the process, a sense of regional consciousness and mutual interests began to emerge and became increasingly strengthened. Consequently, by the second half of the 1980s, there had been improved strategic, economic and political environment in East Asia, which finally set the stage for rapid growth of economic ties in the region.

As part of new regionalism in the world economy, regional economic integration in East Asia after the mid-1980s emerged in the context of the changed environment of global politics and economics as a result of the weakening and eventual end of the Cold War, relative decline of US hegemonic power and rising trend of globalization. On the other hand, however, different from economic regionalism elsewhere, Western Europe in particular, regional economic integration in East Asia since the mid-1980s started as an autonomous and uninstitutionalized process characterized by rising intraregional trade and FDI flows, which was primarily driven by market forces and economic imperatives, although encouraged by the governments in the region in varying degrees. Over time, however, regional integration in East Asia, while continuing the process of deepening intraregional trade and FDI flows, gradually involved a new dimension of increasingly institutionalized regional economic cooperation among states in the region, particularly in the wake of the Asian financial crisis of 1997–98. The evolution of East Asian regional integration from a market-driven autonomous process to growing institutionalized regional cooperation over a rising range of regional issues reflected the efforts of East Asian states to respond actively to the changing conditions of the global and regional economy brought about by globalization, which not only made national economies increasingly integrated through trade, finance, production, and a growing web of treaties and institutions, but also brought fundamental impact on economic growth, the distribution of income and wealth, patterns of trade and finance, and political institutions. Adopting an export-oriented development strategy, most East Asian states relied heavily on the global economy for markets, capital, technology and resources, a position that made the region even more susceptible to the negative as well as positive effects of globalization. Particularly, concurrent with the trend of globalization was the rising economic regionalism and protectionism in many parts of the world, Western Europe and North America in particular, which exerted a mounting

pressure on East Asia, the only major region that had not yet been organized into an economic grouping. On the other hand, in the process of globalization, a network of economic interdependence had been gradually established among East Asian economies, which in turn helped the East Asian peoples develop and strengthen an increasingly strong sense of community and common destiny of the East Asian region. It is within such a context that the Asian financial crisis, which was largely seen as being caused by the negative effects of globalization, provided a direct catalyst for East Asian states to move toward institutionalized regional integration, on a par with the EU and NAFTA, not only as a defensive measure against challenges of globalization but also as a logical development of increasingly closer economic and other ties in the region.

### **1. Rising regional economic integration in East Asia since the mid-1980s**

The rapidly rising regional economic integration in East Asia since the mid-1980s is a phenomenal development in the East Asian political economy. Driven primarily by market forces, the process of East Asian integration is particularly manifested in the deepening economic interdependence among the economies in the region with rising intra-regional trade and FDI flows and the concurrent declining importance of the US both as a market and as a source of investment for East Asian economies. As a result of the relative decline of US economic power and the ensuing intensification of trade frictions between the US and East Asian states, the importance of the US as a market for East Asian exports continuously declined, while the importance of regional markets for the East Asian economies was steadily growing. The significant change in the direction of East Asian exports and imports is demonstrated by the statistics in Table 5.1. The trend toward growing intra-regional trade is similarly evidenced from the data on individual economies in East Asia. (See Table 5.2 and Table 5.3)

In any analysis of growing intraregional trade in East Asia, it is important to point out that a large proportion of the growth in intra-regional trade was directly related to the increased manufacturing and intra-industry trade that was derived from the rising FDI flows between the economies in East Asia. The regional FDI in East Asia, accompanied by transfers of technology and management know-how and access to world markets, was primarily flowing from Japan to other economies in the region and from NIEs to China since the mid-1980s.<sup>3</sup> It is

**Table 5.1** Distribution of East Asian Exports and Imports: Intra-regional and US, 1985–2003

	Intra-regional			United States			World		
	1985	1995	2003	1985	1995	2003	1985	1995	2003
Value of Exports (\$ billion)	67.6	343.1	576.3	103.9	235.2	312.1	295.7	1,002.6	1,473.0
Share of Total Exports (%)	22.9	34.2	39.1	35.1	23.5	21.2	100	100	100
Value of imports (\$ billion)	67.4	340.4	563.9	45.4	158.1	148.4	253.9	899.7	1,334.5
Share of Total imports (%)	26.5	37.8	42.3	17.9	17.6	11.1	100	100	100

*Source:* Calculated on the basis of data from IMF, *Direction of Trade Statistics Yearbook* (various years), with the exception of the data for Taiwan, which are obtained from Council for Economic Planning and Development (CEPD), *Taiwan Statistical Data Book, 2004* (Taipei: Council for Economic Planning and Development, ROC, 2004).

**Table 5.2 East Asia and the United States: Shares of East Asian Economies' Exports, 1985–2003 (% of Total)**

From	Japan			South Korea			Taiwan			Hong Kong			China		
	1985	1995	2003	1985	1995	2003	1985	1995	2003	1985	1995	2003	1985	1995	2003
East Asia	17.7	24.8	32.4	20.8	32.6	38.4	20.4	37.8	46.0	34.4	43.7	52.5	48.4	49.8	37.6
United States	37.6	27.5	24.8	35.6	19.3	17.8	48.1	23.7	18.0	30.8	21.8	18.7	8.5	16.6	21.1

*Source:* Calculated on the basis of data from IMF, *Direction of Trade Statistics Yearbook* (various years), with the exception of the data for Taiwan, which are obtained from CEPD, *Taiwan Statistical Data Book, 2004*.

**Table 5.3 East Asia and the United States: Shares of East Asian Economies' Imports, 1985–2003 (% of Total)**

From	To	Japan			South Korea			Taiwan			Hong Kong			China		
		1985	1995	2003	1985	1995	2003	1985	1995	2003	1985	1995	2003	1985	1995	2003
East Asia		11.4	20.9	28.5	26.8	32.1	37.4	30.1	38.2	42.4	61.2	64.6	67.2	46.9	47.4	43.1
United States		20.0	22.6	15.6	21.1	22.5	13.9	23.6	20.1	13.2	9.5	7.7	5.5	12.2	12.2	8.2

*Source:* Calculated on the basis of data from IMF, *Direction of Trade Statistics Yearbook* (various years), with the exception of the data for Taiwan, which are obtained from CEPD, *Taiwan Statistical Data Book, 2004*.

important to note that China also heavily invested in Hong Kong for political as well as economic reasons.<sup>4</sup>

While US FDI dominated the region during the 1950s–60s, Japanese corporations started in the late 1960s to take an increasingly larger share of regional FDI. Particularly, stimulated by massive trade surplus and the rapid appreciation of the yen, Japanese foreign investment had a big boost in the second half of the 1980s. By the end of 1989, Japan had accumulated a total of \$254.4 billion in FDI outflows. In absolute terms, the US received the largest amount of Japanese overall FDI – \$104.4 billion (41.0% of the total) and the EC as a whole received \$40.0 billion (15.7%), while the amount going to East Asia was only \$16.7 billion (6.6%). However, the East Asian economies received the lion's share of Japanese FDI to non-OECD member economies.<sup>5</sup> Although the Japanese overall FDI lost momentum after 1990, the shift of Japanese investment to East Asia became even more evident, particularly to China. (See Table 5.4) Significantly, in 2004 Japanese investment in East Asia, which amounted to \$6.8 billion and represented 18.4% of Japan's total FDI outflows, surpassed that in the US for the first time ever, which fell to \$4.8 billion and accounted for only 13.2%.<sup>6</sup> On the other hand, however, Japanese FDI to EU countries substantially increased as well after the mid-1990s, which was largely intended to take advantage of the EU's single market that had been created by the end of 1992. (See Table 5.4)

Even more significant than the Japanese FDI in terms of value is the number of cases of Japanese investment and a high proportion of Japanese investment in the manufacturing sector in East Asia. As the data on East Asia are not available, the data on Asia as a whole can still be illustrative. According to the statistics of Japan's Ministry of Finance, of the total cases of Japanese overseas investment between 1989 and 2004, 27.4% took place in North America, 23.3% in Europe and 33.7% in Asia. More important, of a total of 16,424 cases of Japanese investment in Asia, 63.4% (10,418 cases) was in the manufacturing sector, as compared to 26.8% (3,576 out of 13,356 cases) for North America and 16.9% (1,919 out of 11,387 cases) for Europe. In a similar fashion, of the total value of Japanese FDI in Asia between 1989 and 2004, 56.9% was in the manufacturing sector, as compared to 37.6% for North America and 31.6% for Europe.<sup>7</sup> As will be discussed below, the high proportion of Japanese investment in the manufacturing sector in East Asia was of particular significance, because it was Japanese investment in manufacturing that was of central importance in the growth of economic integration in the region.

**Table 5.4 Japan's Direct Investment Abroad, 1985–2004**

	1985–1989	1990–1994	1995–1999	2000–2004
<b>World total</b>				
\$ million	182,463	214,111	263,581	191,381
<b>US</b>				
\$ million	84,505	91,902	99,207	42,461
% of world total	46.3	42.9	37.6	22.2
<b>EU-15*</b>				
\$ million	33,945	43,049	65,486	74,467
% of world total	18.6	20.1	24.8	38.9
<b>East Asia</b>				
\$ million	11,495	15,575	20,578	19,658
% of world total	6.3	7.3	7.8	10.3

Source: K. G. Cai, *The Political Economy of East Asia, Regional and National Dimension* (Basingstoke and New York, Palgrave Macmillan, 2008), Table 8.4, p.192.

\*EU-15 refers to 12 countries that signed the Treaty of Maastricht in 1992, which transformed the EC into the EU in 1993 – including France, Belgium, Luxemburg, Netherlands, Italy, Germany, UK, Ireland, Denmark, Greece, Spain and Portugal – plus three new members that joined the EU in 1995, namely, Austria, Sweden and Finland. Regardless of different dates of joining the EU, they are put together for the convenience of comparison. On the other hand, ten new members that joined the EU in 2004 are quite marginal in this comparison, hence not included.

After the mid-1980s, Hong Kong, Taiwan and South Korea also became major investors in the region, particularly in China. Hong Kong was the largest investor among East Asian NIEs. Between 1984 and 1989, Hong Kong's total FDI abroad reached \$25.9 billion, of which \$12.9 billion (49.7%) went to East Asia. Among East Asian economies, China took the lion's share (\$11.7 billion or 91.1%) of Hong Kong's FDI in East Asia (or 45.2% of Hong Kong's total FDI abroad), followed by Taiwan (\$756 million and 5.9%), Japan (\$281 million and 2.2%) and South Korea (\$113 million and 0.9%).<sup>8</sup> By the end of 2003, the stock of Hong Kong's FDI outflows reached \$338.6 billion, of which \$119.6 billion was in China (35.3%).<sup>9</sup> With huge foreign exchange reserves, Taiwan became a new important source of capital in the world and a growingly important investor in East Asia. According to Taiwan's official statistics, by the end of 2006 Taiwan's total approved investment stock abroad reached \$100.7 billion, rising from \$375 million in 1987. In the process, the share of Taiwan's total FDI outflow stock to the US dropped from 62.2% in 1987 to 7.6% in 2006, while that to East Asia increasing rapidly from 4.0% to 64.6% over the same period. Most importantly, Taiwan's dramatic jump in investment in China since the late 1980s

is overwhelmingly responsible for the sharp increase in Taiwanese FDI outflows to East Asia. Of Taiwan's total FDI outflow stock by the end of 2006, China alone took 54.5% (\$54.9 billion), surpassing British Central America, which received the second largest amount of Taiwanese outward FDI (\$18.5 billion or 18.3%), by a wide margin.<sup>10</sup> Although relatively small compared to those of Hong Kong and Taiwan, South Korea's outward FDI also grew rapidly. Between 1985 and 1990, South Korean total FDI abroad rose 26 times, from \$31 million to \$821 million.<sup>11</sup> By 1998, the total stock of South Korean FDI outflows had reached \$20.3 billion, of which \$5.0 billion, accounting for 24.7%, was in East Asia. Notably, like those of Japan, Hong Kong and Taiwan, South Korean investment in East Asia concentrated in China, which took about \$4.0 billion (80%).<sup>12</sup> By the end of 2003, the total stock of South Korea's actual FDI in China had reached \$8.0 billion.<sup>13</sup> As the largest recipient of FDI in the region, China also heavily invested in Hong Kong. By the end of 2003, the stock of China's FDI in Hong Kong had reached \$98.9 billion, accounting for 26.0% of total FDI in Hong Kong, which made China the largest source of inward FDI in Hong Kong if tax haven economies of British Virgin Islands were excluded.<sup>14</sup> As a result of rapidly rising intraregional FDI flows, the FDI that originated in the region itself became a major source of FDI in East Asia (excluding FDI in Japan).

Behind the quantitative data of growing economic ties, what was significant was the qualitative nature of the economic relationships that developed in East Asia after the mid-1980s. Notably, the ongoing economic integration in East Asia differed significantly from that in Europe and North America. As two institutionalized regional economic groupings, the EU and NAFTA sought to create a single common market, designed to enhance free movement of goods and production factors to the mutual advantage of their members. By contrast, regional integration in East Asia primarily derived from the growth and expansion of international production networks (IPNs) in the region,<sup>15</sup> which was the result of changing comparative advantages between the economies in the region and were closely related to the economic restructuring in both capital-exporting and importing economies with FDI serving as a bridge. Through regionalization of manufacturing production, which was accompanied by rapidly increasing flows of capital, trade and technology transfer, a network of multiple division of labor and commodity chains was established in East Asia, based on comparative advantages among the economies with different resource endowments and levels of development. In this process, the growth of IPNs that accompanied

rapid FDI flows within the region particularly helped promote what Christopher Dent calls “functional integration” in East Asia through the expanding development of regional business systems and operations.<sup>16</sup> In this network of economic ties, Japan was playing a leading role as a major supplier of capital, technology and advanced products as well as a significant market for raw materials and consumer goods; East Asian NIEs were an important base for industry, finance and trade, an important supplier of intermediate equipment and products, and a major consumer of raw materials; China and other economies in the region served as major recipients of FDI, suppliers of raw materials, and growingly important markets for manufactured products. This complementarity of economic ties suggests that all stood to benefit from greater economic integration. The result was that national borders in East Asia, though still visible and important, were becoming increasingly porous with the movement of capital relatively free of constraints.<sup>17</sup> According to Edward Lincoln, FDI is more significant than foreign trade in terms of the depth of external ties. Merchandise trade, which is conducted primarily through a limited number of general trading companies, requires relatively little economic intimacy between trading nations or societies and minimum knowledge of foreign cultures, political systems and other social aspects. On the contrary, FDI, through direct management of a subsidiary in a foreign country, requires closer personal contacts and better understanding of local culture, legal and political systems.<sup>18</sup> As such, FDI involves closer commitment and greater influence than generally are involved in and derived from trading relations.<sup>19</sup> It is in this sense that increasing FDI flows among East Asian economies imply much closer economic integration than the statistics may simply suggest.

While the MNCs of Japan and NIEs were the driving forces behind the flow of regional FDI and the region’s increasing integration, Japanese FDI was central to this process. Rapid economic growth and location advantages constituted major attractions of the East Asian economies for Japanese companies. The location advantage included, among other things, the use of local low-cost and skilled labor, higher profitability of FDI in this region compared to the rest of the world, and progressively (South Korea, Taiwan, China) or thoroughly (Hong Kong) liberalized FDI regimes. Unlike Japanese FDI in developing countries during the 1970s and early 1980s that was heavily concentrated in the natural resource sector, the expansion of Japanese FDI in East Asia after the mid-1980s was primarily in the manufacturing sector.<sup>20</sup> The result was the expansion of regional division of labor and increasing regional econ-

omic integration centered on Japan. Hong Kong, Taiwan and South Korea were also promoting the process of regional integration through FDI outflows. While facing the challenge of upgrading their economic structures, these economies were not only receiving Japanese FDI in more advanced industries and service sectors but moving their labor- and land-intensive industries offshore to China through FDI, thus creating a new layer of division of labor in East Asia. This development was particularly manifested in the economic integration of Hong Kong, Taiwan, South Korea and Japan with geographically adjacent coastal areas of China, linking comparative advantages of adjacent territories in these economies into a dynamic network of regional division of labor.<sup>21</sup>

Indeed, economic integration of this kind resembles the historical flying geese pattern that linked Korea and Taiwan to the metropolitan economy of Japan during the Japanese colonial period.<sup>22</sup> In the post-war years, the economic relationship of the flying geese type revived between Japan on the one hand and South Korea and Taiwan on the other, although under transformed regional and global conditions.<sup>23</sup> After the mid-1980s, this Japan-centered vertical economic integration in East Asia expanded to involve China (and ASEAN in a broader sense) with South Korea, Taiwan and Hong Kong playing an intermediate role between Japan and China. The rapid growth of South Korean, Taiwanese and Hong Kong investments in China was largely the result of the ongoing structural changes in these three economies, required by changing domestic and international economic conditions, that is, the loss of competitiveness of labor-intensive industries due to the rising domestic labor costs and the emergence of new producers in other economies where labor costs were much lower. As part of this restructuring process, South Korea, Taiwan and Hong Kong moved labor-intensive as well as heavily-polluting industries into China. On the part of China, investments from South Korea, Taiwan and Hong Kong provided mid-level technology and management, both of which seemed more suited to a large part of the Chinese economy than, say, investments from Japan. More important, FDI inflows brought China technology, capital, managerial and marketing know-how, employment creation and trade growth, and this could eventually lead to changes in the comparative advantages of China's own industries.<sup>24</sup>

Obviously, the flying geese integration placed Japan in a superior position *vis-à-vis* its neighboring economies. Japan clearly dominated the trade and investment structure of East Asia through a pattern of production structures that had vertically integrated other economies

with the Japanese economy over time. Consequently, over the postwar years Japan gradually replaced the US as the economic hegemon in the region, and became the dominant economic power in almost all economic areas in the East Asian region. While other East Asian economies enjoyed huge trade surpluses with the US and Western Europe, they all had huge trade deficits with Japan. Accordingly, Japan played a leading and critical role in the ongoing economic integration in East Asia.

On the other hand, however, unlike many other developing countries that were locked in a permanent subordinate position in their rigid vertical integration with the West, South Korea, Taiwan and Hong Kong managed to improve their respective positions in the vertical relationship of flying geese type in East Asia. Consequently, there was gradually increasing horizontal trade between Japan and East Asian NIEs. In the meantime, South Korea, Taiwan and Hong Kong were playing an intermediate role in this triangular network of vertical economic links, having growing investment in China and Southeast Asian countries. Although China was further behind in the flying geese formation, it had much leeway in the regional division of labor, given its economic size, abundant resources, huge domestic market and comprehensive economic structure. Thus, the newly emerging division of labor in the region could progressively become more horizontal and equitable in the long run. The flying geese integration, at least in the case of much of East Asia, seemed to represent a relatively complementary and dynamic economic relationship, or a relationship of positive interdependence, though somewhat unbalanced. Clearly, the growing economic ties in East Asia contributed to the region's prosperity and competitiveness in the world economy. All these economies in the region obtained benefits from such regional economic relationships.<sup>25</sup>

## **2. Regional economic integration in East Asia: dynamics and constraints**

The growing regional economic integration in East Asia, based on the intensifying flow of economic interaction across ideological-political boundaries, was an autonomous economic process primarily driven by market forces and spearheaded by business rather than engineered by governments. As a matter of fact, rapid growth was achieved particularly in those areas where economics overrode politics and where rising economic ties were more rapid than governments could deal with. With the increasingly evident enormous success and advantages

of the region's growing interdependence, the governments of East Asia were then facilitating this development. Consequently, MNCs in concert with their respective governments were, attendant to the pursuit of their larger economic objectives, systematically promoting expansion of division of labor and integration of production in East Asia. Hence, an autonomous economic process and policy cooperation among the governments in the region were growingly reinforcing each other.

The market forces that were driving the growing regional integration in East Asia came from both without and within. In the first place, growing economic regionalism and protectionism in Western Europe and North America raised serious concerns in East Asia about the continued openness of these two major markets, which absorbed by far a major chunk of manufacturing products of East Asian economies. As a result, the regional markets, especially the huge Chinese market, were becoming increasingly attractive to the economies in East Asia. According to gravity theory of trade, trade between countries is proportional to their economy's size as well as their geographic distance. As such, with its rapid economic growth China became increasingly important to the other economies in the region due to its expanding market and geographical proximity.<sup>26</sup> It is in this sense that the growing regional economic integration among East Asian economies, strategically, would provide a secure alternative outlet for their exports and lessen their dependence on increasingly protected North American and Western European markets, and, technically, could provide opportunities for solving East Asia's intractable economic frictions with the US and Western Europe.

On the other hand, domestic economic conditions in East Asia had substantially changed following the fast economic growth. The rising labor shortage, growing labor costs, escalating land prices and strict environmental controls caused growing production costs and an increasingly difficult operating environment first in Japan and then in South Korea, Taiwan and Hong Kong. Besides, as Japan, South Korea, Taiwan and Hong Kong were all moving to their respective new levels of sophistication in terms of technology and value-added products, it became imperative for the companies in these economies to relocate their labor-intensive and low-value-added industries abroad. As a natural process, the economic forces steadily drove the economic activities across national boundaries to areas of less expensive land and labor to maintain competitiveness and growth. Furthermore, the steadily appreciating currencies of these economies made acquisition of foreign assets both desirable and less expensive, while continued huge trade

surpluses allowed the funding of foreign investment. In a last analysis, South Korea, Taiwan and Hong Kong, like other small industrial nations with limited domestic market capacity, shared their "small economy problem" and could find solutions only through trade and investment abroad. In a different situation, China, with plentiful land and labor but short of capital and technologically immature, was facing an increasing need for capital for its modernization and reform programs. All these made the economic relationships among East Asian economies overwhelmingly complementary with their different resource endowments and levels of development, which provided a strong economic rationale for growing economic ties among the economies in the region.

As such, growing regional economic integration in East Asia can be viewed as a defensive measure against external imperatives as well as an inevitable choice as a result of domestic economic development in the region. The growing intraregional trade and FDI flows after the mid-1980s were all subject to these economic forces. Indeed, either as a diplomatic means or as a policy objective, economics was clearly playing an increasingly important role in shaping international relations in East Asia.<sup>27</sup> As political situation in many developing countries was volatile and economic protectionism in Western industrialized countries was growing, Japan learned to appreciate, even more than before, the value of closer economic ties with its neighboring economies. Japan desperately needed markets and resources. The neighboring economies in the region, with growing purchasing power, could make a sizeable and growing market for Japanese products, and increasing exports of Chinese raw materials could meet some of Japan's resource needs. Japanese surplus capital also needed to find outlets for profits, and, again, these economies were considered as ideal places for investment with their cheaper and relatively sophisticated labor force. Although the political considerations were largely behind the transformed relations between China and Taiwan and between China and South Korea, economic imperatives were obviously an important reason in both cases. Particularly important, the issue of unification between China and Taiwan had always been considered in political and nationalistic terms in the past. However, it became increasingly viewed in an economic perspective as well on both sides of the Taiwan Straits. As geo-economics became growingly prominent in international relations, both China and Taiwan were looking upon each other increasingly in economic terms. In a world of economic warfare Taiwan might show more positive interest in a closer relationship with the mainland. The island would be at a disadvantage scrambling for the world's depleting natural

resources in competition with other resource-dependent economies and members of closed trading blocs, such as Western Europe and North America. Closer relationship with the mainland would offer Taiwan access to badly needed resources and a vast potential market. Likewise, the normalization of diplomatic relations between China and South Korea was also largely motivated by economic needs on both sides – South Korea's capital and technology needed by China and Chinese cheap labor and land, resources, and market wanted by South Korea. No doubt, growing economic ties in East Asia were deeply rooted in this economic necessity.

As the most significant driving force, Japan was both directly and indirectly associated with the process of regional economic integration in East Asia. Through the flying geese mechanism, the process of Japanese investment and concomitant trade brought a profound influence on the economic development of South Korea, Taiwan and Hong Kong. This chain of influence was most recently extending downward to involve China and Southeast Asian countries. Japanese companies located or relocated manufacturing operations throughout East Asia to reduce costs, assist domestic economic restructuring, protect against the protectionist policies of other countries, deal with fluctuating exchange rates, and hedge against the consequences of rising regionalism elsewhere in the world economy. Japanese investment played a crucial role in linking the Japanese economy and other economies in East Asia. Through the relocation of manufacturing production offshore, Japanese FDI stimulated a process of industrial restructuring both in Japan and in the recipient economies in the region. More significant, as part of this process, some of the Japanese industries not only relocated production abroad but also increased sales back to Japan. Traditionally, Japanese foreign investment in manufacturing was intended to supply either local markets or third markets and not to manufacture products for shipment back to Japan. The shift was a further indication of Japan's deepening integration with other economies in the region.<sup>28</sup>

While East Asia was moving toward regional economic integration, it was not organized into a formal regional grouping like the EU, NAFTA, and MERCOSUR. The regional integration in East Asia was uninstitutionalized, not discriminatory against the economies outside the region. This very nature of regional economic integration in East Asia was the result of the interactions of internal conditions in East Asia and the region's external linkages. There were political, historical, cultural, ideological and structural factors in play, both pushing and hindering the process toward institutionalized integration in the East

Asian region. Of those factors that helped promote regional integration and institutionalized cooperation, the following five elements seem to be important.

In the first place, the East Asian states shared mutual interests in keeping a stable political environment in the region for continued fast economic growth, as economic development was top on the national agenda for almost all governments in the region. Moreover, in the past several decades, extensive economic ties were established among East Asian economies to the extent that no government could afford disruption of these ties. On the contrary, the force of inertia was working for continuing to deepen these regional ties.

Secondly, the economies in East Asia were complementary in terms of production factor endowments and economic structures. They could offer an entire range of technological layers, ranging from labor intensive to knowledge intensive production and processing systems. While Japan possessed capital and the most sophisticated processing technologies, South Korea, Taiwan and Hong Kong had capital and mid-level production and processing technologies. With its abundant human and natural resources and huge market potential, China could provide relatively cheap labor and land and serve as important markets for both capital and consumer goods. Thus, East Asian economies were sufficiently complementary and, in case of a crisis, they could easily secure technology, capital, labor, and resources from within the region even in a worst situation of disruption of their external linkages with the outside world.

Thirdly, in the process of growing economic interactions in the region, there were an increasing number of issues that had to be dealt with effectively on a collective basis. Two such issues of critical importance relating to economic relations in East Asia, for example, were the need for periodic adjustment of exchange rates and means of rectifying persistent trade imbalances. The emergence of several integrated economic sub-regions along the Chinese coast involved issues of jurisdiction and control, which also required collaboration among the governments involved. There were also non-economic issues that had to be handled at the supra-national level, such as environmental protection, energy security, illegal immigration, smuggling and other crimes, and so forth. More recently, the need to check the rapid spread of such epidemics as SARS, bird flu and swine flu further indicated the importance of closer cooperation and policy coordination among regional governments.<sup>29</sup>

Fourthly, the geographical proximity among East Asian economies provided tremendous cost advantages in moving goods and services as

well as encouraging technological exchange and direct investment in neighboring economies. It was not accidental that the most integrated sub-regions were precisely adjacent areas between economies, as was seen in Southern China integrated with Hong Kong and Taiwan and in Northern China closely tied with South Korea and Japan.

Finally, most East Asian peoples had long shared, in varying degrees, the common cultural tradition of Confucianism, Daoism and Buddhism as a unifying force. In some sub-regions there were also ethnic ties and linguistic affinities as a stimulus, such as those between Taiwan, Hong Kong and Southern China, and to a less extent between South Korea and Northern China. These kinship ties were a contributing factor in economic integration in the sub-regions involved. Moreover, there was a growing sense of regional consciousness, identity and mutual interests in East Asia, which became an increasingly important force to unify the region.

While the unifying forces were strong, however, there were major obstacles that worked against more institutionalized regional integration in East Asia. In the first place, despite growing regional economic ties, the role of economics in East Asia was still largely defined within the existing framework of political relationships among the players involved, and low politics was still generally subordinated to high politics. Because of the diversity in ideology and socio-political and economic system, deep mutual political understanding and trust were far from having been built up yet among East Asian states. There also remained regional issues of a political-strategic nature, such as the politically sensitive issues of the divided states (two-Korea division and China-Taiwan division), unresolved territorial issues (the Diaoyu/Chiaoyutai Islands or Senkaku contested by China, Taiwan, and Japan), and some jurisdictional issues pertaining to the Sea of Japan, a name that the Koreans refused to accept. Moreover, there were few signs that the East Asian states themselves were reducing their armaments, and the danger of military confrontation still existed on the Korean Peninsula (where more than one and a half million troops were under arms with the Demilitarized Zone (DMZ) remaining as one of the most hostile borders in the world today), and across the Taiwan Straits. With the increasing attention of the US to domestic concerns in the post-Cold War era and to the war against international terrorism in the post-11 September era, these regional political and security issues became all the more projective. It is in this sense that expanding economic cooperation and prosperity in the region would be highly contingent on the maintenance of peace and stability and on the creation

of a peaceful political environment in the entire East Asian region. Moreover, strong nationalist sentiments, stemming from attitudes of resistance to foreign powers, also worked against institutionalized regional integration dominated by regional powers.

As far as economics was concerned, East Asian economies were externally-oriented as evident in the high ratio of trade in their GDP, and their fast economic growth was closely related to their external ties. East Asia remained heavily dependent on trade outside the region, especially export markets in North America and Western Europe and energy and resource supplies from the Middle East, Australia and the Americas. By 2003, there was still 40.1% of Japanese exports going to the US and EU-15 (24.8% to the US and 15.3% to EU-15). For South Korea, Taiwan, Hong Kong and China, the share of exports destined for the US and EU-15 for 2003 was still 30.7% (17.8% for the US and 12.9 for EU-15), 30.9% (18.0% for the US and 12.9% for EU-15), 32.0% (18.7% for the US and 13.3% for EU-15) and 37.6% (21.1% for the US and 16.5% for EU-15) respectively. In particular, although the importance of the US as a market relative to regional markets in East Asia has declined, it was nevertheless still the single most important market for Japan and China and the second largest market for South Korea, Taiwan and Hong Kong in 2003, and will remain a vital market for the indefinite future.<sup>30</sup> As such, without access to global markets – the US and EU markets in particular, the opportunities for economic dynamism of East Asian economies would be severely constrained. This linkage of external economic ties was clearly a big constraint on the formation of any closed regional grouping in East Asia.

Furthermore, there were persistent bitter memories in East Asia of wartime Japanese atrocities and exploitation and Japan's disastrous attempt to create a Greater East Asia Co-prosperity Sphere during the 1930s and the first half of the 1940s. There was also worry about a militarily resurgent Japan. In the meantime, Japanese economic hegemony stimulated region-wide concern about each economy's dependence on Japan for its most important trade and investment relations. This, together with the growing trade deficits with Japan, worried other states in the region. As such, they would be wary of entering into too close association with Japan, for political and psychological as well as economic reasons. Japan and others, however, were concerned about a China that might manage to combine its growing economic power with political cohesion in such a fashion as to reach genuine military power. Largely because of these worries, continued US strategic presence in the region was still strongly supported by most East Asian states

as essential for the region's security and for balancing the regional powers, particularly Japan and China. This was not because the US was the most loved, but because it was the least feared. With dependence on the US for security and balance of power in the region, it was therefore difficult that a closed regional grouping would easily develop in East Asia.

Obviously, competing forces were pushing East Asia in opposite directions. On the one hand, the mounting protectionism and rising regionalism in Europe and North America and the difficulties in the maintenance of multilateralism through the WTO system, together with the increasingly self-confident recognition of a huge potential for intraregional trade and economic cooperation in the region, made it essential and desirable for the region to develop a mechanism (or institution) to increase economic cooperation on a permanent basis within East Asia. In the meantime, strong interdependent relationship developed with an extensive network of ties being established in East Asia since the 1980s. East Asian states were therefore more and more motivated to develop close economic ties among them for practical reasons. The relaxed political atmosphere that began to emerge in the 1980s strengthened this trend. The existence of these conditions created a favorable environment, and even incentive, for institutionalized regional cooperation in East Asia. On the other hand, however, due to the heterogeneity of interests and motives among the states, it was difficult for East Asian states to join together in pursuit of certain common goals, namely, the formation of a formal regional grouping. For such a regional body to work, it usually required a political commitment to dilute national sovereignty in favor of broader regional politics (though this commitment could sometimes be weak, as in the case of the EFTA and NAFTA). In addition, the continuing dependence of East Asian economies on external markets and US military presence further hindered the creation of an exclusive regional grouping. The dynamic interactions of both favorable and unfavorable conditions therefore brought uninstitutionalized regional integration in East Asia short of establishment of a formal regional grouping.

In a further analysis, largely due to their different stages of economic development and different positions in the world economy, the East Asian economies were pursuing diverse policy objectives. These differences in policy objectives might also explain their respective attitudes toward growing economic ties in the region. The nature of Japan's relations with the US and Europe was an important factor affecting Japan's choice of foreign policy options. Economic forces and values almost pushed Japan in the direction of multilateralism. As such, Tokyo always

stressed that, despite its major commitment to investment and rapidly growing trade in the region, Japan was playing no favorites. However, the constant fear of being rejected by the West and forced to “change Japanese culture” (pressures from the West to share more burdens both in economics and politics/security) could strengthen the forces of going regional in Japan. This scenario is similar to that of London that insisted on its special relationship with Washington when joining the EEC, which would build closer ties between Britain and its continental neighbors. Under such circumstances, there was a growingly strong sentiment of going regional among the Japanese. On the part of other East Asian economies, while they had strong desire to maintain close economic ties with Japan, they were surely to resist a Japan-dominated regional economic bloc for historical, political, economic and psychological reasons. As such, it was, ironically, perhaps only a Japan that was closely associated with the West that was acceptable as a partner to its neighbors in the region.

Difference in policy objectives might also explain why there was little consensus among states in East Asia as to the nature and scope of multi-lateral economic cooperation in the region. Japan seemed to envisage regional cooperation in a much broader and longer-term framework of vertical and horizontal division of labor among East Asian economies as a possible means to protect Japan’s economic supremacy from economic blocs of Western Europe and North America. By contrast, China tended to view institutionalized regional integration as a way to increase its influence in regional politics and economics with its rising power. South Korea, Taiwan and Hong Kong preferred regional cooperation as a way to expand their export market. Although these views might not be mutually exclusive in the longer run with the gradual deepening of economic cooperation in the region, they could not be easily compromised.

Despite these constraints, however, in the wake of the Asian financial crisis of 1997–98, politicians, business leaders and academics across the East Asian region began to rethink the issue of institutionalized regional integration in East Asia.

### **3. The impact of the Asian financial crisis on East Asian integration**

The Asian financial crisis started in Thailand on 2 July 1997, originally characterized by sharp currency depreciation, plummeting asset values, dramatic drop of stock prices, and huge capital outflows. However, it rapidly spread to the whole region and soon deteriorated into an overall region-wide economic crisis, hitting East Asian economies severely. As

the most severe economic crisis in East Asia in terms of scope, depth and nature ever since the end of World War II, the Asian financial crisis became a major milestone in the economic transformation in East Asia. Particularly, the Asian financial crisis triggered rethinking of the issue of institutionalized regional economic cooperation among political leaders, businesses and academics in the region.

While the causes of the Asian financial crisis were seen as multi-dimensional at both domestic and global levels, the lack of a regional mechanism for close economic policy coordination and cooperation among the governments in the region was widely cited as being responsible for so rapid spread of a crisis unchecked across the region in such a magnitude. This bitter experience was not only a further proof that economies in the region were so closely interdependent, but also a clear indication of how greatly East Asian economies were now exposed, vulnerable and even fragile to an economic crisis that originated in a neighboring economy. As a consequence, there was a dramatic change in thinking among political and business leaders in East Asia with growing realization of urgent need for the creation of a formal regional mechanism that would be able to deal with a similar crisis in the future and to maintain the economic growth of the region. It is in this sense that the Asian financial crisis created an imperative that had significantly transformed the political economy of East Asia, thus providing the background for increasing institutionalized regional economic cooperation in East Asia.<sup>31</sup>

In a further analysis, the nature and magnitude of trade links in the region were probably more significant mechanisms for the region-wide contagion of the Asian financial crisis than "competitive" currency devaluations. According to a 1998 World Bank report, *East Asia: The Road to Recovery*, intraregional exports among East Asian countries accounted for almost 40% of total exports in 1996, up from 32% in 1990. If Japan was included, the figure rose to 50%. These high levels of intraregional trade reflected a process of specialization and outsourcing of activities from the more advanced to the lower income countries in the region. About three-fourths of the intraregional trade was in raw materials, intermediate inputs, and capital equipment, which accounted for more than 50% of the total East Asian imports of these products. Such trade complementarity probably increased the speed and directness of the contagion across the region.<sup>32</sup>

Under such circumstances, the Asian financial crisis created an imperative for East Asian states to establish a more systematic mechanism for regional cooperation and policy coordination. Consequently,

political and business leaders in East Asia, particularly significant in the core economies of the region (Japan, China and South Korea), were increasingly serious about the issue of regional institution-building in the wake of the Asian financial crisis, a development that dramatically deviated from the past attitudes of both governments and business leaders in East Asia. While proposals were made in launching a single Asian currency and other regional financial reforms, there was more serious discussion and proposals across the region for official regional arrangements in the trade area, as this was believed to be a most significant area in terms of institutionalized regional integration. In this respect, Japan was noticeably active, in sharp contrast to its past official position regarding regional economic arrangements. The first such move came from Kazuo Ogura, Japanese ambassador to South Korea, in mid-September 1998 when he openly called for the establishment of a trade alliance between Japan and South Korea as opposed to economic blocs in the West. This was the first time ever that a senior Japanese official had made such a proposal in public.<sup>33</sup> On 20 March 1999, during his visit to Seoul, Japanese Prime Minister Keizo Obuchi in his address at Korea University further urged that Japan and South Korea take a leading role in creating a free trade zone in East Asia that would stand on par with the EU.<sup>34</sup>

A more significant move came on 21 May 1999 when Japan's famed Ministry of International Trade and Industry (MITI) formally proposed in its annual report on trade that Japan take the lead to pursue a regional trade bloc in East Asia. The proposed trade bloc would encompass Japan, South Korea, Hong Kong, and Taiwan. The new regional arrangement was envisioned to counteract such economic groupings as the EU and NAFTA. In addition, MITI asked the government to take a step beyond building an economic bloc. "We should not only pursue a limited economic grouping such as a free trade zone or tariff pact, but also activate human exchanges and promote mutual understanding," the report stated. The report also noted that the Japanese economy must break out of the current recession for Asia to stage an export-led recovery and to get back on the road to coherent economic development again.<sup>35</sup>

Although the South Korean government initially responded to Japan's proposal with some hesitation, largely for fear of the Japanese dominance in such a trade bloc due to the huge gap in economic strength and industrial structure between the two countries, Seoul soon started talks with Tokyo on the proposed bilateral FTA at both government and private levels. As a concrete step, several government and private

research institutes in both Japan and South Korea began research projects concerning various specific aspects of a FTA between the two countries.<sup>36</sup> After five years of joint studies on the issue, in October 2003 Japan and South Korea formally decided to launch an official negotiation on a bilateral FTA.

While Beijing was initially quite cautious on any such regional free trade arrangements for political, economic and psychological reasons, it soon became quite positive in pursuing a FTA with Japan and South Korea.<sup>37</sup> Chinese officials openly called for a FTA with Japan in several occasions. On 18 May 2005, Chinese Vice Premier Wu Yi explicitly called for a Chinese-Japanese FTA in a speech at the 50<sup>th</sup> anniversary of Japan's East Sea Japanese-Chinese Trade Center in Nagoya, Japan.<sup>38</sup> On the Japanese side, a report prepared by the Economic and Social Research Institute, a think tank affiliated with the Japanese Cabinet, was very positive about a Japanese-Chinese FTA, concluding that a FTA with China, compared to similar FTAs with other countries, would bring Japan the most benefits by raising Japan's GDP by 0.5%.<sup>39</sup> Despite this, however, Tokyo was still quite hesitant about such a move toward a Japanese-Chinese FTA at the moment, wary of rising Chinese influence with its growing economic power.

While the movement toward a Chinese-Japanese FTA remained stagnant, China and South Korea achieved quite some success in moving toward a bilateral FTA. Following several years of preliminary studies of the issue on both sides, Chinese President Hu Jintao and South Korean President Roh Moo-hyun reached an agreement on joint research on a Chinese-South Korean FTA during the APEC summit held in Santiago, Chile in November 2004. The decision made by the political leaders of the two countries soon materialized when the governmental think-tanks of both countries – the Development Research Center of the State Council of the PRC and the Korea Institute for International Economic Policy – formally launched joint feasibility study of a Chinese-South Korean FTA on 20 March 2005. As this research project was sponsored and financed by both governments, it was widely seen as a prelude of formal government negotiations on a FTA between the two countries.<sup>40</sup> It is likely that a Chinese-South Korea FTA, if signed, would provide stimulus for a similar arrangement between China and Japan.

While efforts were made at bilateral FTAs in East Asia in the wake of the Asian financial crisis, at Japanese Prime Minister Obuchi's initiative, China, Japan and South Korea held an unprecedented tripartite summit on 27 November 1999 on the sidelines of the APT meeting in Manila. The tripartite agreement reached from this summit committed

the three countries to a joint research forum to seek ways of institutionalizing economic cooperation among them. Under the agreement, the three leaders designated their respective think-tanks to work out concrete steps to boost trilateral economic cooperation and identify ten target sectors for such cooperation, including commerce, customs, maritime, environmental and fisheries sectors. In view of the absence of formal regional dialogue or consultative bodies in East Asia, this Manila tripartite summit was therefore seen as historic.<sup>41</sup> In the following year, the tripartite summit was formally institutionalized and became regular. Moreover, as concrete steps of institutionalized trilateral cooperation, seven functional bodies at the ministerial level were formally established to pursue trilateral cooperation and policy coordination in specific areas.

Mostly significantly, at the 5<sup>th</sup> tripartite summit held in Bali, Indonesia on 7 October 2003, the leaders of the three countries signed a historical document for promotion of tripartite cooperation in regional and global affairs in the 21<sup>st</sup> century, "The Joint Declaration on the Promotion of Tripartite Cooperation among the People's Republic of China, Japan and the Republic of Korea." In the meantime, the Three-Party Committee was established, headed by foreign ministers, to study, plan, coordinate and monitor cooperation activities. The joint study conducted by the think-tanks of the three countries submitted to the tripartite summit a report and policy proposal on the feasibility of a trilateral FTA with the conclusion that a trilateral FTA would bring substantial macroeconomic effects favorable to the three countries. In 2004, the joint study group started a sector-oriented study of the economic effect of a tripartite FTA on such specific sectors as agriculture, electric machinery manufacturing and automobile.

During the 6<sup>th</sup> tripartite summit in Vientiane, Laos on 29 November 2004, the leaders of the three countries endorsed two important documents that had been adopted by the Three-Party Committee on 27 November 2004, "The Action Strategy on Trilateral Cooperation among the People's Republic of China, Japan and the Republic of Korea" and "The Progress Report of the Trilateral Cooperation among the People's Republic of China, Japan and the Republic of Korea." The Action Strategy outlined the strategic direction of the trilateral cooperation in the future, while the Progress Report summarized the progress of the trilateral cooperation since the adoption of the Joint Declaration in 2003. During the 2004 tripartite summit, while Japanese Prime Minister Junichiro Koizumi called for deepening discussions of an East Asian trilateral FTA at the academic level, Chinese Premier Wen Jiabao emphasized the need to accelerate the work to realize a trilateral FTA. Moreover, Japan stressed the

need to further develop a legal framework of investment among the three countries and construct a stable business environment.<sup>42</sup> By 20 November 2007 eight such tripartite summits had been held.

During the third tripartite meeting of the Three-Party Committee held in Kyoto, Japan on 7 May 2005, the foreign ministers of Japan, China and South Korea reiterated their commitment to continuing study of creating a trilateral free trade zone and agreed to explore a legal framework for investment, to improve business environment and to strengthen cooperation on the energy area among the three countries.<sup>43</sup>

It is also important to note that the moves of the regional governments in the wake of the Asian financial crisis were soon endorsed and supported by business leaders in East Asia, particularly in Japan and South Korea. At the 15<sup>th</sup> annual meeting between the Federation of Korean Industries (FKI) and the Japan Federation of Economic Organization (keidanren) held in Tokyo in October 1998, the business leaders of the two countries decided to push to set up the so-called "Korea-Japan-China industrial cooperation committee" in an effort to help ease overcapacity and overinvestment problems among regional firms. According to the joint statement released after the meeting, both Japanese and Korean business leaders shared the view that the time was ripe for Japan, Korea and China to discuss a trilateral free trade zone to further stimulate trade and industrial cooperation in the region. As an initial move toward the trilateral free trade zone, the business leaders agreed to launch joint research on the economic effects of the proposed Korea-Japan free trade zone. Then they would study the possibility of expanding the free trade zone to include China in the longer term.<sup>44</sup>

Again, in early May 1999 business leaders from Japan, South Korea, China and other economies in the region participated in a regional forum in Seoul and announced a plan to establish an organization to promote economic cooperation in East Asia and stabilize the region's economy. They agreed that East Asian countries needed an organization similar to ASEAN to address issues of common interests and to develop efforts to cope with financial crises, eliminate excess industrial capacity and boost technology transfer. The envisioned regional body would focus on stabilizing member countries' financial systems and preventing the recurrence of a financial crisis.<sup>45</sup> One month later, business leaders from Japan, South Korea and China met again in Seoul to finalize the plan of setting up a permanent consultative body among them in the following month. The top agenda for the proposed organization included stabilization of Asian currencies, adoption of measures to prevent recurrence of a financial crisis, setting-up of a free trade zone

and capital market within the zone, and elimination of excess production capacity.<sup>46</sup> In June 2002, South Korean business leaders further proposed the formation of a joint economic policy coordination body among South Korea, China and Japan as a preparatory move toward establishing an East Asian free trade zone.<sup>47</sup>

Obviously, as a direct consequence of the Asian financial crisis, the government and business leaders in major East Asian economies took unequivocal moves in pushing the establishment of a regional economic grouping, dramatically deviating from the past attitudes of both governments and business leaders in the region.

#### **4. The moves toward an East Asian regional grouping?**

While the idea of forming an East Asian regional economic grouping did not appear until 1990, the discussion of regional economic cooperation among the countries in the Asia-Pacific emerged as early as the mid-1960s. The Asia-Pacific is generally seen as a much broader concept than that of East Asia in terms of geographical scope. Nevertheless, East Asia is frequently the focus of studies on contemporary political and economic issues of the "Asia-Pacific" in the existing literature. The discussion of regional economic cooperation in the Asia-Pacific evolved around a process of research studies and periodic meetings through three most important forums, the Pacific Basin Economic Council (PBEC), the Pacific Trade and Development Conference (PAFTAD), and the Pacific Economic Cooperation Conference (PECC). The PBEC was initiated by a group of business leaders in 1967; the PAFTAD was established in 1968 by scholars from the major market economies in the Asia-Pacific; and the PECC was established in 1980 with representation from government officials in their private capacities, academics, and business leaders. However, all these forums were non-governmental institutions, as governments in the region were unwilling to commit themselves to an official regional institution for economic cooperation at the time.<sup>48</sup> By the end of the 1980s, a new mood for closer regional economic cooperation emerged in the region as a result of changed global, regional and domestic conditions. Most notably, the rising economic regionalism in the world economy – as particularly exemplified by the negotiation of the US-Canada Free Trade Agreement and the movement of the EC toward a single market – concurrent with the difficulties in multilateral trade negotiations at the Uruguay Round brought a fear among Asia-Pacific governments that the global trading regime would breakdown into rival regional trade blocs if the Uruguay

Round negotiations failed. Equally important, the growing economic interdependence in the region and the ongoing structural transformation of many of Asia-Pacific economies helped the governments realize the need and desirability of promotion of economic liberalization and more institutionalized regional economic cooperation. Furthermore, China's adoption of economic-oriented domestic and foreign policies and the Soviet Union's new reconciliatory foreign policy under Gorbachev at the time provided a favorable environment for more institutionalized economic cooperation in the Asia-Pacific. Under such circumstances, the governments in the region began to embrace the idea of promoting institutionalized regional economic cooperation. This development is particularly significant for the region, because, unlike Europe where regional institutions have long been part of its history, the Asia-Pacific lacks a tradition as well as experience of any regional institution-building in its history. Consequently, the moves toward institutionalized regional cooperation became a milestone in the Asia-Pacific in general and East Asia in particular. Most pronounced in this development was the creation and rapid development of APEC and the reorientation and expansion of ASEAN.

In a further analysis, the moves of Asia-Pacific states toward a regional grouping occurred in a much broader context of the accelerating globalization since the 1980s, which not only made national economies increasingly integrated through trade, finance, production, and a growing web of treaties and institutions, but also brought fundamental impact on economic growth, the distribution of income and wealth, patterns of trade and finance, and political institutions. As the East Asian economies all heavily relied on the global economy for market, capital, technology and resources, the region was highly susceptible to the negative as well as positive effects of globalization. Particularly, concurrent with the trend of globalization was the rising economic regionalism and protectionism in the world economy, most notably in Western Europe and North America, which exerted mounting pressure on East Asia, the only major region that had not yet been organized into an economic grouping. On the other hand, however, while East Asian states had an external fear of the closing of the markets in the West in general and the US in particular, they also had an internal fear of an East Asian grouping that would be dominated by regional powers, Japan and China. It was against such a dual fear that after the late 1980s East Asian states began to search for cross-Pacific economic cooperation within the framework of APEC and pursue APEC as a useful umbrella to achieve their dual policy objective to balance the regional powers

on the one hand and to serve as a guarantee for the continuation of free access to the North American market on the other. In the meantime, APEC was also viewed as an additional useful mechanism for constructing a more smooth economic relationship across the Pacific and resolving the protracted conflicts in the US-East Asian economic relationship. Moreover, APEC was seen by its members as a safe haven for their global connections in the face of the overbearing EU.<sup>49</sup>

## APEC

Based on the initiative of Australia, APEC was established in 1989 as a pan-Pacific institution that linked East Asia with Oceania and the Americas.<sup>50</sup> Since its inception, APEC has expanded from 12 to 21 member countries, including all of the major Asia-Pacific economies (most notably, the US, Japan and China) and the most dynamic, fastest growing NIEs. By today APEC has more than 2.7 billion people and represents about 54% of world GDP and 44% of total world trade.<sup>51</sup>

APEC started as an informal dialogue group and in its initial years largely focused on exchanges of views and project-based initiatives. The concerns simply were to advance the process of Asia-Pacific economic cooperation and to promote a positive conclusion of the Uruguay Round of multilateral trade negotiations. A turning point came in 1993 when the US President Clinton elevated APEC by inviting heads of state and government for an informal summit meeting in Seattle, during which the leaders envisioned APEC to be a community of Asia-Pacific economies and a flexible forum for promoting economic growth in the region. Since then, the annual APEC summit meetings have set the direction and pace of APEC's development, and APEC has become a primary regional vehicle for facilitating economic growth, cooperation, trade and investment in the Asia-Pacific region. Particularly significant is the annual session of Bogor, Indonesia in 1994, during which APEC leaders set a goal of free and open trade and investment in the Asia-Pacific by 2010 for developed member economies and 2020 for developing members.<sup>52</sup> In the subsequent annual sessions, APEC leaders reiterated this goal of trade and investment liberalization, while at the same time promoting a range of other goals like business facilitation, economic and technological cooperation, human resources development, and sustainable and equitable development with the understanding that liberalization could not be effective unless all APEC members benefited from economic growth.

APEC is the first regional institution that involves all East Asian economies.<sup>53</sup> However, as a regional institution of such geographical vastness, APEC covers a far more diversified area than any other “regional” institutions in terms of history, cultural and social traditions, political systems and government structures, and levels of economic development. As a matter of fact, the concept of the “Asia-Pacific” is quite ambiguous and unsettled in terms of its boundaries and constituencies, particularly when it is compared with clearly defined “Europe” and “North America.”<sup>54</sup> As such, according to John Ravenhill, APEC could actually be seen as a trans-regional as well as a regional institution, which is more similar to the Asia-Europe Meeting (ASEM) than to the free trade areas that exist in the Asia-Pacific region in terms of institutionalization and decision-making procedures.<sup>55</sup> Due to highly diverse interests and policy objectives between its Anglo-American members and East Asian members, APEC does not always reflect and represent the interests of East Asia. Particularly, by the mid-1990s it became apparent that there was a growing division within APEC between the Anglo-American members and the East Asian members over the direction of the organization. While the Anglo-American members pushed hard for the binding nature of APEC and focused on the promotion of trade and investment liberalization in the Asia-Pacific, East Asian members insisted on the loose and consultative nature of APEC and emphasized trade facilitation, economic and technical cooperation among Asia-Pacific economies.<sup>56</sup> Moreover, as is shown during the Asian financial crisis of 1997–98, East Asian economies were under no protection and assistance of any form under the existing framework of APEC. This raises the question of efficacy of APEC for East Asian economies.<sup>57</sup> Most notably, in pursuing its declared objectives, APEC adheres to the principle of “open regionalism,” that is, the promotion of regional economic integration without discrimination against non-members.<sup>58</sup> While the idea of “open regionalism” does help promote the universal norm of global trade and investment liberalization, it hardly brings any effective protection of East Asian economies from the ongoing protectionism and regionalism elsewhere. As such, APEC, with all its limitations and weaknesses, is unable to help East Asian states pursue their common interests of maintaining regional economic stability and promoting prosperity.

Moreover, in keeping with its overall philosophy of loose cooperation and open regionalism, APEC has few institutional structures and operates on the basis of non-binding commitments, open dialogue and equal respect for the views of all participants. Unlike the WTO or other multi-lateral trade bodies, APEC has no treaty obligations required of its

members. Decisions made within APEC are reached by consensus and commitments are undertaken on a voluntary basis.<sup>59</sup> This unique structural and functional feature of APEC reflects the organization's effort to accommodate high diversities among its members in terms of economic structure, the level of economic development, political and economic system, ethnicity, culture, society, ideology, history, policy approaches, policy objectives, and views on regional cooperation.<sup>60</sup> This forum is therefore different from such tightly structured regional arrangements as the EU and NAFTA.

Under such circumstances, APEC's weaknesses in promoting East Asian countries' interests help strengthen their sense of the East Asian community and "the desirability of having their own regional institution beyond the 'trans-regional' APEC."<sup>61</sup>

### ASEAN

In contrast to trans-regional and loosely structured APEC, ASEAN is narrower in geographical scope but more institutionalized in structure. ASEAN was originally founded by Indonesia, Malaysia, the Philippines, Singapore and Thailand in 1967 primarily for political reasons when the region was seriously divided by ideological conflict and war, internal insurgencies and economic hardship. The declared objective of ASEAN was to promote peace, stability and political and economic cooperation in the region.<sup>62</sup> As the five original members of ASEAN were small and weak countries that shared a preoccupation with nation-building and a vulnerable strategic position susceptible to external influence, organizing into a grouping would help enhance their strength collectively through unity and cooperation so as to better maintain their independence and autonomy.<sup>63</sup> On the other hand, however, despite aligning with the US and acting as a *de facto* bulwark against communist expansion in the region in the Cold War confrontation, ASEAN as a regional organization was generally inactive and hardly received real attention from the major powers involved in the region before the mid-1970s.

Significant changes occurred to ASEAN only after the Vietnam War was over in the mid-1970s. As US military forces were withdrawn from Vietnam and the country was unified under the communist regime, the importance of ASEAN in regional geopolitics increased. Particularly, the Vietnamese occupation of Cambodia after 1978 provided strong political coherence for ASEAN to become increasingly united and active. By playing a high profile role in opposing Vietnamese intervention in Cambodia and seeking a solution to the Cambodian conflict

in cooperation with the US and China, ASEAN became increasingly influential in regional affairs in East Asia in the course of the 1980s.

By the end of the 1980s and early 1990s, there was a dramatic transformation of geopolitics in the region as a result of the end of the Cold War in general and the end of the Cambodian conflict in particular. Consequently, while the previous political coherence for ASEAN created by Vietnamese occupation of Cambodia disappeared, ASEAN became growingly concerned about a possible decline of US presence in the region as a result of the end of the Cold War on the one hand and rising Chinese power and the potential danger of Japan's remilitarization in East Asia on the other. It was under such circumstances that ASEAN not only expanded to bring in Vietnam, Cambodia, Laos and Myanmar in the course of the 1990s in order to balance rising influences of regional powers, but also became increasingly active in promoting regional peace and stability through creating a region-wide security framework that was institutionalized in the ASEAN Regional Forum (ARF). The ARF, which was established in 1994, is the first genuinely region-wide forum for security dialogue that involves ASEAN's ten member countries and 17 other countries, including all the major regional and global powers.<sup>64</sup> The forum provides a venue for its members to discuss regional political and security issues and develop cooperative measures to promote regional stability and peace in East Asia. The ARF is characterized by minimal institutionalization, consensus decision-making and the use of "first and second track" diplomacy (that is, official and non-official seminars and workshops on regional security issues that involve academics and officials in their personal capacities). It has agreed on a gradual three-stage evolution of confidence building, preventive diplomacy and, in the longer term, approaches to conflict resolution. It is the belief of ASEAN that it would promote regional stability and security if major powers are integrated into a regional security mechanism. Obviously, such a region-wide security framework is designed to address ASEAN's concerns about the regional security and stability in East Asia in the post-Cold War context.<sup>65</sup>

In the economic sphere, by the early 1990s with the end of the Cold War there had been increasing prominence of economics in international relations, rising regionalism and economic competition in the world economy, and growing economic interdependence in the region. Consequently, ASEAN leaders began to reorient the organization and push for closer economic cooperation and integration as a single market and production unit to increase the competitiveness of ASEAN economies in response to the new reality.<sup>66</sup> As a result, in January 1992

ASEAN took a first step toward the AFTA by agreeing to eliminate most tariffs on manufactured goods between its member countries over the following decade.<sup>67</sup> By 1 January 2003, the AFTA had been duly established among the ASEAN's original five members and Brunei, while the newer members (Vietnam, Laos, Myanmar and Cambodia) are scheduled to join in 2012. The AFTA that had been established not only broadened tariff reductions but also promoted efforts to eliminate non-tariff barriers, harmonization of customs nomenclature, valuation, and procedures and development of common product certification standards. However, unlike the EU, the AFTA does not adopt a common external tariff on imports. As envisioned by the ASEAN Vision 2020 that was adopted in 1997, ASEAN aims to forge close regional economic integration, covering a wide range of areas, including investment, industry, services, finance, agriculture, forestry, energy, transportation and communication, intellectual property, small and medium enterprises, and tourism.

While the individual members of ASEAN have their own particular interests, they have adopted a common position on many issues that concern them. Particularly, acting as a caucus ASEAN plays an important role within APEC. Moreover, ASEAN has also managed to institutionalize annual dialogue channels with major powers on regional economic, political, security and other issues. By acting as a unified body, ASEAN commands far greater influence on those various issues than its members could achieve individually.

As an institution of regional integration, ASEAN is very different from the most advanced regional institution, the EU, in terms of organizational structures and integrating mechanisms.<sup>68</sup> Unlike the EU that represents a system of regional governance with a supranational decision-making structure, ASEAN is a regional intergovernmental organization that adopts such unique organizational and operational principles as consultation, consensus, and cooperation, dubbed the "ASEAN Way."<sup>69</sup> Particularly, the principles of mutual respect for sovereignty, non-interference in the internal affairs and consensus-based decision-making form the very basis of ASEAN as a regional institution.

While these principles are generally seen as responsible for ASEAN's survival and achievements so far, they are obviously posing constraints on its further deepening of cooperation and effective management of increasingly complex affairs. Particularly, the expansion of its membership in the course of the 1990s to include Vietnam, Laos, Myanmar and Cambodia makes ASEAN even more diversified in political values and national interests and therefore further complicates its already

problematic consensus-based decision-making and effective implementation of policy. These constraints make ASEAN's ability to promote regional development and integration highly in question.<sup>70</sup>

Moreover, although ASEAN is quite active and increasingly influential in regional affairs, it is basically quite weak as a regional grouping, consisting of small and middle regional powers. In the meantime, while ASEAN countries are promoting economic integration among themselves, they all adopt similar export-oriented industrialization strategies with competitive rather than complimentary economic structures. Largely because of this, ASEAN economies actually have far closer economic ties with more powerful Northeast Asian economies than their ASEAN partners. Particularly, the Asian financial crisis shows that ASEAN is not only very vulnerable to external shocks but, more importantly, incompetent in dealing with a crisis of such magnitude by itself due to its limited capacity. Under such circumstances, it seems quite logical for ASEAN leaders to rethink of the organization's future by tying its economic fortune to the much more powerful economies outside Southeast Asia, Japan and China in particular, given the increased regionalism in Western Europe and North America. It is in this sense that the Asian financial crisis provided a catalyst for ASEAN to realize the need for institutionalized economic cooperation of the whole East Asian region not only to promote its interests but also to survive. This understanding led to ASEAN's initiative to host and institutionalize a regular annual meeting of East Asian states through APT and APO forums. It is in this sense that ASEAN helps to bring reconfiguration of East Asian politics and regional identity that will form the basis of a burgeoning encompassing institutionalized grouping of East Asia.

### **ASEAN Plus Three (APT)**

The idea of forming an exclusive East Asian regional grouping was first explicitly proposed by Malaysian Prime Minister Mahathir Mohamad in 1990 when he openly called for the formation of the East Asian Economic Grouping (EAEG). However, Mahathir's proposal not only received strong opposition from the US, which feared that it might evolve into an exclusive East Asian bloc, but also met with a cold response from other East Asian states, which were not only under the US pressure for not supporting this idea but were themselves wary of Mahathir's plan.<sup>71</sup>

Despite the failure of the EAEG plan, however, the idea of an East Asian grouping was revived in the wake of the Asian financial crisis. As the lack of regional institutionalized policy coordination and

cooperation was widely seen as a major cause of the rapid and unchecked spread of such a damaging crisis across the region, East Asian leaders began to understand the urgent need for creating a regional mechanism that would allow institutionalized cooperation among the states in the region to deal with those regional issues of common concerns. This understanding led East Asian states to make serious efforts to promote regional institution-building and formation of an East Asian regional grouping.

These efforts finally led to the creation of the APT forum. According to Douglas Webber, the APT, which is seen as the “in effect” EAEG, has actually “gone far beyond” Mahathir’s original proposal.<sup>72</sup> Initiated by ASEAN, the APT first emerged from the need of ASEAN and three Northeast Asian countries – China, Japan and South Korea – to prepare for the first ASEM meeting to be held in 1996.<sup>73</sup> But very soon, particularly in the wake of the Asian financial crisis, the APT evolved into an institutionalized forum of consultation and cooperation between ASEAN and three Northeast Asian powers over a growing range of regional issues, including economic cooperation, financial and monetary cooperation, social and human resource development, scientific and technical development, culture, information, development, political and security areas, and various transnational issues.<sup>74</sup> The most publicized of the APT forum is its annual informal summit meeting (which was first held in 1997) that immediately follows the annual ASEAN summit on top of a range of regular ministerial and other official meetings involving foreign ministers, finance ministers, economic ministers, central bank governors and senior officials from other ministries and government offices. As concrete steps, the East Asian Vision Group (EAVG) and the East Asian Study Group (EASG) were established within the APT respectively in 1998 and 2001 “to explore practical ways and means to deepen and expand the existing cooperation” among ASEAN and three Northeast Asian countries “and prepare concrete measures and, as necessary, action plans for closer cooperation in various areas.”<sup>75</sup>

A most important achievement of the APT in the wake of the Asian financial crisis seemed to be the introduction of the Chiang Mai initiative (CMI) in 2000, which led to the establishment of a system of 15 bilateral currency swap arrangements among APT member states plus ASEAN swap arrangement that was designed to improve regional financial stability.<sup>76</sup> Efforts were then made to multilateralize the CMI by converting bilateral swap arrangements into a common funding pool of foreign exchange reserves. By 3 May 2009, the CMI was further

strengthened by an agreement signed by 13 APT member states to set up an emergency currency pool that would amount to \$120 billion (80% of which would come from China, Japan, and South Korea on a 2:2:1 ratio) to boost liquidity and help the region overcome the ongoing global crisis.<sup>77</sup> In addition to the CMI, efforts were also made to introduce the Asian Bond Markets Initiative (ABMI) and the Asian Bond Fund (ABF) as part of the regional mechanism on financial governance in East Asia within the APT framework. Furthermore, there were even discussions of the eventual development of a regional common currency, the Asian Currency Unit (ACU). Obviously, all these moves through the APT represent important signs of “financial regionalism” in East Asia.<sup>78</sup>

More significantly, while there were important steps forward in the construction of regional financial governance in East Asia, there were also growing calls for the APT to be transformed into an East Asian FTA. It is believed that through trade and investment liberalization, a regional FTA would bring the most important and significant integration effects for the region by consolidating the ongoing process of East Asian regional integration and forming East Asia into a true regional grouping and community. Most prominent among these calls came from South Korean President Kim Dai-jung at the 2001 APT submit meeting in Brunei.

While the enthusiasm for an East Asian grouping, an East Asian FTA in particular, has been mounting in the wake of the Asian financial crisis, there are still obstacles that make the creation of such an institution far from an easy job. Most notable among these obstacles are US opposition, lack of political trust among the states in the region, smaller states’ fear of an East Asian grouping dominated by Japan and China, Sino-Japanese rivalry, the huge gap in the level of economic development among East Asian countries, and different policy priorities.

Among the major obstacles, America’s opposition continues to be a most important external hurdle to the formation of an East Asian grouping. Washington’s opposition matters not only because the US market, which still absorbs over 20% of the exports from East Asia as a whole (see Table 5.1), remains very important for East Asian economies, but also because America’s military presence is widely seen as crucial in maintaining security and stability in the region. For small players, US presence in the region is even implicitly welcomed as necessary for balancing two regional powers, China and Japan.

Even America’s opposition aside, the obstacles within the region are even more formidable. In the first place, political trust among states,

which is essential for any effective regional integration, has not yet been truly established in East Asia. The lack of political trust derives not only from the lingering historical legacies of Japanese imperialism before and during World War II, but also from the smaller states' worries of an East Asian grouping dominated by two regional powers, Japan and China. Moreover, the continuing security issues and territorial disputes are not conducive to the establishment of political trust either.

As far as economics is concerned, the huge gap in the level of economic development among East Asian countries also works against effective economic cooperation in East Asia. Because of different levels of economic development, East Asian states have different policy priorities and pursue diverse economic and social policies. As a result, it would be no easy job to conduct policy coordination and cooperation among such diverse members within a regional grouping.

In a further analysis, successful regional integration largely hinges on the willingness and capacity of a hegemonic state to assume a leadership role.<sup>79</sup> However, as the most powerful economy in the region, Japan seems reluctant as well as unready to take a leadership role in creation of an East Asian grouping, partly due to its increasing incapacity to play the role of "consumer of last resort" for the exports of other East Asian economies, given its own financial and economic crisis – a role that is essential for a hegemonic state to play in promoting regional integration, and partly due to its economic policy and closed economic system that do not favor such a role. On the other hand, while there has been rising Chinese influence in the region following its economic and market expansion and the Chinese economy is widely seen as very open as a major importer as well as a massive exporter,<sup>80</sup> China has not yet psychologically as well as physically prepared for such a leadership role in the formation of an East Asian grouping.<sup>81</sup>

Moreover, as cooperation between regional powers is seen as equally crucial for successful regional integration – for example, Franco-German cooperation in European integration and, to a less extent, American-Canadian cooperation in the integration of North America, the lack of cooperation between China and Japan remains a further important obstacle to East Asian grouping. Seeing each other more as rivals than anything else, Beijing and Tokyo simply remain suspicious of each other's intention in regional affairs rather than cooperate on promotion of East Asian grouping. To some extent, Sino-Japanese rivalry constitutes a single most intractable obstacle to the formation of a grouping like FTA within the framework of the APT.

Largely because of these obstacles, it is interesting to note that regional cooperation in East Asia within the framework of the APT contains two important features. The first feature is that regional cooperation has been initiated and led by small players rather than major powers in the region. This strategy seems to work quite well for having initiated an institution-building process in East Asia, given the complexity of regional politics and distrust of major regional powers. As this process of regional cooperation was initiated by small players in East Asia, other states in the region, big or small, were therefore less suspicious of the initiative and more comfortable to get involved, which could hardly have happened if the process had been initiated by either regional powers, China or Japan.<sup>82</sup>

However, it is important to point out that ASEAN only plays a “quasi-leadership role” in the process of regional cooperation through the APT due to the lack of leadership by major powers in East Asia. This role of ASEAN within the framework of the APT is possible simply because such an arrangement has received tacit consent from both China and Japan, which believe that this arrangement serves their respective interests quite well for the moment. If the APT is to be transformed into a true regional institution, it would be very difficult to imagine how ASEAN, given its limited capacity and internal divisions, could provide needed strong leadership that is usually assumed by major powers. This probably explains why it is difficult for the APT to be transformed into an East Asian grouping within its existing framework.<sup>83</sup>

A second important feature of the APT process is that while the APT provides a forum for consultation and cooperation for ASEAN and three Northeast Asian countries, specific dialogues for actual cooperation are conducted largely through three parallel mechanisms of APO forums, that is, ASEAN plus China, ASEAN Plus Japan, and ASEAN Plus South Korea. Understanding that there are still huge constraints in the region that prevent the APT from implementing APT-wide cooperative programs, APT leaders therefore adopt a practical strategy of promoting regional cooperation through the APO to circumvent the obstacles to APT-wide cooperation. As a result, specific cooperative projects are largely pursued between ASEAN and three Northeast Asian powers on a bilateral basis within the framework of the APO. This feature of reliance on bilateral cooperation within the APO framework is well illustrated in the successful conclusion of the China-ASEAN bilateral FTA and the South Korea-ASEAN bilateral FTA and the ongoing process of negotiations on a similar bilateral FTA between Japan and ASEAN.

Although specific cooperation within the APT framework is largely conducted on a bilateral basis through three parallel APO forums, the APT still shows the increasing consciousness of distinctively regional concerns, identities and politico-economic practices and represents East Asia's most unequivocal movement toward regional institutionalized cooperation involving all major economies in the region (with the notable exception of Taiwan).<sup>84</sup> Although no consensus has been reached yet within the APT on how East Asian institution-building is to be achieved, APT leaders do envision the creation of an East Asian FTA as a long-term policy objective.<sup>85</sup> This intention is explicitly expressed in the Chairman's Statement of the Eighth APT Summit, "Strengthening ASEAN Plus Three Cooperation," issued on 29 November 2004, in which the APT agreed to set up an expert group to conduct a feasibility study on the establishment of an East Asia Free Trade Area (EAFTA).<sup>86</sup> On the other hand, however, the efforts to convert the APT into a more institutionalized regional framework of the East Asia Summit (EAS) finally failed due to the insistence of Japan and Indonesia to bring in external members of Australia, New Zealand and India into the EAS (but with noticeable exclusion of the US) in order to balance the rising influence of China. As a result, although the first EAS was duly held in Malaysia in December 2005, it failed to replace the APT as the main vehicle for advancing regional economic cooperation in East Asia.<sup>87</sup>

According to Mark Beeson, the APT is relatively viable largely due to three important reasons. Firstly, different from its policy toward the EAEG, Washington has adopted a far more tolerant attitude to the APT, which might be due to its preoccupation with other parts of the world and a relative general neglect of Asia, or to its judgment that the APT would pose little threat to its vital interests. Secondly, Washington's tacit acceptance of the APT makes it easier for Japan to support the grouping and give additional momentum to the overall process. Thirdly, the APT receives active support from China, which has become increasingly important for regional economic growth.<sup>88</sup>

### **Proliferation of bilateral free trade arrangements in East Asia**

Largely because of the difficulty and complexity of forming a region-wide FTA all at once, East Asian governments seem to be adopting a pragmatic and incremental approach to the issue of regional integration by taking initiatives to negotiate and conclude bilateral FTAs as a first step.<sup>89</sup> As a result, there has been the proliferation of bilateral FTAs in the region over the past several years,<sup>90</sup> some of which have

been concluded and currently in force (see Table 5.5), while others are still under negotiation or study (see Table 5.6).

Particularly significant of these bilateral FTAs are the three parallel free trade initiatives within the APO framework. As the APT is not likely to be transformed into an East Asian FTA any time soon due to the existing constraints as discussed above, the conclusion of FTAs between ASEAN and three Northeast Asian powers – China, Japan and South Korea – separately on the bilateral basis of the APO is seen as a promising alternative strategy, which, it is argued, would not only circumvent the existing major hurdles that prevent the creation of a region-wide FTA in East Asia through the framework of the APT, but would gradually create conditions for a true East Asian FTA to eventually emerge.

**Table 5.5 Bilateral Regional Trade Agreements in East Asia**

RTA Name	Coverage	Date of entry into force
China-Hong Kong	Goods & Services	1 January 2004
China-Macao	Goods & Services	1 January 2004
China-Singapore	Goods & Services	1 January 2009
China-ASEAN <sup>91</sup>	Goods	1 July 2003
China-ASEAN	Services	1 July 2007
Japan-Brunei	Goods & Services	31 July 2008
Japan-Indonesia	Goods & Services	1 July 2008
Japan-Malaysia	Goods & Services	13 July 2006
Japan-Philippines	Goods & Services	11 December 2008
Japan-Singapore	Goods & Services	30 November 2002
Japan-Thailand	Goods & Services	1 November 2007
South Korea-Singapore	Goods & Services	2 March 2006

Source: WTO, RTA database, "List of all RTAs,"

<http://rtais.wto.org/UI/PublicAllRTAList.aspx>, accessed on 17 April 2009.

**Table 5.6 Bilateral Regional Trade Agreements under Negotiation in East Asia**

RTA Name	Launch of Negotiations
Japan-ASEAN	1 April 2005
Japan-South Korea	1 December 2003
Japan-Vietnam	1 January 2007
South Korea-ASEAN*	30 November 2004

Source: WTO, RTA database, "List of early announcements," <http://rtais.wto.org/UI/PublicEARTAList.aspx>, accessed on 17 April 2009.

\*South Korea and ASEAN finally completed a sweeping free trade agreement on 2 June 2009, which covers investment as well as trade in goods and services. AFP (2 June 2009).

It is within this context that China and ASEAN took the first most significant step in moving toward a FTA in East Asia. After three years of negotiation, China and ASEAN formally signed a free trade pack, called the Framework Agreement on Comprehensive Economic Cooperation between China and ASEAN, in Vientiane, Laos on 29 November 2004. According to the agreement, a FTA will be established between China and the five original ASEAN members plus Brunei by 2010 and the remaining ASEAN members will join the FTA by 2015. After the FTA is established, tariffs will be substantially lowered to 0.5% on all commodities (with the exception of a few special commodities) and all non-tariff barriers are removed among the FTA participating economies. At the same time, service trade and investment will also be liberalized and measures of trade and investment facilitation created within the FTA. In addition to the removal of tariff and non-tariff barriers and the measures of trade and investment facilitation, the China-ASEAN FTA will also serve as a framework for overall economic cooperation between the two sides. The whole idea is to establish a comprehensive and close relationship between China and ASEAN, involving a FTA, cooperation in finance, regional development, technological assistance, macro-economic cooperation, and other issues of common concerns.<sup>92</sup>

The decision to create a China-ASEAN FTA not only represents a response of China and ASEAN to the intensifying economic regionalism elsewhere and the impact of the Asian financial crisis, but also reflects the adjustment of their respective policies toward East Asian integration in general and policies toward each other in particular.<sup>93</sup> More importantly, this is obviously a single most significant move in the process of East Asian economic integration in the sense that a free trade arrangement between China and ASEAN has been exerting great pressure on Japan and South Korea, forcing these two economic powers to be more serious on the issue of an East Asian regional grouping. It is within this context that as a response to the initiative of a China-ASEAN FTA in general and China's growing influence in Southeast Asia in particular, Japan first signed a free trade pack with Singapore in early 2002 and very soon moved to conclude a joint declaration with ASEAN on the comprehensive economic partnership during the Phnom Penh Summit in November 2002, which finally led to Japan signing an agreement with ASEAN on 29 November 2004 on the launching of negotiation on a Japan-ASEAN FTA, on a par with the free trade agreement between China and ASEAN. This move obviously deviated from Tokyo's previous policy toward a FTA with ASEAN. In a similar situation, South Korea, in order not to be marginalized in the process of East Asian

regional grouping, also signed an agreement with ASEAN on the starting of negotiation on a free trade pact on the same day of 29 November 2004. After rounds of negotiations, South Korea and ASEAN moved quickly to sign free trade agreements on goods and services on 26 August 2006 and 21 November 2007 respectively. Finally, on 2 June 2009 South Korea and ASEAN signed a free trade pact on investment, which completed a comprehensive free trade agreement, called "South Korea-ASEAN Framework Agreement on Comprehensive Economic Cooperation."<sup>94</sup>

Obviously, the China-ASEAN FTA provides a stimulus to the process of creating an East Asian region-wide FTA, the economic rationality of which is widely recognized.<sup>95</sup> Although no schedule has been set for the formation of an East Asian FTA, the establishment of three parallel FTAs within the structure of the APO, together with other bilateral FTAs in East Asia, will inevitably create favorable conditions for the eventual establishment of a truly East Asian region-wide FTA with expanding bilateral FTAs in the region serving as building blocks. Moreover, expanding FTAs in East Asia have also helped governments achieve their non-economic policy agenda and promoted increased communication among East Asian states through frequent meetings among heads of state and government, trade officials, and other ministers. All this development will undoubtedly provide positive spillover effects on the overall cooperation in the region, contributing to the eventual formation of an East Asian community. No doubt, it is no easy job to have the existing formidable political and other obstacles in East Asia removed. Nevertheless, what is significant is that in the first decade of the 21<sup>st</sup> century the East Asian states have started the process of forming a formal regional economic grouping in East Asia. It seems that a formal East Asian economic grouping is not as unimaginable as it was in the past.

# 6

## Conclusion

Rising regional economic integration in East Asia over the past three decades is part of the new regionalism that has emerged and developed in the world economy since the mid-1980s. However, economic regionalism in East Asia has followed a very different process as compared with that in other areas, particularly in Western Europe and North America. Different from government-engineered and highly institutionalized regionalism in Europe and North America, economic regionalism in East Asia emerged as an autonomous and uninstitutionalized process of rapidly rising intraregional trade and FDI flows, driven primarily by market forces and economic imperatives rather than deliberately planned by the governments in the region. Over time, however, while the economic interdependence of East Asian states continued to deepen through intraregional trade, investment, and other economic and non-economic activities, the autonomous and uninstitutionalized process of East Asian regional economic integration gradually evolved into a process of increasingly institutionalized regional economic cooperation among states in the region over a widening range of regional issues, particularly in the wake of the Asian financial crisis of 1997–98, although a true regional grouping of East Asia is still far from emerging. The evolution of East Asian regional integration from a market-driven autonomous process to growingly institutionalized regional cooperation clearly reflected the efforts of East Asian states to respond actively to the changing conditions at the global, regional and domestic levels.

While major theories of regionalism in the existing literature are primarily constructed to explore institutionalized regional integration, European integration in particular, the analytical approach developed in Chapter 2 of this book could more effectively explain a unique process and pattern of regional integration in East Asia.

East Asian regional integration emerged as an autonomous market-driven process primarily in response to both external and internal imperatives. Externally speaking, there was the changed international political environment as a result of the relative decline of US hegemony and the end of the Cold War by the late 1980s. The fundamental changes in international politics had altered the very foundation of the postwar liberal international economic order. On the one hand, the end of the Cold War and the disappearance of the Soviet threat weakened the political bonds of Western allies, whereas concerns over economic issues increased in importance on national policy agenda. On the other hand, the relative decline of American power seriously undermined US ability and willingness to continue its commitment to a liberal international economic order.<sup>1</sup> Although American power had resurrected by the late 1990s, the US seemed unwilling to pursue multilateralism with the same enthusiasm as in the 1950s–60s. It was within this changed international political environment that there was the emergence, deepening, and expansion of economic regionalism in the world economy after the mid-1980s. Particularly, the rising and deepening regionalism in Western Europe and North America, the two major economic regions in the world, created an imperative sense in East Asia that regionalism were the order of the day and caused great fear among East Asian states of the would-be diversion of trade and investment flows. Of particular importance in this respect was the conversion of the US to regionalism, a power that used to be a key defender of multilateralism throughout the postwar years. As the trend of regionalism in the world economy continued and intensified, those countries that remained outside of any regional bloc might eventually become economically isolated. The psychological and practical effects of this development on East Asia were therefore tremendous. It is in this sense that the emergence and development of regional economic integration in East Asia was a general and defensive reaction to intensifying economic regionalism elsewhere in the world economy.<sup>2</sup>

In the meantime, there was the erosion of norms of multilateralism among major economies and a visible shift in economic thinking toward trade liberalization and market forces. Although major economies were still paying lip service to liberal principles, their economic policies tended to be more and more self-interest-centered. National governments were facing increasingly strong pressures for protectionism, created by domestic industries and groups of organized workers that were hurt by foreign competition. As a result, nation-states were more prone to adopt nationalistic fiscal and monetary policies, pursue highly

competitive export-led growth strategies, attempt to export unemployment to other economies, and safeguard their own industries and social welfare. As most of East Asian economies were highly export-oriented, the erosion of norms of multilateralism and growing protectionism in Europe and North America would inevitably stifle the growth potential of East Asia and therefore forced these economies to adjust their foreign economic policies and practices. Economic regionalism was therefore considered to be an alternative option.

Domestically, as a result of rapid economic growth over three decades, there had been changed economic conditions in East Asian market economies by the mid-1980s as reflected in rising labor shortage, growing labor costs, escalating land prices and strict environmental controls, which in turn caused increasing production costs and a growingly difficult operating environment first in Japan and then in South Korea, Taiwan and Hong Kong. Under such circumstances, there was an imperative for these economies to pursue economic restructuring and move to their respective new levels of sophistication in terms of technology and value-added products, while at the same time relocating their labor-intensive and low-value-added industries to the areas of less expensive land and labor in the region. This development helped promote a process of regional integration through rising intraregional trade and investment flows in East Asia.

While both the external and internal imperatives forced East Asian economies to move toward growing regional economic integration, a formal regional grouping like that in Western Europe and North America failed to emerge in East Asia largely due to some major existing conditions at both regional and national levels that were not conducive to the development of institutionalized regionalism in the East Asian region. There were political, security, historical, ideological and psychological factors that prevented East Asian states from moving toward institutionalized economic regionalism. Most important among those factors were continuing salience of geopolitical and security issues in the region, diversity in ideology and socio-political and economic systems, persistent bitter memories of wartime Japanese atrocities and exploitation, strong nationalist sentiments, unresolved territorial disputes, and worries in the region about a militarily resurgent Japan and a rising and provocative China. Because of the continuing existence of these conditions in the region, true political trust, which was so crucial for the establishment of an institutionalized regional grouping, could hardly be established yet among East Asian states. Consequently, the interaction of both external and internal imperatives and the existing

regional conditions led to a unique pattern of regional economic integration in East Asia that was characterized by non-institutionalization and a commitment to non-discrimination in trade and international economic policy, cooperation in support of the multilateral trading system, and cooperation in the provision of international public goods in the regional and global economy.<sup>3</sup> Table 6.1 provides a summary of how the interactions of various factors at global, regional and national levels as specified in the analytical framework developed in Chapter 2 helped lead to such a unique pattern of soft-open economic regionalism in East Asia.

In the wake of the Asian financial crisis of 1997–98, however, economic regionalism in East Asia gradually moved toward growing institutionalized regional cooperation among East Asian states. Particularly, as the Asian financial crisis unequivocally showed that East Asian economies were not only closely interdependent for common economic fortune but also exposed, vulnerable and even fragile to an economic crisis that originated in a neighboring economy, there was a sea change in attitudes of political and business leaders in East Asia toward the creation of a formal East Asian regional grouping. It is in this sense that the Asian financial crisis created a novel imperative for East Asian states to initiate moves to establish a more institutionalized mechanism for regional cooperation and policy coordination that would be able to deal with a similar crisis in the future and to maintain the economic growth of the region. As such, the Asian financial crisis had significantly transformed the political economy of East Asia by providing the background for increasing institutionalized regional economic cooperation in East Asia.

While East Asian states has taken important steps in the wake of the Asian financial crisis to move toward the creation of a regional grouping in East Asia, a free trade area in particular,<sup>4</sup> some fundamental conditions in the region, especially political conditions, remain largely unchanged. Under such circumstances, successful formation of an East Asian regional grouping would essentially depend on how well the following three major obstacles could be circumvented or even overcome.

The first major obstacle is the political mistrust between the two major regional powers, China and Japan. As is shown in the integration process of Western Europe, cooperation between regional powers is usually the key to a successful regional grouping. It is true that when Western Europe was first set on the track of regional integration, similar political mistrust did exist between France and Germany. However, this Franco-German mistrust was largely subdued in their

Table 6.1 Impact of External and Internal Conditions on Economic Regionalism in East Asia

East Asian Regionalism		
	Hard-closed -----	----- Soft-open
External imperative and connections	<u>Forces pushing toward hard-closed regionalism:</u> <ul style="list-style-type: none"> <li>* Decline of hegemonic power and decreasing willingness of hegemon to uphold multilateralism.</li> <li>* Eroding norms of multilateralism.</li> <li>* Growing competition in the world economy.</li> <li>* Growing protectionism in the world economy.</li> <li>* Growing regionalism in Western Europe, North America and elsewhere.</li> <li>* Negative effects of globalization and international interdependence.</li> </ul>	<u>Forces pushing toward soft-open regionalism:</u> <ul style="list-style-type: none"> <li>* Dependence on external political and military support.</li> <li>* Dependence on outside economic relations.</li> <li>* Positive effects of globalization and international interdependence.</li> </ul>
Internal (regional and national) conditions	<u>Forces pushing toward hard-closed regionalism:</u> <ul style="list-style-type: none"> <li>* Strong sense of mutual economic interests.</li> <li>* High complementary economic structures in the region.</li> <li>* Need for regional cooperation.</li> <li>* Expanding regional ties.</li> <li>* Geographical proximity.</li> <li>* Shared cultural tradition and values.</li> <li>* Rising sense of regional identity and consciousness.</li> </ul>	<u>Forces pushing toward soft-open regionalism:</u> <ul style="list-style-type: none"> <li>* Continuing salience of geopolitical and security issues.</li> <li>* Strong nationalist sentiments.</li> <li>* Political/ideological diversity.</li> </ul>

**Table 6.1** Impact of External and Internal Conditions on Economic Regionalism in East Asia – *continued*

East Asian Regionalism	
Hard-closed -----	Soft-open
<ul style="list-style-type: none"> <li>* Bitter memories of the history</li> <li>* Different policy objectives.</li> <li>* Rivalry between regional powers.</li> <li>* Lack of political trust.</li> <li>* Worries about regional powers.</li> <li>* Weak tradition and experience of regional institution-building.</li> </ul>	Soft-open regionalism
<p>Result of interaction of external and internal conditions</p>	

common concern over an immediate threat to their national security from the Soviet Union at the time in the context of Cold War politics, and was later gradually diluted in the process of Western European integration. When this common security threat disappeared with the end of the Cold War and the breakup of the Soviet Union in the late 1980s and early 1990s, a well-functioning regional mechanism had already been firmly established in Western Europe, tightly binding the two powers in a new cause of defending their common interests in the face of growing economic competition from other regions. By contrast, the mistrust between China and Japan, which has derived from both bitter historical experience and current geopolitics in the region, has long been existent, and more often than not constitutes a top concern in the formulation of respective foreign policies of both powers, especially in the post-Cold War era. As such, it would be a challenging and difficult task for China and Japan to establish political trust between them, the trust that is so essential for an East Asian regional grouping to be formed successfully and to be maintained smoothly thereafter. In a similar fashion, there must also be political trust among all the participants with diversified national interests if a regional grouping is going to be successful. This is because any effective institutionalized regional grouping would inevitably require political commitment of its member states to dilute national sovereignty in favor of broader regional goals, although this commitment could sometimes be weak, as in the case of the EFTA and NAFTA.

A second major obstacle is America's opposition to the formation of a regional grouping in East Asia, in contrast to Washington's strong encouragement of European integration for its geopolitical and strategic considerations at the time.<sup>5</sup> Having a huge economic stake in the dynamic East Asian region, Washington has long been suspicious of any exclusive regional grouping in East Asia that might harm its own economic interests there. As such, the US has always tried to put economic relations in East Asia within the framework of APEC, through which US influence over economic affairs in the region could be best secured and maximized. Washington's strong opposition to Asia's proposal for creation of the Asian Monetary Fund (AMF) is an indication of Washington's attitude toward the issue of an Asian economic grouping.<sup>6</sup> As the US still has profound influence on political, security and economic matters in the region, East Asian states had to compromise Washington's opposition should a regional grouping be successfully formed.

Even regional and international political factors aside, East Asian states are less experienced in multilateral negotiations on regional

institution-building, contrary to Western Europe that has historically had comprehensive experience in institution-building in various areas. As institutionalized regional cooperation requires surrender of part of national sovereignty, which is politically very sensitive everywhere, functionalist institution-building skills with spillover mechanism in full play are highly crucial for a regional grouping to be successful. In this respect, politicians in East Asia particularly lack skills of effective bargaining and compromise in multilateral negotiations, as the political culture in oriental societies is traditionally prone to consensus rather than bargaining and compromise.

On the other hand, however, there are also favorable conditions and strong forces in the context of the Asian financial crisis that might help circumvent or even overcome the above-mentioned obstacles, pushing forward the formation of a regional grouping in East Asia.

In the first place, political relations in East Asia, although sometimes strained (particularly between Japan and its two neighbors, China and South Korea), are well managed by regional political leaders, who are generally quite rational. As all the states in the region have an immense stake in maintaining a stable and peaceful regional environment for economic growth and prosperity, the states in East Asia have been making persistent and arduous efforts in improving their mutual understanding and political relations. This is well explained by the very fact that despite the lack of true political trust in the region, regional leaders have maintained multiple bilateral and multilateral dialogue channels for discussion, consultation and cooperation. Particularly, the political leaders in the region have deliberately been making efforts to prevent their disagreements in the political area from affecting their policy coordination and cooperation in economic and other low politics areas.

Secondly, by the first decade of the 21<sup>st</sup> century, growing economic regionalism in the world economy has created a very important external imperative for East Asian states. The vast majority of WTO members are affiliated with one or more regional preferential trade agreements. Consequently, about 97% of total global trade involves countries that are members of at least one regional trade arrangement, compared with 72% in 1990.<sup>7</sup> Particularly, of the three global economic centers, East Asia is the only region that is not yet formally organized into a grouping of any form, while Western Europe has been entrenched in the EU and North America has been formed into NAFTA. What makes East Asia even more worrisome is the expansion of the EU to involve Eastern European countries and the prospect of the enlargement of NAFTA to involve Latin

**Table 6.2 Balance Sheet for FTAs Involving South Korea, Japan, and China: GDP Growth (%) and Economic Gains (\$ million)**

	South Korea-China-Japan FTA		South Korea-China FTA		South Korea-Japan FTA		China-Japan FTA	
	GDP growth	Economic gains	GDP growth	Economic gains	GDP growth	Economic gains	GDP growth	Economic gains
South Korea	3.2	12,644.5	2.4	10,687.8	1.1	3,682.8	-0.2	-1,189.6
China	1.3	8,191.2	0.2	917.0	0.0	-358.0	1.1	7,335.3
Japan	0.2	12,265.1	0.0	119.9	0.0	2,184.7	0.2*	10,289.8

Source: Cai, *The Political Economy of East Asia*, Table 8.5, p.212.

\*This estimated figure was obtained in early 2002. The Economic and Social Research Institute of the Japanese Cabinet raised this figure to 0.5% in early 2005. See the earlier discussion of this section.

America. Given the heavy dependence of East Asian economies on these two major markets and their outward-oriented development strategies, the intensifying regionalism in Europe and North America is causing increasing fear among East Asian states of the diversion of trade and investment flows. On the other hand, an East Asian regional FTA could bring substantial benefits to all the parties involved, as is shown in Table 6.2.<sup>8</sup> Moreover, the EU and NAFTA not only form themselves into increasingly closed markets but could also come to the bargaining table in multilateral trade negotiations as blocs. This leaves East Asian states frequently in a much weaker bargaining position in multilateral trade negotiations as individual negotiators. All this brings an unorganized East Asia a strong sense of exclusion and isolation in global economic competition and multilateral negotiations. It is under such circumstances that East Asian states have become more serious about pursuing an East Asian regional grouping in the wake of the Asian financial crisis.

Thirdly, the immature financial liberalization that the IMF and Washington pushed hard on East Asian states in the early 1990s is now widely believed as precipitating the Asian financial crisis of 1997–98.<sup>9</sup> As globalization proceeded, many forms of international capital flows rose dramatically, including FDI, portfolio investment through country funds, bank loans, bond lending, derivations (swaps, options, forward transactions, etc.), reinsurance, and other financial instruments. These unfettered financial flows from advanced to emerging markets finally brought profound destabilization in East Asia, causing a region-wide financial crisis. Once the Asian financial crisis set in, the IMF quickly interpreted it as a traditional balance of payments crisis brought about by government fiscal excesses and therefore suggested policy prescriptions that involved the conventional remedies of fiscal and monetary contraction and high interest rates. Furthermore, to cope with the fundamental structural causes of the crisis, which the IMF ascribed to the Asian model, it recommended further financial liberalization together with far reaching changes in basic social institutions.<sup>10</sup> All these Washington-backed IMF policy prescriptions, which were required under IMF rescue package, caused catastrophic economic and social consequences in the crisis-hit countries (although some of these policies were later modified somewhat after the serious negative consequences of the IMF's prescriptions were growingly revealed and criticism of the IMF was mounting). These Western-enforced, particularly US-enforced, policies together with Washington's strong opposition to the creation of the AMF, which was proposed in the early stage of the crisis by East Asian countries to help bail out the crisis-hit economies and stop the further

spread of the crisis, strengthened what Richard Higgott calls the region's "resentment" of US dominance and therefore increased willingness of East Asian countries to explore regional cooperative relationships that would help to weaken this US dominance in the political economy of the region.<sup>11</sup>

Fourthly, in the current round of efforts to form a formal regional grouping, regional leaders seem to be more pragmatic and creative in pursuing their objective. Both government and business leaders seem to be adopting a pragmatic strategy that is based on the approaches of functionalism and incrementalism. As political issues are still highly sensitive in East Asia, East Asian leaders have started the process of regional grouping in the economic sphere, avoiding sensitive political issues at this initial stage. By this, East Asian states have obviously followed the APEC formula, under which political issues are put aside so that political rivals, such as China and Taiwan, can be involved in the same venture. In a similar fashion, this APEC formula may also enable China and Japan to cooperate on regional economic and other functional issues while keeping their disagreements on political issues for the time being. This is precisely the approach that has been adopted within the framework of the tripartite summit among China, Japan and South Korea, which is conducted in an informal way with the discussion being purely confined to economic cooperation. Obviously, this pragmatic strategy will likely increase the chance of success in the eventual formation of a formal regional economic grouping in East Asia. Equally significant, it seems to be an effective strategy to start with bilateral FTAs first and then gradually transform them into a region-wide free trade grouping, involving all East Asian economies. This strategy would likely work because it is relatively easier to conclude a bilateral FTA than a multilateral one. Furthermore, once a trilateral FTA is formed among China, Japan and South Korea, it would be possible to bring in Taiwan and Hong Kong on the basis of the model of APEC and the WTO, which has well accommodated the membership of the three Chinese constituencies.

Finally, understanding that the official process of creating a regional grouping is usually quite slow, involving lengthy bargains and negotiations, the regional business community has started rolling the ball to find out those areas that are mutually beneficial for cooperation rather than passively wait until their governments have everything settled. By taking their own initiatives, the business community is therefore helping create a more favorable environment for their governments to speed up the process of regional institution-building.

Undoubtedly, given the existing conditions in the region, there will still be a long way to go if East Asian states could eventually be formed into a formal regional grouping. This said, however, if an East Asian grouping eventually emerges, it will truly become a third unified pole in the world economy, inevitably bringing significant impact on the global political economy as well as major policy implications for the region and the world at large.

In the first place, the formation of an East Asian economic grouping would reconfigure the balance of economic power in the world economy. Particularly, it would help East Asian states acquire a strengthened bargaining position *vis-à-vis* Washington and Western Europe on various economic issues.

Secondly, if an East Asian grouping in the form of the EFTA were to become reality, the result would be the emergence of a tripolar world trading system, which would exert a great challenge to the existing global trade regime embodied in the WTO. This development would bring substantial implications on nation-states' trade policy in general and WTO policy in particular.

Thirdly, if the economic integration in East Asia were to lead to the eventual formation of a true East Asian community, it would bring significant geopolitical implications for the Asia-Pacific and beyond. Particularly, the establishment of an East Asian grouping would inevitably complicate US-East Asia overall relationship, thus bringing implications on Washington's East Asia policy.

Fourthly, as the US has economic disputes with almost all major states in East Asia, an East Asian grouping that involves all these states would make these disputes even more vocal, particularly when an East Asian FTA would bring immediate trade diversion effects on American exports. According to C. Fred Bergsten, the US would immediately lose at least \$25 billion of annual exports from the discriminatory impact of an East Asian FTA.<sup>12</sup>

Finally, while APEC as a pan-Pacific organization is already highly divided between its Anglo-American members and East Asian members with respect to the future direction of the organization, the establishment of an East Asian economic grouping would further divide and marginalize APEC, directly challenging the efficacy of the APEC policy on both sides of the Pacific.

# Notes

## Chapter 1 Introduction

- 1 C. M. Dent, *East Asian Regionalism* (London and New York: Routledge, 2008), p.7.
- 2 N. D. Palmer, *The New Regionalism in Asia and the Pacific* (Lexington, MA: Lexington Books, 1991), p.12.
- 3 F. Soderbaum, "African Regionalism and EU-African Interregionalism," in Mario Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), p.187. For more discussion of "old" and "new" regionalism, also see B. Hettne, "Beyond the 'New' Regionalism," *New Political Economy*, vol.10, no.4 (December 2005) 543–71; J. Wunderlich, *Regionalism, Globalisation and International Order: Europe and Southeast Asia* (Aldershot, Hampshire and Burlington, VT: Ashgate, 2007).
- 4 B. M. Russett, *International Regions and International System: A Study in Political Ecology* (Chicago, IL: Rand McNally & Company, 1967), p.11.
- 5 K. G. Cai, *The Political Economy of East Asia: Regional and National Dimensions* (Basingstoke and New York: Palgrave Macmillan, 2008), pp.2–3.

## Chapter 2 Theoretical Perspectives: Constructing an Analytical Framework

- 1 A similar approach is implied in the analysis of regionalism by Mario Telo in his edited volume. See M. Telo, "Introduction: Globalization, New Regionalism and the Role of the European Union," in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), pp.1–18.
- 2 D. Mitrany, *A Working Peace System* (Chicago: Quadrangle, 1966).
- 3 C. C. Pentland, "Integration, Interdependence, and Institutions: Approaches to International Order," in D. G. Haglund and M. K. Hawes (eds), *World Politics: Power, Interdependence & Dependence* (Toronto: Harcourt Brace Jovanovich Canada, Inc., 1990), pp.181–2.
- 4 The notions of high politics and low politics were first given by Stanley Hoffmann in 1963: *high politics* refers to issues of war and peace in world politics, while low politics implies economic and welfare issues in international relations. S. Hoffmann, "Discord in Community: The North Atlantic Area as a Partial International System," *International Organization*, vol.17, no.3 (1963) 521–49.
- 5 *Ibid.*, p.182.
- 6 E. B. Haas, *The Obsolescence of Regional Integration Theory* (Berkeley, CA: Institute of International Studies, University of California, 1975), pp.9–11.

- 7 See J. S. Nye, *Peace in Parts: Integration and Conflict in Regional Organization* (Boston: Little, Brown, 1971).
- 8 *Ibid.*, p.64.
- 9 *Ibid.*, p.190.
- 10 *Ibid.*, pp.89–90.
- 11 *Ibid.*, pp.84–5.
- 12 In fact, Nye himself is identified as a neofunctionalist by many authors. See, for example, J. E. Dougherty and R. L. Pfaltzgraff, *Contending Theories of International Relations: A Comprehensive Survey* (New York: Harper & Row, 1990), pp.442–6.
- 13 J. Viner, *The Customs Union Issue* (New York: Carnegie Endowment for International Peace, 1950). This book has now become a classical work of customs union theory. For more discussions of the development of the customs union theory, see the survey articles by R. G. Lipsey, "The Theory of Customs Unions: A General Survey," *Economic Journal*, no.70 (1960) 496–513; M. B. Krauss, "Recent Developments in Customs Union Theory: An Interpretive Survey," *Journal of Economic Literature*, vol.10, nos.1–2 (1972) 413–36; A. Hazlewood, "Customs Unions," entry in *The New Palgrave: A Dictionary of Economics* (New York: Stockton Press, 1987), pp.743–4; and F. R. Gunter, "Customs Union Theory: Retrospect and Prospect," in D. Greenaway, T. Hyclak and R. J. Thornton (eds), *Economic Aspects of Regional Trading Arrangements* (New York: Harvester Wheatsheaf, 1989), pp.1–30.
- 14 F. Gehrels, "Customs Union from a Single Country Viewpoint," *The Review of Economic Studies*, vol. 24 (1956) 61–4.
- 15 R. G. Lipsey, "The Theory of Customs Unions: Trade Diversion and Welfare," *Economica*, N.S., vol.24, no.93 (1957) 44–6.
- 16 P. Collier, "The Welfare Effects of Customs Unions: An Anatomy," *Economic Journal*, vol.89 (1979) 84–5.
- 17 Lipsey, "The Theory of Customs Unions: A General Survey."
- 18 Krauss, "Recent Developments in Customs Union Theory," 413. This survey article largely summarizes this shift in research emphasis.
- 19 C. A. Cooper and B. F. Massell, "Toward a General Theory of Customs Unions for Developing Countries," *Journal of Political Economy*, vol.73 (1965) 461–76; and "A New Look at Customs Unions Theory," *Economic Journal*, vol.75 (1965) 742–7.
- 20 H. G. Johnson, "An Economic Theory of Protectionism, Tariff Bargaining and the Formation of Customs Unions," *Journal of Political Economy*, vol.73 (1965) 256–83.
- 21 Krauss, "Recent Developments in Customs Union Theory."
- 22 G. Floystad, "Non Discriminating Tariffs, Custom Unions, and Free Trade," *Kyklos*, vol.28 (1975) 641–4.
- 23 R. Dauphin, *The Impact of Free Trade in Canada* (Ottawa: Economic Council of Canada, 1978).
- 24 E. Berglas, "Preferential Trading Theory: The n Commodity Case," *Journal of Political Economy*, vol.87 (1979) 315–31.
- 25 This argument was frequently used for British membership of the EEC prior to 1973.
- 26 However, early researchers in the field of customs union theory assumed that the economies-of-scale effects of customs union formation were small

- enough to be ignored. This led some writers to claim the simple-mindedness of the economies-of-scale argument. For detailed discussion on this issue, see Gunter, "Customs Union Theory: Retrospect and Prospect," pp.16–19.
- 27 Cooper and Massell, "Toward a General Theory of Customs Unions for Developing Countries," and "A New Look at Customs Unions Theory."
  - 28 For more discussion on this issue, see Gunter, "Customs Union Theory: Retrospect and Prospect," p.7.
  - 29 Cooper and Massell, "A New Look at Customs Union Theory."
  - 30 A. O. Hirschman, "Three Uses of Political Economy in Analyzing European Integration," in A. O. Hirschman, *Essays in Trespassing* (Cambridge: Cambridge University Press, 1981), pp.266–84.
  - 31 M. Marrese and J. Vanous, *Soviet Subsidization of Trade with Eastern Europe* (Berkeley, CA: Institute of International Studies, 1983).
  - 32 For a comprehensive treatment of the theoretical aspects of economic nationalism, see M. A. Heilperin, *Studies in Economic Nationalism* (Geneva: Publications of the Graduate Institute of International Studies, 1962); for a discussion of the contending explanations of economic nationalism, see A. D. Smith, *Theories of Nationalism*, 2<sup>nd</sup> edition (New York: Holmes & Meier, 1983); also see P. L. Burnell, *Economic Nationalism in the Third World* (Brighton, Sussex: Wheatsheaf Books Ltd., 1986), pp.16 and 26; R. Gilpin, *The Political Economy of International Relations* (Princeton, NJ: Princeton University Press, 1987), p.31.
  - 33 O. Hieronymi, "The New Economic Nationalism," in O. Hieronymi (ed.), *The New Economic Nationalism* (London: Macmillan, 1980), p.12.
  - 34 Rappard defines economic nationalism as the policy of national self-sufficiency; Dernberger defines it as a policy that "stresses the creation of an independent economy." Both are quoted from Burnell, *Economic Nationalism in the Third World*, p.51, note 27.
  - 35 Hieronymi identifies economic nationalism as a complex phenomenon, which includes dumping, export subsidies and various forms of "beggar-my-neighbour" policies. Hieronymi, "The New Economic Nationalism," p.2.
  - 36 Benjamin Cohen distinguishes "malign nationalism," the pursuit of national self-interest even at the risk of provoking instability in the international economic system, from "benign nationalism" that accepts and upholds the linkage between national interest and international stability, even though national priorities might have to be compromised. See B. J. Cohen, "United States Monetary Policy and Economic Nationalism," in O. Hieronymi (ed.), *The New Economic Nationalism* (London: Macmillan, 1980), p.52. Gilpin also uses the same terminology, see Gilpin, *The Political Economy of International Relations*, p.32.
  - 37 See H. G. Johnson, "Mercantilism: Past, Present, Future," in H. G. Johnson (ed.), *The New Mercantilism: Some Problems in International Trade, Money and Investment* (Oxford: Basil Blackwell, 1974), pp.3–4; also G. Macesich, *Economic Nationalism and Stability* (New York: Praeger, 1985), p.28.
  - 38 Thomas Mun, a director of the East India Trading Company and one of the best-known 17<sup>th</sup>-century English mercantilist authors, explained the significance of the balance of payments in his *England's Treasure by Foreign Trade* (Garden City, NY: Doubleday, 1953). For discussions of mercantilism,

- see also L. L. Snyder, *The Meaning of Nationalism* (New Brunswick, NY: Rutgers University Press, 1954), p.138.
- 39 Snyder, *The Meaning of Nationalism*, p.139.
- 40 D. Seers, *The Political Economy of Nationalism* (Oxford: Oxford University Press, 1983), p.52; H. G. Johnson (ed.), *Economic Nationalism in Old and New States* (Chicago: The University of Chicago Press, 1967).
- 41 Burnell identifies a closed economy as the extreme form of economic independence and autarky and self-sufficiency as less extreme, see Burnell, *Economic Nationalism in the Third World*, pp.35–9.
- 42 According to Johnson, the pursuit of protectionist aims through the formation of supranational trading blocs is one of the emerging characteristics of contemporary mercantilism. See Johnson, “Mercantilism: Past, Present, Future,” pp.14–15.
- 43 The leading works of classical liberalism include: Adam Smith (*Wealth of Nations*, 1776), Herbert Spencer (*The Man Versus the State*, 1892), Friedrich A. Hayek (*Constitution of Liberty*, 1960), Ludwig von Mises (*Liberalism: A Socio-Economic Exposition*, 1962), and Milton Friedman (*Capitalism and Freedom*, 1960).
- 44 Among the leading works within neoliberalism are: Jeremy Bentham (*The Principles of Morals and Legislation*, 1848), John Stuart Mill (*Principles of Political Economy with Some Social Applications*, 1848), T. H. Green (*Lectures on the Principles of Political Obligation*, 1895), Alfred Marshall (*Principles of Economics*, 1890), John Dewey (*Liberalism and Social Action*, 1935), and John Maynard Keynes (*Essays in Persuasion*, 1931).
- 45 R. N. Cooper, *The Economics of Interdependence; Economic Policy in the Atlantic Community* (New York: McGraw Hill, 1968, published for the Council on Foreign Relations).
- 46 R. O. Keohane and J. S. Nye, *Power and Interdependence*, 2<sup>nd</sup> edition (Glenview, IL; Boston; London: Scott, Foresman and Company, 1989), pp.24–9.
- 47 K. N. Waltz, *Theory of International Politics* (New York: McGraw-Hill, Inc., 1979), p.144.
- 48 Gilpin, *The Political Economy of International Relations*, p.31.
- 49 C. P. Kindleberger, “Dominance and Leadership in the International Economy: Exploitation, Public Goods, and Free Rides,” *International Studies Quarterly*, vol.25 (1981) 243.
- 50 R. Jervis, “Security Regimes,” *International Organization*, vol.36 (1982) 357–78.
- 51 Gilpin, *The Political Economy of International Relations*, p.74.
- 52 The theory of hegemonic stability was initially developed by Charles P. Kindleberger, see C. P. Kindleberger, *The World in Depression, 1929–1939* (Berkeley, CA: University of California Press, 1973 and 1986). Other works on the theory of hegemonic stability include: R. Gilpin, *U.S. Power and the Multinational Corporation: The Political Economy of Foreign Direct Investment* (New York: Basic Books, 1975) and *The Political Economy of International Relations*, pp.72–80; S. D. Krasner, “State Power and the Structure of International Trade,” *World Politics*, vol.28, no.3 (1976), 317–47; R. O. Keohane, “The Theory of Hegemonic Stability and Changes in International Economic Regimes, 1967–1977,” in O. R. Holsti, R. M. Siverson and A. L. George (eds), *Change in the International System* (Boulder, CO: Westview Press, Inc., 1980), pp.131–62; R. O. Keohane, *After Hegemony: Cooperation and Discord in the*

- World Political Economy* (Princeton, NJ: Princeton University Press, 1984 and 2004 with a new Preface); M. Olson, *The Rise and Decline of Nations* (New Haven and London: Yale University Press, 1982); A. A. Stein, "The Hegemons Dilemma: Great Britain, the United States, and the International Economic Order," *International Organization*, vol.38, no.2 (1984) 355–86; S. Strange, "The Persistent Myth of Lost Hegemony," *International Organization*, vol.41, no.4 (1987) 551–74.
- 53 B. Frey, *International Political Economics* (New York: Basil Blackwell, 1984), ch.7.
- 54 D. Snidal, "The Limits of Hegemonic Stability Theory," *International Organization*, vol.39, no.4 (1985) 579–614.
- 55 P. J. Katzenstein, "International Relations and Domestic Structures: Foreign Economic Policies of Advanced Industrial States," *International Organization*, vol.30, no.1 (1976) 1–45; J. G. Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization*, vol.36, no.2 (1982) 379–415.
- 56 Keohane, *After Hegemony*, pp.44–5.
- 57 N. Frohlich, J. A. Oppenheimer and O. R. Young, *Political Leadership and Collective Goods* (Princeton, NJ: Princeton University Press, 1971).
- 58 Gilpin, *The Political Economy of International Relations*, p.73.
- 59 Gilpin, *ibid.*; for detailed discussion of these conditions, see R. Gilpin, *War & Change in World Politics* (Cambridge and New York: Cambridge University Press, 1981), ch.3.
- 60 S. D. Krasner, "Structural Causes and Regime Consequences: Regimes as Intervening Variables," in S. D. Krasner (ed.), *International Regimes* (Ithaca, NY: Cornell University Press, 1983), p.2.
- 61 R. O. Keohane, "The Demand for International Regime," *International Organization*, vol.36, no.2 (1982) 354.
- 62 Gilpin, *The Political Economy of International Relations*, p.75.
- 63 *Ibid.*, p.73.
- 64 C. P. Kindleberger, *Economic Response: Comparative Studies in Trade, Finance, and Growth* (Cambridge, MA: Harvard University Press, 1978), ch.3.
- 65 For a discussion of the forces that cause the decline of a hegemon, see Gilpin, *The Political Economy of International Relations*, pp.77–8. In so far as liberal conditions are viewed as contributing to the erosion of the primacy of the hegemon in the postwar system, some theorists, liberal and others, note that liberal orders tend to self-destruct. These arguments are reviewed in D. Sylvan, "The Newest Mercantilism," *International Organization*, vol.35, no.2 (1981) 375–9.
- 66 Krasner, "State Power and the Structure of International Trade," 342–3.
- 67 Keohane, *After Hegemony*, p.58.
- 68 E. B. Haas, "Why Collaborate? Issue-Linkage and International Regimes," *World Politics*, vol.32 (1980) 357–405.
- 69 Gilpin, *The Political Economy of International Relations*, p.79.
- 70 See S. Kuznets, *Economic Growth of Nations: Total Output and Production Structure* (Cambridge, MA: The Belknap Press of Harvard University, 1971).
- 71 Gilpin, *The Political Economy of International Relations*, p.34.
- 72 V. I. Lenin, *The Development of Capitalism in Russia: The Process of the Formation of a Home Market for Large-scale Industry* (Moscow: Foreign Language Publishing Housing, 1956).

- 73 P. A. Baran, *The Political Economy of Growth* (New York: Monthly Review Press, 1957).
- 74 R. Prebisch, "Commercial Policy in the Underdeveloped Countries," *American Economic Review*, vol.49 (May 1959) 251–73.
- 75 The world system theory is primarily related to the works of Immanuel Wallerstein, including, *The Modern World-System: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century* (New York: Academic Press, 1974), *The Capitalist World Economy* (Cambridge: Cambridge University Press, 1979), and *The Modern World System II: Mercantilism and the Consolidation of the European World Economy, 1600–1750* (New York: Academic Press, 1980).
- 76 Gilpin, *U.S. Power and the Multinational Corporation*, p.43.
- 77 B. J. Cohen, "The Political Economy of International Trade," *International Organization*, vol.44, no.2 (1990) 274.
- 78 R. Gilpin, "Three Models of the Future," *International Organization*, vol.29, no.1 (1975) 37.
- 79 C. F. Bergsten, R. O. Keohane and J. S. Nye, "International Economics and International Politics: A Framework for Analysis," *International Organization*, vol.29, no.1 (1975) 19–20.
- 80 As a matter of fact, Gilpin envisages the emergence of a "mixed" regime combining multilateralism with elements of economic nationalism and regionalism. See Gilpin, *The Political Economy of International Relations*, p.408.
- 81 K. N. Waltz, *Man, the State and War* (New York: Columbia University Press, 1959).
- 82 However, Gilpin's analysis is based on a line of reasoning that is different from that developed in this chapter. See Gilpin, *War & Change in World Politics*, pp.149–52.
- 83 For a systematic discussion of new regionalism since the mid-1980s, see Chapter 4.
- 84 Some scholars distinguish regionalism from regionalization. While "regionalism" is seen as the result of government policy initiatives, such a free trade agreement or other state-led projects of economic cooperation and integration that originate from inter-governmental dialogues and treaties, "regionalization" refers to a micro-level process of growing exchanges among private sectors and individuals in a region. See, for example, Dent, *East Asian Regionalism*, p.7.
- 85 Nondiscrimination is one of the two basic elements of postwar international liberalism. Another basic element is the liberalization of payments.
- 86 For a discussion on controversy over the definition of regionalism, see E. D. Mansfield and H. V. Milner, "The New Wave of Regionalism," *International Organization*, vol.53, no.3 (1999) 590–2.
- 87 Depending on the degree of institutionalization, hard-closed regionalism may cover a multitude of negotiated preferential trading arrangements, including sectoral cooperation, free trade areas, customs unions, common markets, and economic and political unions.
- 88 For studies of soft and open regionalism, see, for example, A. Elek, "Trade Policy Options for the Asia Pacific Region in the 1990s: the Potential of Open Regionalism," *American Economic Review*, vol.82, no.2 (1992) 74–8;

- P. J. Katzenstein, "Introduction: Asian Regionalism in Comparative Perspective," in P. J. Katzenstein and T. Shiraishi (eds), *Network Power: Japan and Asia* (Ithaca, NY: Cornell University Press, 1997) pp.1–44; S-J Wei and J. A. Frankel, "Open versus Closed Trade Blocs," in T. Ito and A. O. Krueger (eds), *Regionalism versus Multilateral Trade Arrangements* (Chicago: The University of Chicago Press, 1997), pp.119–39; and I. Yamazawa, "On Pacific Economic Integration," *The Economic Journal*, vol.102 (1992) 1519–29.
- 89 Non-tariff barriers range from customs valuation procedures to the application of national safety and health standards to imports.
- 90 For a discussion on dispute-settlement mechanisms, see B. V. Yarbrough and R. M. Yarbrough, "Dispute Settlement in International Trade: Regionalism and Procedural Coordination," in E. D. Mansfield and H. V. Milner (eds), *The Political Economy of Regionalism* (New York: Columbia University Press, 1997), pp.134–63.
- 91 The essence of market forces is profit-maximization for business, or "invisible hand" as termed by Adam Smith (1723–90). Because of the principle of profit-maximization, the individual enterprise intends only its own gains by conducting its corporate behavior in conformity with the changing conditions of market, as evidenced by production costs. In the world economy, the changes in market conditions are generally brought about by changes in comparative advantage among economies, thus resulting in growing production costs in some economies. This would inevitably drive private economic activities in these economies across national boundaries to areas of low production costs to maintain gains. This process is supported by those national governments that pursue a national strategy of restructuring domestic economy so as to make national economy strategically competitive in the world market. On the contrary, if the national government, in the face of changed comparative advantage, is unable to conduct restructuring of domestic economy and attempts to maintain man-made "favorable domestic market conditions" for business, it would inevitably resort to protectionism.
- 92 However, this view, mostly held by American scholars, may not be widely shared by European and Japanese scholars.
- 93 As Jagdish Bhagwati aptly points out, "GATT's (unconditional) MFN is universal only for its members, so it falls short of total universalism. But the important point to remember is that the GATT is open to membership to all who meet the criteria for admission and has generally been inclusive rather than exclusive." J. Bhagwati, "Regionalism and Multilateralism: An Overview," in J. de Melo and A. Panagariya (eds), *New Dimensions in Regional Integration* (Cambridge and New York: Cambridge University Press, 1993), p.46, note 2.
- 94 Bhagwati identifies the abortive first regionalism in the 1960s and the more promising second regionalism that emerged in the 1980s. Bhagwati, "Regionalism and Multilateralism: An Overview," pp.22–51.
- 95 Two types of international interdependence can be identified, namely, *positive* and *negative*. *Positive international interdependence* implies that the nations involved in economic interdependence basically benefit from such a relationship. By contrast, *negative international interdependence* implies that some economies are in a very unfavorable position in the world division of

labor. That is to say, such an international economic relationship brings more damaging effects than benefits to these economies.

- 96 The discussion of the four assumptions here fits with Mario Bunge's concept of "systemism." See M. Bunge, *Finding Philosophy in Social Science* (New Haven: Yale University Press, 1996), pp.264–81.
- 97 Nye expresses a similar idea by using the term of "demonstration effects," (Nye, *Peace in Parts: Integration and Conflict in Regional Organization*, p.84) whereas Mansfield and Milner use the term "contagion" effects. (Mansfield and Milner, "The New Wave of Regionalism," p.615) Also see the discussion of the so-called "domino theory" in this respect by Telo in his "Introduction: Globalization, New Regionalism and the Role of the European Union," p.5.
- 98 Keohane and Nye, *Power and Interdependence*, pp.16–18.
- 99 See, for example, R. Gilpin, *U.S. Power and Multilateral Corporations, The Political Economy of International Relations*, and *Global Political Economy: Understanding the International Economic Order* (Princeton, NJ: Princeton University Press, 2001); Kindleberger, *The World in Depression, 1929–1939*; and Krasner, "State Power and the Structure of International Trade."
- 100 The concept of complex interdependence as advanced by Keohane and Nye can be viewed as such kind of positive interdependence. Keohane and Nye, *Power and Interdependence*, pp.23–37. The essence of this concept is that economic intercourse is a source of peaceful relations among nations because the mutual benefits of expanding economic interdependence among nations will tend to foster cooperative relations.
- 101 For example, of all the variables identified here, global hegemonic power seems to be the single most important one. This view is particularly expressed by the theory of hegemonic stability. See Keohane, *After Hegemony*, pp.31–46.
- 102 See, for example, K. G. Cai, "The Political Economy of Economic Regionalism in Northeast Asia: A Unique and Dynamic Pattern," *East Asia: An International Quarterly*, vol.17, no.2 (1999) 6–46; Katzenstein, "Introduction: Asian Regionalism in Comparative Perspective"; and J. J. Nogués and R. Quintanilla, "Latin America's Integration and the Multilateral Trading system," in J. de Melo and A. Panagariya (eds), *New Dimensions in Regional Integration* (Cambridge and New York: Cambridge University Press, 1993), p.285.

### Chapter 3 The Evolution of the Global Economic Order since 1945

- 1 We assume here that the decision-makers are able to identify what are the true national interests for their respective nation-states, although different social groups within nation-states might have different views on their national-interests.
- 2 Gilpin, "Three Models of the Future," p.37.
- 3 The Cold War was initially signaled in Winston Churchill's famous "iron curtain" speech at Fulton, Missouri on 5 March 1946 and then took definite shape successively in Iran, Turkey, Greece, Czechoslovakia, Berlin and Yugoslavia, and in the Marshall Plan and the Comecon. For a summary discussion on the origins and causes of the Cold War, see R. J. Lieber, *No Common Power: Understanding International Relations*, 2<sup>nd</sup> edition (New York:

- HarperCollins Publishers, 1991), pp.33–58; also see R. J. Bresler, “The Origins and Development of the Cold War, 1945–58,” in R. Barston (ed.), *International Politics Since 1945: Key Issues in the Making of the Modern World* (Aldershot, England: Edward Elgar Publishing Limited, 1991), pp.1–18.
- 4 See R. Jervis, “The Impact of the Korean War on the Cold War,” *Journal of Conflict Resolution*, vol.24 (December 1980) 563–92.
  - 5 In the initial years of the Cold War, the US was concerned about stabilizing the economies and political systems of Western European countries so as to avoid upheaval and revolution there. The Truman Doctrine and the Marshall Plan made this quite clear. The EROA reflected similar concerns of the US over Japan.
  - 6 Despite this general consensus, however, the specific process of establishing, defining and maintaining the liberal order was not without conflict between the United States on the one hand and its allies on the other, for none of them could escape the temptation of maximizing benefits and minimizing costs from whatever system was established.
  - 7 “Opportunity cost” refers to the cost of sacrifice of an alternative action.
  - 8 These views are found in W. Heinrichs, *Threshold of War: Franklin D. Roosevelt and American Entry into World War II* (New York: Oxford University Press, 1988); J. Gaddis, *Strategies of Containment* (New York: Oxford University Press, 1982); and J. Gaddis, *The Long Peace* (New York: Oxford University Press, 1987). Quoted in T. D. Lairson and D. Skidmore, *International Political Economy: The Struggle for Power and Wealth* (Fort Worth, TX: Holt, Rinehart and Winston, Inc., 1993), p.73.
  - 9 See the discussion by J. Culbert, “War-time Anglo-American Talks and the Making of the GATT,” *The World Economy*, vol.10 (1987) 381–408.
  - 10 J. Morse, “The Dollar as a Reserve Currency,” *International Affairs*, vol.55, no.3 (July 1979) 359–66.
  - 11 Keynes had originally proposed a scheme which would have had the effect of giving all states an equal stake in the maintenance of monetary order. At the same time, it was designed to give them maximum individual freedom to pursue their own national economic and welfare policies. Clearly, this scheme favored Britain and other countries which were short of reserves and heavily dependent on world trade, at the expense of the United States and countries whose economies depended primarily on the home market. Obviously, such a scheme had no chance of securing the support of the US.
  - 12 Considering the huge task of rebuilding the war-shattered economies of Europe, the US permitted Western European countries to temporarily control their foreign reserves and adopt discriminatory trade practices against US goods while their economies recovered. However, Western European countries were committed to a timetable for liberalizing their trading relations and external payments, which was also a condition of their receiving Marshall Plan aid.
  - 13 GATT was originally considered as a provisional agency that would go out of existence on the establishment of the International Trade Organization (ITO). The ITO Charter was agreed at a UN conference in Havana in March 1948. However, in 1950, when the Havana Charter failed to be presented for US Congressional ratification, the ITO was effectively dead and GATT

became the principal instrument for commercial policy and international trade regulation.

- 14 The five GATT rounds before the Kennedy Round include: Geneva, 1947; Annecy, 1949; Torquay, 1950–51; Geneva, 1955–56; Geneva (Dillon Round), 1959–62. As a result of the Kennedy Round of negotiations, agreement was reached in 1967 on tariff cuts which affected about 75% of total industrial trade. The average tariff reduction amounted to a cut of something over 36%. At the start of the 1970s, the average tariff on actually traded industrial goods stood at 7.2%. J. Williamson and C. Milner, *The World Economy: A Textbook in International Economics* (New York: Harvester Wheatsheaf, 1991), pp.332–3.
- 15 See Kuznets, *Economic Growth of Nations*.
- 16 It is obvious that some other factors also contributed to the high growth rates of the postwar period. Among them were high defense spending, governments' official assistance, technological advancement and, particularly important, inflationary economic policies as adopted by major capitalist economies to achieve full employment and certain social objectives.
- 17 This view is shared mostly by American politicians and scholars, but challenged by those of other countries.
- 18 M. Sakamoto, "Japan's Role in the International System," in J. H. Makin and D. C. Hellmann (eds), *Sharing World Leadership? A New Era for America & Japan* (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1989), pp.182–3 and 186.
- 19 For a discussion on this issue, see Lairson and Skidmore, *International Political Economy*, p.73.
- 20 Telo, "Introduction: Globalization, New Regionalism and the Role of the European Union," pp.2–3.
- 21 According to Syed Maswood, "relative decline" refers to a narrowing of the gap separating the hegemon and the second largest country without a reversal in their relative standing. In itself, this is not sufficient to deny the hegemon control over the system unless it is also accompanied by a secular economic decline. When that happens, the system must either be reconstituted under a new hegemon, ..., or generate supporters. S. J. Maswood, *Japan and Protection: The Growth of Protectionist Sentiment and the Japanese Response* (London: Routledge, 1989), p.31.
- 22 For a summary discussion of *détente* of the 1970s, see Lieber, *No Common Power*, pp.70–9.
- 23 Sakamoto, "Japan's Role in the International System," p.182.
- 24 UNCTAD, *Handbook of International Trade and Development Statistics*, Supplement (New York and Geneva: United Nations, various years).
- 25 Sakamoto, "Japan's Role in the International System," pp.182–3 and 186.
- 26 Or "uneven development," to use Marxist terminology.
- 27 D. K. Das, *The Asia-Pacific Economy* (London: Macmillan Press Ltd., 1996), p.36.
- 28 For more detailed discussion of the economic development of Japan in the postwar years, see Cai, *The Political Economy of East Asia*, pp.49–82.
- 29 T. Andersson, *Managing Trade Relations in the New World Economy* (London and New York: Routledge, 1993), p.17.

- 30 Robert Triffin, an economist at Yale University, exposed this flaw at the heart of the dollar-exchange standard in his book, *Gold and the Dollar Crisis: The Future of Convertibility* (New Haven: Yale University Press, 1960).
- 31 H. W. Singer and J. A. Ansari, *Rich and Poor Countries*, 3<sup>rd</sup> edition (London: George Allen and Unwin, 1982), p.262.
- 32 Ruggie, "International Regimes, Transactions, and Change," 393–8.
- 33 The tariff cuts agreed at the Tokyo Round, in similar form and size to those of the Kennedy Round, were about 34% on industrial products for all industrial countries. Williamson and Milner, *The World Economy*, p.341.
- 34 For a brief discussion on the causes of the end of the Cold War, see Lieber, *No Common Power*, pp.60–1.
- 35 As Stanley Hoffmann indicates, if the Soviet-American contest should cease being the most important issue in world affairs, conflicts of economic interest among Western allies might well escalate. S. Hoffmann, "The European Community and 1992," *Foreign Affairs*, vol.68, no.4 (Fall 1989) 44. See also E. Luttwak, "From geopolitics to geo-economics," *The National Interest* (Summer 1990) 17–23.
- 36 The concept of power has many broad meanings and is conceived of in different ways. For Hans Morgenthau, power is the immediate aim of international politics. However, a more general and all-encompassing definition sees power as the ability to achieve a desired outcome through control of one's environment. For a detailed discussion on the definition of power, see B. Russett and H. Starr, *World Politics: The Menu for Choice*, 2<sup>nd</sup> edition (New York: W. H. Freeman and Company, 1985), pp.129–30.
- 37 H. Gelber, "Economic Strength and Military Power: Uneasy Allies?" in *Economics and Pacific Security: The 1986 Symposium* (Washington, D.C.: National Defense University Press, 1987).
- 38 C. Bergsten, "The World Economy after the Cold War," *Foreign Affairs*, vol.69, no.3 (Summer 1990) 96.
- 39 Keohane, *After Hegemony*, p.244.
- 40 For a reference discussion of globalization, see J. Ervin and Z. A. Smith, *Globalization: A Reference Handbook* (Santa Barbara, CA: ABC-CLIO, Inc., 2008).
- 41 According to Gillian Youngs, in the stage of complex hegemony of globalization, a rising China is exerting economic and likely political and cultural influence on the world as much as the US, the EU and Japan. See G. Youngs, "Complex Hegemony and Twenty-first Century Globalization," in E. Kofman and G. Youngs (eds), *Globalization: Theory and Practice*, 3<sup>rd</sup> edition (New York and London: The Continuum International Publishing Group Inc, 2008), pp.3–13.
- 42 For a recent discussion of globalization and the multiple dimensions of the globalization process, see C. Gopinath, *Globalization: A Multidimensional System* (Los Angeles; London; New Delhi; Singapore: SAGE Publications, 2008).
- 43 D. A. Rondinelli and J. M. Heffron, "Adjusting to Globalization: Change and Transformation in Asia," in D. A. Rondinelli and J. M. Heffron (eds), *Globalization & Change in Asia* (Boulder, CO: Lynne Rienner Publishers, Inc., 2007), pp.1–2.

- 44 It is important to note that while state sovereignty is declining as a result of globalization, it is far from over in such crucial sectors as national security and welfare.
- 45 For discussion of global civil society, see W. D. Coleman and S. Wayland, "The Origins of Global Civil Society and Nonterritorial Governance: Some Empirical Reflections," *Global Governance: A Review of Multilateralism and International Organizations*, vol.12, no.3 (2006) 241–61; P. Willetts, "The Cardoso Report on the UN and Civil Society: Functionalism, Global Corporatism, or Global Democracy?" *Global Governance: A Review of Multilateralism and International Organizations*, vol.12, no.3 (2006) 305–24.
- 46 On the other hand, however, according to Eleonore Kofman, the events of 11 September 2001 have reinforced national borders and strengthened security state. E. Kofman, "Political Geography and Globalization in the Twenty-first Century," in E. Kofman and G. Youngs (eds), *Globalization: Theory and Practice*, 3<sup>rd</sup> edition (New York and London: The Continuum International Publishing Group Inc, 2008), pp.14–25.
- 47 B. J. Cohen, "The international monetary system: diffusion and ambiguity," *International Affairs*, vol.84, no.3 (2008) 455–70.
- 48 M. P. Karns and K. A. Mingst, *International Organizations: The Politics and Processes of Global Governance* (Boulder, CO; London: Lynne Rienner Publishers, Inc., 2004), pp.4–5.
- 49 M. Carbone, "Supporting or Resisting Global Public Goods? The Policy Dimension of a Contested Concept," *Global Governance*, vol.13, no.2 (2007) 179–98.
- 50 For more discussion of the concept of global governance, see J. N. Rosenau, "Toward an Ontology for Global Governance," in M. Hewson and T. J. Sinclair (eds), *Approaches to Global Governance Theory* (Albany, NY: State University of New York, 1999), pp.287–302; Karns and Mingst. *International Organizations: The Politics and Processes of Global Governance*; K. Dingwerth and P. Pattberg, "Global Governance as a Perspective on World Politics," *Global Governance: A Review of Multilateralism and International Organizations*, vol.12, no.2 (2006) 185–203; S. Forman and D. Segaar, "New Coalitions for Global Governance: The Changing Dynamics of Multilateralism," *Global Governance: A Review of Multilateralism and International Organizations*, vol.12, no.2 (2006) 205–25.
- 51 J. H. Jackson, "The case of the World Trade Organization," *International Affairs*, vol.84, no.3 (2008) 437–54.
- 52 As a matter of fact, the postwar trade liberalization under GATT is itself a practice of negotiated and controlled lessening of barriers rather than a *laissez faire* "free-for-all," as the Multi-Fibre Agreements or the various rounds of negotiations have shown.
- 53 H. James, "Globalization, empire and natural law," *International Affairs*, vol.84, no.3 (2008) 421–36.
- 54 P. Subacchi, "New power centres and new power brokers: are they shaping a new economic order?" *International Affairs*, vol.84, no.3 (2008) 485–98.
- 55 For example, for S. Strange, the US remaining hegemonic power is still reflected in its military and associated technological dominance and concentration of US institutional and corporate power in the global economy. S. Strange, *States and Markets* (London: Printer, 1988 and 1994), and *The Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge and New York: Cambridge University Press, 1996).

- 56 According to Nayan Chanda, without the US leadership and cooperation in global governance, the world is at considerable risk in the age of globalization. N. Chanda, "Runaway Globalization Without Governance," *Global Governance*, vol.14, no.2 (2008) 124–5.
- 57 For a comprehensive study of global governance, see Karns and Mingst, *International Organizations: The Politics and Processes of Global Governance*. Also see A. F. Cooper, J. English and R. Thakur (eds), *Enhancing Global Governance: Toward a New Diplomacy?* (Tokyo; New York; Paris: United National University Press, 2002).
- 58 For more discussion of G8 and G8+5, see A. Payne, "The G8 in a changing global economic order," *International Affairs*, vol.84, no.3 (2008) 519–33.
- 59 P. Martin, "Breaking Deadlocks in Global Governance: The L-20 Proposal," *Global Governance*, vol.13, no.3 (2007) 301–5. Also see responses to Paul Martin's proposal for the L-20 in the same issue of the journal by M. de Azambuja, "Design for a Multipolar World," *Global Governance*, vol.13, no.3 (2007) 307–10; P. B. Mehta, "Summit Reform: The Good and the Bad News," *Global Governance*, vol.13, no.3 (2007) 311–14; E. Sidiropoulos, "Toward More Inclusive Informal Global Governance: A View from South Africa," *Global Governance*, vol.13, no.3 (2007) 315–19; L. Xue, "Breaking Deadlocks in Global Governance: How to Make the L-20 Work," *Global Governance*, vol.13, no.3 (2007) 320–3.
- 60 As a matter of fact, for some critics, what is known as "globalization" in the world today should be better understood as "imperialism." See, for example, J. Petras, "World Development: Globalization or Imperialism?" in H. Veltmeyer (ed.), *New Perspectives on Globalization and Antiglobalization: Prospects for a New World Order* (Aldershot, England; Burlington, VT: Ashgate Publishing, 2008), pp.35–47. This point is also accepted by the other contributors of this edited volume. Also see B. K. Gills (ed.), *Globalization and the Global Politics of Justice* (London and New York: Routledge, 2008).
- 61 It is believed that widening inequality in this respect is caused by a combination of factors, of which technology plays a particularly crucial role as compared to trade. For economists, however, everyone will eventually be better off from globalization in the long run through higher incomes, cheaper consumer products and rising living standard, although in the short term inequality might occur. For merits and demerits of globalization, see J. E. Stiglitz, *Globalization and its Discontents* (New York and London: W.W. Norton and Company, 2002); J. Bhagwati, *In Defense of Globalization* (Oxford: Oxford University Press, 2006); D. Rodrik, *Has Globalization Gone Too Far?* (Washington, D.C.: Institute for International Economics, 1997); D. Rodrik, "Globalization for whom? Time to change the rules – and focus on poor workers," *Harvard Magazine*, vol.104, no.6 (2002) 29–31. For impacts of globalization on LDCs, see D. Bigman, *Globalization and the Least Developed Countries: Potentials and Pitfalls* (Wallingford, UK and Cambridge, MA: CABI, 2007); O. Worth and P. Moore (eds), *Globalization and the 'New' Semi-Peripheries* (Basingstoke and New York: Palgrave Macmillan, 2009).
- 62 For discussions of macroeconomic imbalances as a result of globalization, see A. Aslund and M. Dabrowski (eds), *Challenges of Globalization: Imbalances and Growth* (Washington, D.C.: Peterson Institute for International Economics, 2008).

- 63 The US financial crisis has primarily been caused by the government's exceedingly accommodative monetary policy and loose regulation, which then has resulted in overheating, surging commodity prices and global inflation.

## Chapter 4 Regionalism in the World Economy since the 1950s

- 1 Paragraphs 4 to 10 of Article XXIV of GATT provide for the formation and operation of customs unions and free trade areas that involve trade in goods.
- 2 The Enabling Clause refers to the 1979 Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries, which permits preferential trade arrangements in trade in goods between developing country members of GATT.
- 3 GATS was reached at the Uruguay Round of multilateral negotiations. Article V of GATS governs the conclusion of RTAs in service trade for both development and developing countries.
- 4 L. H. Summers, "Regionalism and the World Trading System," in *Policy Implications of Trade and Currency Zones*, a symposium sponsored by the Federal Reserve Bank of Kansas City (Kansas City, MO: The Federal Reserve Bank of Kansas City, 1991), pp.295–301.
- 5 WTO Secretariat, *Regionalism and the World Trading System* (Geneva: WTO, 1995).
- 6 R. Baldwin and P. Low (eds), *Multilateralizing Regionalism: Challenges for the Global Trading System* (Cambridge and New York: Cambridge University Press, 2008).
- 7 WTO, [http://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm), and [http://www.wto.org/english/tratop\\_e/region\\_e/regfac\\_e.htm](http://www.wto.org/english/tratop_e/region_e/regfac_e.htm), accessed on 28 March 2009.
- 8 WTO, *Understanding the WTO: Cross-Cutting and New Issues: Regionalism: friends or rivals?* [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/bey1\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey1_e.htm), accessed on 28 March 2009. For a case study of the effects of economic regionalism on the multilateral trade system, see G. P. Sampson and S. Woolcock (eds), *Regionalism, Multilateralism, and Economic Integration: The Recent Experience* (Tokyo and New York: The United Nations University, 2003).
- 9 See C. Archer, *The European Union* (London and New York: Routledge, 2008), pp.20–2; A. Staab, *The European Union Explained* (Bloomington, IN: Indiana University Press, 2008), p.7.
- 10 As a matter of fact, in the immediate postwar years, there was a debate over the future direction of Europe. While both sides supported European integration as a way to safeguard peace, they disagreed on political objectives with one party calling for the creation of a political and economic union with a federal structure and the other envisioning only a economic union. See A. Staab, *The European Union Explained*, pp.4–5.
- 11 For the background of the French initiative, see F. Delmartino, "The Experience of European Integration in an Historical Perspective," in W. Moon and B. Andreosso-O'Callaghan (eds), *Regional Integration – Europe*

- and Asia Compared* (Aldershot, England and Burlington, VT: Ashgate Publishing, 2005), pp.10–12.
- 12 A. Staab, *The European Union Explained*, pp.8–9.
  - 13 Following the treaty revision signed at Maastricht in February 1992, the term “European Community” (EC) is to substitute for the old term EEC, while the other two Communities retain their old terms.
  - 14 For the process of European integration by the early 1970s, see D. Watts, *The European Union* (Edinburgh: Edinburgh University Press, 2008), pp.5–29.
  - 15 M. Wise, “The European Community,” in R. Gibb and W. Michalak (eds), *Continental Trading Blocs: The Growth of Regionalism in the World Economy* (Chichester, England: John Wiley & Sons, 1994), pp.75–109. Also M. Trachtenberg, *A Constructed Peace: The Making of the European Settlement, 1945–63* (Princeton, NJ: Princeton University Press, 1999).
  - 16 For a background discussion on the EC-EFTA relationship, see A. M. Williams, *The European Community: The Contradictions of Integration*, 2<sup>nd</sup> edition (Oxford, UK: Blackwell Publishers, 1994), pp.53–6.
  - 17 Telo, “Introduction: Globalization, New Regionalism and the Role of the European Union,” p.3. Haas, *The Obsolescence of Regional Integration Theory*.
  - 18 For example, how Great Britain should contribute to the common agricultural policy became a very contentious issue within the EEC.
  - 19 See Chapter 3.
  - 20 Among important discussions of the new wave of regionalism in the world economy are Mansfield and Milner, “The New Wave of Regionalism”; W. Larner and W. Walters, “The Political Rationality of ‘New Regionalism:’ Toward a Genealogy of the Region,” *Theory and Society*, vol.31, no.3 (June 2002) 391–432; Hettne, “Beyond the ‘New’ Regionalism,” 554–71.
  - 21 The Maastricht Treaty of 1992 decided to establish a complete EMU. The provisions made for the creation of EMU were by far the most specific and far-reaching. The date for the entry into the final stage was set as 1 January 1999, or two years earlier if a majority of member countries were deemed by the Council to fulfill the necessary conditions. The final stage would involve the irrevocable fixity of intra-EC exchange rates, the adoption of a common currency, the ECU, and the establishment of a federal system of central banks (the European System of Central Banks – ESCB) with the European Central Bank (ECB) in the middle. The latter would be responsible for the conduct of monetary policy and exchange rate policy for the union as a whole.
  - 22 Staab, *The European Union Explained*, pp.19–20.
  - 23 For a discussion of the EU’s domestic policies, see Archer, *The European Union*, pp.59–98.
  - 24 For an extended discussion of the European Central Bank and the euro, see M. Dutta, *European Union and the Euro Revolution* (Amsterdam and Oxford: Elsevier, 2007), pp.85–115.
  - 25 For the European integration since the mid-1980s, see Watts, *The European Union*, pp.30–60.
  - 26 Hoffmann, “The European Community and 1992,” 32–3.
  - 27 Williams, *The European Community: The Contradictions of Integration*, pp.91–149.

- 28 For opposing views on the future of the EU, see N. Merino (ed.), *The European Union: Opposing Viewpoints* (Farmington Hills, MI: Greenhaven Press, 2008).
- 29 For the EU's foreign policy and external relations, see European Commission, Directorate-General for Communication, *The EU in the World: The Foreign Policy of the European Union* (Luxembourg: Office for Official Publications of the European Communities, 2007); Z. Laidi (ed.), *EU Foreign Policy in a Globalized World: Normative Power and Social Preferences* (London and New York: Routledge, 2008); Archer, *The European Union*, pp.99–133.
- 30 For a discussion of the nature and institutions of the EU, see Archer, *The European Union*, pp.5–18 and 33–58.
- 31 A. M. Sbragia, "European Union and NAFTA," in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), p.153.
- 32 R. Grinspun and M. A. Cameron, *The Political Economy of North American Free Trade* (New York: St Martin's Press, 1993), p.16.
- 33 External Affairs and International Trade of Canada, *NAFTA: What's It All About?* (Ottawa: Government of Canada, 1993), p.3.
- 34 Sbragia, "European Union and NAFTA," p.155.
- 35 M. Kahler, *Regional Futures and Transatlantic Economic Relations* (New York: Council on Foreign Relations Press, 1995), p.23.
- 36 S. Weintraub, "The North American Free Trade Agreement," in A. M. El-Agraa (ed.), *Economic Integration Worldwide* (New York: St. Martin's Press, 1997), pp.203–26. G. Boyd, "Regional Economic Cooperation: EU, NAFTA, and APEC," in G. Boyd and A. Rugman (eds), *Euro-Pacific Investment and Trade: Strategies and Structural Interdependencies* (Cheltenham, UK and Brookfield, VT: Edward Elgar, 1997), pp.130–58.
- 37 Sbragia, "European Union and NAFTA," p.164.
- 38 J. Sen, "The North American Free Trade Agreement," in G. P. Sampson and S. Woolcock (eds), *Regionalism, Multilateralism, and Economic Integration: The Recent Experience* (Tokyo and New York: The United Nations University, 2003), pp.135–66.
- 39 *Ibid.*
- 40 According to Peter Leslie, economic union can be conceptualized in terms of a trade and investment union (the most basic type), a labor market union, a foreign economic policy union, a monetary union and a structural/development union. P. M. Leslie, "Abuses of Asymmetry: Privilege and Exclusion," in K. Neunreither and A. Wiener (eds), *European Integration Amsterdam: Institutional Dynamics and Prospects for Democracy* (Oxford: Oxford University Press, 2000), pp.192–217.
- 41 Sbragia, "European Union and NAFTA," pp.153–64.
- 42 M. Telo, "Between Trade Regionalization and Various Paths toward Deeper Cooperation," in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), p.142.
- 43 B. Hettne, "Interregionalism and World Order: The Diverging EU and US Models," in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), pp.107–23.

- 44 The North American Agreement on Labor Cooperation is “the first international agreement to link labor issues to an international trade pact.” GAO, *North American Free Trade Agreement: Impacts and Implementation*, statement of Jay Etta Z. Hecker, Associate Director, International Relations and Trade Issues, National Security and International Affairs Division, testimony before the Subcommittee on Trade, Committee on Ways and Means, House of Representatives, 11 September 1997 (US Government General Accounting Office, Washington D.C., 1997).
- 45 Sbragia, “European Union and NAFTA,” pp.153–64.
- 46 See J. Bhagwati, “Regionalism and Multilateralism,” *The World Economy*, vol.15, no.5 (September 1992).
- 47 For more discussion of MERCOSUR, see A. Vasconcelos, “European Union and MERCOSUR,” in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), 165–83.
- 48 Telo, “Between Trade Regionalization and Various Paths toward Deeper Cooperation,” pp.143–6.
- 49 Soderbaum, “African Regionalism and EU-African Interregionalism,” pp.186–202.
- 50 Hettne offers one of comprehensive discussions of regionalism and world order in his article, “Beyond the ‘New’ Regionalism,” 559–64.
- 51 Telo, “Introduction: Globalization, New Regionalism and the Role of the European Union,” p.6.
- 52 P. C. Padoan, “The Political Economy of New Regionalism and World Governance,” in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), pp.37–54.
- 53 This is a strategic trade view. See A. Gamble, “Regional Blocs, World Order and the New Medievalism,” in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), p.27.
- 54 Mark Wise has a similar discussion. See Wise, “The European Community,” p.77. Also see Telo, “Introduction: Globalization, New Regionalism and the Role of the European Union,” p.10.
- 55 Telo, “Introduction: Globalization, New Regionalism and the Role of the European Union,” p.7.
- 56 T. Meyer, “Cultural Difference, Regionalization and Globalization,” in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), pp.55–73.
- 57 R. Higgott, “Alternative Models of Regional Cooperation? The Limits of Regional Institutionalization in East Asia,” in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), p.15.
- 58 Telo, “Introduction: Globalization, New Regionalism and the Role of the European Union,” pp.9–10.
- 59 Keohane, *After Hegemony*.

- 60 E. M. Preeg, "The GATT Trading System in Transition: An Analytic Survey of Recent Literature," *The Washington Quarterly*, vol.12 (1989) 201–13. For more discussion on whether preferential trading arrangements may or may not bring welfare gains for participating countries and whether they may benefit or harm global welfare levels, see R. Gibb, "Regionalism in the World Economy," in R. Gibb and W. Michalak (eds), *Continental Trading Blocs: The Growth of Regionalism in the World Economy* (Chichester, England: John Wiley & Sons, 1994), pp.28–34.
- 61 Gamble, "Regional Blocs, World Order and the New Medievalism," pp.21–36.
- 62 According to Susan Strange, the world becomes more like the European middle ages with multi-level systems of authority than the Westphalian system of nation-states with territorial sovereignty. Strange's observation has been further developed by Robert Cox. Strange, *States and Markets*, and *The Retreat of the State*. R. W. Cox, *Approaches to World Order* (Cambridge and New York: Cambridge University Press, 1996).
- 63 Telo, "Introduction: Globalization, New Regionalism and the Role of the European Union," pp.10–11.
- 64 Padoan, "The Political Economy of New Regionalism and World Governance," pp.37–54.
- 65 K. A. Oye, *Economic Discrimination and Political Exchange* (Princeton, NJ: Princeton University Press, 1992).
- 66 Telo, "Introduction: Globalization, New Regionalism and the Role of the European Union," p.13.
- 67 *Ibid.*
- 68 Indeed, these countries will find their exports becoming increasingly non-competitive in the markets of regional blocs, even if the external tariffs of these blocs are not raised to non-members. There would be the same effect even if tariffs were lowered as long as internal tariffs among the members of the bloc were zero. As an extreme example, if all countries except one were members of regional trading blocs, and the internal tariffs in these blocs were zero, that country would be effectively isolated from all other markets.
- 69 In fact, some scholars estimate very low percentage of world trade as being governed by the GATT. Oxley (1990) cites figures to suggest that only 7% of world trade takes place within the GATT, while Choate and Linger (1986) calculate that for all global transactions, trade as well as capital flows, the figure may be as low as 5%. However, most analysts agree on a figure much higher, estimating that between 50% and 60% of world trade in goods and services is subject to the GATT disciplines. Significantly, even these higher estimates leave almost 50% of world trade GATT-free. Whatever the precise figure, a substantial amount of trade is conducted outside the GATT rules. Quoted from Gibb, "Regionalism in the World Economy," p.21.
- 70 K. Anderson and R. Blackhurst (eds), *Regional Integration and the Global Trading System* (New York: Harvester Wheatsheaf, 1993), p.1.
- 71 J. McConnell and A. MacPherson, "The North American Free Trade Area: An Overview of Issues and Prospects," in R. Gibb and W. Michalak (eds), *Continental Trading Blocs: The Growth of Regionalism in the World Economy* (Chichester, England: John Wiley & Sons, 1994), p.168.

- 72 To take the most developed regionalism in Western Europe as an example, EC trade policy is considered to be able to promote either protectionist or free trade ends (or, most likely, a mixture of both). Parts of the EEC Treaty, notably those dealing with agriculture, have indeed permitted the establishment of protective measures according to the principle of Community preference. However, Article 110 of the Rome Treaty sets the free trade aim of progressively lowering tariffs and abolishing restrictions on international trade. In fact, the general trend has been for the EC to accept the general lowering of tariffs in successive GATT negotiations since the 1960s, although agriculture has been a notable exception. Wise, "The European Community," p.83.
- 73 Gamble, "Regional Blocs, World Order and the New Medievalism," pp.28–9.

## Chapter 5 Regional Economic Integration in East Asia

- 1 Cai, *The Political Economy of East Asia*, pp.34–40.
- 2 For a discussion of the political economy of China, see Cai, *ibid*, pp.151–87.
- 3 For the role of FDI in East Asian integration, see E. J. Lincoln, *East Asian Economic Regionalism* (Washington, D.C.: The Brookings Institution, 2004), pp.72–113.
- 4 For a discussion of China's outward FDI in general and outward FDI in Hong Kong in particular, see K. G. Cai, "Outward Foreign Direct Investment: A Novel Dimension of China's Integration into the Regional and Global Economy," *The China Quarterly*, no.160 (December 1999) 856–80.
- 5 Ministry of Finance (Japan), *Monthly Finance Review*, various Issues, cited in OECD, *International Direct Investment Statistics Yearbook 1995* (Paris: Organization for Economic Cooperation and Development, 1995), pp.154–5.
- 6 Ministry of Finance (Japan), statistics database, <http://www.mof.go.jp/english/index.htm>.
- 7 Calculated from *ibid*.
- 8 OECD, *Foreign Direct Investment Relations between the OECD and the Dynamic Asian Economies* (Paris: Organization for Economic Cooperation and Development, 1993), p.135.
- 9 Census and Statistics Department (Hong Kong), statistics database, <http://www.info.gov.hk/censtatd/eng>. The original data are in Hong Kong dollar, which are converted into the US dollar at the 2003 exchange rate.
- 10 The data for 1987 are from UNCTAD, *World Investment Directory, Volume VII – Part 2: Asia and the Pacific* (New York and Geneva: United Nations, 2000), pp.546–7; the data for 2006 are from Mainland Affairs Council (MAC), *Cross-Strait Economic Statistics Monthly No.175*, Table 13 (Taipei: Mainland Affairs Council, ROC), <http://www.mac.gov.tw>.
- 11 OECD, *Foreign Direct Investment Relations*, p.139.
- 12 Calculated from UNCTAD, *World Investment Directory, Volume VII – Part 2*, pp.444–6.
- 13 Export-Import Bank of Korea, cited in C. Lee, "Economic Relations between Korea and China," *Korea's Economy 2004*, vol.20 (Washington, D.C.: Korea Economic Institute, 2004) 71.

- 14 Census and Statistics Department (Hong Kong), statistics database. The original data are in Hong Kong dollar, which are converted into the US dollar at the 2003 exchange rate.
- 15 An IPN refers to an international division of labor, in which different functional activities of the production process (including design, research and development, material processing, supplier logistics, information and communications management, finance, manufacturing, marketing and end-product distribution) are reorganized to be conducted in the most efficient locations by different firms, including MNEs and local firms. See C. Yun, "International production networks and the role of the state: lessons from the East Asian development experience," *European Journal of Development Research*, vol.15, no.1 (2003) 173; Dent, *East Asian Regionalism*, p.46.
- 16 Dent, *ibid*.
- 17 J. C. Abegglen, *Sea Change: Pacific Asia as the New World Industrial Center* (New York: The Free Press, 1994), p.83.
- 18 E. J. Lincoln, "Japanese Trade and Investment Issues," in D. Unger and P. Blackburn (eds), *Japan's Emerging Global Role* (Boulder and London: Lynne Rienner Publishers, Inc., 1993), pp.134–5.
- 19 D. Unger, "Japan's Capital Exports: Molding East Asia," in Unger and Blackburn (eds), *Japan's Emerging Global Role* (Boulder and London: Lynne Rienner Publishers, Inc., 1993), p.156.
- 20 Dent, *East Asian Regionalism*, pp.46–7; G. B. Felker, "Global production and Southeast Asia's industrialization," in K. Jayasuriya (ed.), *Asian Regional Governance: Crisis and Change* (London: Routledge, 2004), pp.82–105; A. Giroud, "Foreign direct investment and the rise of cross-border production networks in Southeast Asia," in N. J. Freeman and F. L. Bartels (eds), *The Future of Foreign Investment in Southeast Asia* (London: Routledge, 2004), pp.104–24; D. Tachiki, "Between foreign direct investment and regionalism: the role of Japanese production networks," in T. J. Pempel (ed.), *Remapping East Asia: The Construction of a Region* (Ithaca, NY: Cornell University Press, 2005), pp.149–69.
- 21 Dent, *East Asian Regionalism*, p.48.
- 22 See Cai, *The Political Economy of East Asia*, pp.9–33.
- 23 Dent, *East Asian Regionalism*, p.48.
- 24 For the important role of FDI in China's economic growth, see L. Lipschitz, C. Rochon and G. Verdier, "A Real Model of Transitional Growth and Competitiveness in China," IMF Working Paper, WP/08/99, IMF (2008), <http://www.imf.org/external/pubs/cat/longres.cfm?sk=21888.0>, accessed on 6 May 2009.
- 25 But there are also criticisms of the flying geese integration. See, for example, M. Bernard and J. Ravenhill, "Beyond Product Cycles and Flying Geese: Regionalization, Hierarchy and the Industrialization of East Asia," *World Politics*, vol.47, no.2 (1995) 171–209.
- 26 Dent, *East Asian Regionalism*, p.45.
- 27 According to Fumitaka Furuoka, for example, the expansion of flying-geese type of Japanese corporate ties in the region was part of a broader development of economic and diplomatic linkages between Japan and a newly industrializing East Asian region. See F. Furuoka, "Japan and the

- flying geese pattern of East Asian integration," *Eastasia.at*, vol.4, no.1 (October 2005).
- 28 K. G. Machado, "Japanese Foreign Direct Investment in East Asia: The Expanding Division of Labour and the Future of Regionalism," in S. Chan (ed.), *Foreign Direct Investment in a Changing Global Political Economy* (London: Macmillan, 1995), pp.39–66; S. Awanohara, "Japan and East Asia: Toward a New Division of Labour," *The Pacific Review*, vol.2, no.3 (1989) 198–208.
  - 29 For a discussion of some of the important transnational issues in East Asia, see Dent, *East Asian Regionalism*, pp.227–70.
  - 30 Calculated from IMF, *Direction of Trade Statistics Yearbook 2004* (Washington, D.C.: International Monetary Fund, 2004).
  - 31 Cai, "Is a Free Trade Zone Emerging in East Asia in the Wake of the Asian Financial Crisis?" *Pacific Affairs*, vol.74, no.1 (Spring 2001) 10.
  - 32 World Bank, *East Asia: The Road to Recovery* (Washington, D.C.: The World Bank, 1998), p.11.
  - 33 *Korea Herald* (17 September 1998) 1.
  - 34 "Japanese Prime Minister Lectures at Korea University," Yonhap (20 March 1999), cited from FBIS-EAS-1999-0320.
  - 35 "MITI Proposes Trade Integration in N.E. Asia," Kyodo World Service (21 May 1999).
  - 36 *The Korea Herald* (1 June 1999) 12.
  - 37 For a thorough discussion of China's changing attitude and policy toward regional free trade arrangements in East Asia in general and East Asia in particular, see K. G. Cai, "Chinese Changing Perspective on the Development of an East Asian Free Trade Area," *The Review of International Affairs*, vol.3, no.4 (Summer 2004) 584–99. This article is reprinted in R. C. Keith (ed.), *China as a Rising World Power and its Response to 'Globalization'* (London and New York: Routledge, 2005), pp.78–93.
  - 38 "Wu Yi Raises Six Suggestions and Calls for Creating a Chinese-Japanese FTA," Sohu News (19 May 2005), <http://news.sohu.com>.
  - 39 "Japan's Cabinet: A Japanese-Chinese FTA Brings Huge Benefits," Zaobao (9 January 2005), <http://www.zaobao.com>.
  - 40 "China and South Korea Start to Negotiate on FTA and Japan's Passive Attitude over Cooperation with China," Sohu News (China) (22 March 2005), <http://news.sohu.com>.
  - 41 "Japan, China, S. Korea Agree on Joint Research," Kyodo World Service (28 November 1999); "ROK, China, Japan to Conduct Joint Research for Economic Cooperation," *Korea Times* (28 November 1999), website edition.
  - 42 Ministry of Foreign Affairs of PRC, official website, <http://www.fmprc.gov.cn/eng>; Ministry of Foreign Affairs of Japan, website, <http://www.mofa.go.jp>.
  - 43 "China, Japan and South Korea Agreed to Study the Creation of a Free Trade Zone," *Zaobao* (5 May 2005), <http://www.zaobao.com>.
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  - 45 "Business Leaders Hold Fourth 'Asian Neighbors Forum'," Yonhap (8 May 1999), cited from FBIS-EAS-1999-0508; *The Korea Herald* (10 May 1999) 1.

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- 47 “KCCI proposes East Asian economic council,” *The Korea Herald* (7 June 2002), website edition.
- 48 For a discussion of these earlier efforts for regional economic cooperation in the Asia-Pacific, see J. Ravenhill, “Institutional Evolution at the Trans-Regional Level: APEC and the Promotion of Liberalisation,” in M. Beeson (ed.), *Reconfiguring East Asia: Regional Institutions and Organisations after the Crisis* (London and New York: Routledge, 2002), pp.228–30. See also M. Beeson, *Institutions of the Asia-Pacific: ASEAN, APEC and Beyond* (London and New York: Routledge, 2009), pp.38–40.
- 49 Cai, “The Political Economy of Economic Regionalism in Northeast Asia,” 42–3.
- 50 However, it was believed that Japan with the support of the US had been the real initiator of the APEC project. The reason that Japan would rather stay behind the initiative and let Australia propose the idea was that Japan wanted to avoid suspicion from other Asia-Pacific countries of its motive behind such a regional project, if the initiative could be successfully launched. See Y. Funabashi, *Asia Pacific Fusion: Japan’s Role in APEC* (Washington, D.C.: Institute for International Economics, 1995).
- 51 APEC Secretariat, *APEC at a Glance* (Singapore: APEC Secretariat, 2009).
- 52 The feasibility of this objective of APEC’s trade liberalization is questioned by Mark Beeson. See Beeson, *Institutions of the Asia-Pacific: ASEAN, APEC and Beyond*, p.44.
- 53 In this respect, APEC is more inclusive than the ASEAN Plus Three forum, which emerged much later, as the latter does not include Taiwan.
- 54 Beeson, *Institutions of the Asia-Pacific: ASEAN, APEC and Beyond*, pp.4–5.
- 55 Ravenhill, “Institutional Evolution at the Trans-Regional Level,” p.227.
- 56 R. Stubbs, “ASEAN Plus Three: Emerging East Asian Regionalism,” *Asian Survey*, vol.42, no.3 (2002) 447.
- 57 Ravenhill, “Institutional Evolution at the Trans-Regional Level,” pp.239–41.
- 58 For a discussion of the origin and debate of “open regionalism,” see Dent, *East Asian Regionalism*, pp.129–31.
- 59 These elements of APEC are largely borrowed from the “ASEAN way,” as will be discussed in the following section on ASEAN. See also Beeson, *Institutions of the Asia-Pacific: ASEAN, APEC and Beyond*, p.43.
- 60 For a discussion of various difficulties of APEC as a regional institution, see Beeson, *ibid.*, pp.36–55.
- 61 Ravenhill, “Institutional Evolution at the Trans-Regional Level,” p.241.
- 62 *The ASEAN Declaration*, 8 August 1967, <http://www.aseansec.org/1212.htm>; Declaration of ASEAN Concord, 24 February 1976, <http://www.aseansec.org/1216.htm>. Both accessed on 12 April 2009.
- 63 M. Beeson, “ASEAN: The Challenges of Organisational Reinvention,” in M. Beeson (ed.), *Reconfiguring East Asia: Regional Institutions and Organisations after the Crisis* (London and New York: Routledge, 2002), p.185.
- 64 In addition to ASEAN members, the ARF involves Australia, Bangladesh, Canada, China, the EU, India, Japan, North Korea, South Korea, Mongolia,

- New Zealand, Pakistan, Papua New Guinea, Russia, Timor-Leste, the US and Sri Lanka.
- 65 For more discussion of the ARF, see Beeson, *Institutions of the Asia-Pacific: ASEAN, APEC and Beyond*, pp.56–73.
- 66 P. Bowles and B. MacLean, "Understanding trade bloc formation: The case of the ASEAN free trade area," *Review of International Political Economy*, vol.3, no.2 (1996) 319–48. Dent, *East Asian Regionalism*, pp.92–3.
- 67 The idea of creating a free trade area in Southeast Asia was first proposed by Singapore in 1976, but failed to receive support from other members of ASEAN until the early 1990s. For more discussion of this issue, see Dent, *East Asian Regionalism*, pp.91–2.
- 68 For a comparative study of the EU and ASEAN, see K. A. Eliassen and C. B. Arnesen, "Comparison of European and Southeast Asian Integration," in M. Telo (ed.), *European Union and New Regionalism: Regional Actors and Global Governance in a Post-Hegemonic Era*, 2<sup>nd</sup> edition (Aldershot, England and Burlington, VT: Ashgate Publishing, 2007), pp.202–21.
- 69 Beeson, *Institutions of the Asia-Pacific: ASEAN, APEC and Beyond*, pp.17–36.
- 70 Beeson, "ASEAN: The Challenges of Organisational Reinvention," pp.193–4.
- 71 Dent, *East Asian Regionalism*, pp.151–2.
- 72 D. Webber, "Two funerals and a wedding? The ups and downs of Regionalism in East Asia and Asia-Pacific after the Asian Crisis," *The Pacific Review*, vol.14, no.3 (2001) 356.
- 73 For a discussion of ASEM, see C. M. Dent, "ASEM and the 'Cinderella Complex' of EU-East Asia Economic Relations," *Pacific Affairs*, vol.74, no.1 (2001) 25–52.
- 74 Stubbs, "ASEAN Plus Three: Emerging East Asian regionalism?" 440–55; Webber, "Two funerals and a wedding?" 339–72.
- 75 EASG, *Final Report of the East Asia Study Group, submitted to ASEAN+3 Summit, Phnom Penh, Cambodia, 4 November 2002*, p.63, <http://www.aseansec.org>.
- 76 Bank of Japan, *Ad Hoc Releases*, "Signing of the agreement on an increase in the maximum amount of the Bilateral Swap Arrangements between Japan and Indonesia under the Chiang Mai Initiative," Annex: The Agreement on the Swap Arrangement under the Chiang Mai Initiative (as of April 6, 2009), <http://www.boj.or.jp/en/type/release/adhoc09/data/un0903a.pdf>, accessed on 24 April 2009.
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- 78 According to William W. Grimes, "financial regionalism" involves attempts to reduce currency volatility, to create frameworks to contain financial crises, and to develop local financial markets in a region. For a thorough discussion of financial regionalism in East Asia, see W. W. Grimes, *Currency and Contest in East Asia: The Great Power Politics of Financial Regionalism* (Ithaca and London: Cornell University Press, 2009).
- 79 W. Mattli, *The Logic of Regional Integration: Europe and Beyond* (Cambridge and New York: Cambridge University Press, 1999).
- 80 B. Eichengreen, "China, Asia, and the world economy: The implications of an emerging Asian core and periphery," *China and World Economy*, vol.14, no.3 (2006) 1–18.

- 81 The discussion of the leadership issue in East Asian regionalism can also be found in E. J. Lincoln, *East Asian Economic Regionalism*, pp.231–49.
- 82 Wu Jianmin, former Chinese Ambassador to France, made a similar point in his recent presentation at the East Asian Dialogue Series under the theme of “What Can China and Japan Do for Peace and Harmony in the Region” on 27 May 2009, an event that was organized by the East Asian Institute of the National University of Singapore. According to Mr. Wu, China and Japan, rather than compete for the leadership role in East Asia, should let ASEAN assume such a role. Otherwise, neither China nor Japan would be satisfied if the other side plays such a leadership role in the region. *Zaobao* (28 May 2009), <http://www.zaobao.com>.
- 83 Shiping Tang has a similar discussion of the leadership issue within the APT. S. Tang, “Leadership in institution building: The case of ASEAN+3,” in B. Fort and D. Webber (eds), *Regional Integration in East Asia and Europe: Convergence or Divergence?* (London and New York: Routledge, 2006), pp.69–84.
- 84 M. Beeson, “ASEAN: The Challenges of Organisational Reinvention,” p.197.
- 85 For more discussion on the APT and the APO, see K. G. Cai, “The ASEAN-China Free Trade Agreement and East Asian Regional Grouping,” *Contemporary Southeast Asia*, vol.25, no.3 (2003) 392–5.
- 86 “Strengthening ASEAN+3 Cooperation,” Chairman’s Statement of the 8<sup>th</sup> ASEAN+3 Summit, Vientiane, 29 November 2004 (<http://www.aseansec.org/16848.htm>). For a discussion of this issue, please also see Cai, “The ASEAN-China Free Trade Agreement,” 395.
- 87 For more discussion of the EAS, see Dent, *East Asian Regionalism*, pp.169–72.
- 88 Beeson, *Institutions of the Asia-Pacific: ASEAN, APEC and Beyond*, pp.77–82.
- 89 However, there are two competing perspectives on whether bilateral FTAs would enhance or undermine regionalism in East Asia. While according to the “region-convergent” perspective, bilateral FTAs would help make positive contributions to the development of regionalism, it is seen otherwise in the “region-divergent” perspective. For a discussion of this issue, see Dent, *East Asian Regionalism*, pp.201–19.
- 90 V. Aggarwal and S. Urata (eds), *Bilateral Trade Agreements in the Asia-Pacific* (London and New York: Routledge, 2005); C. M. Dent, “Bilateral free trade agreements: boon or bane for regionalism in East Asia and the Asia-Pacific?” *European Journal of East Asian Studies*, vol.4, no.2 (2005) 287–314; C. M. Dent, *New Free Trade Agreements in the Asia-Pacific* (Basingstoke: Palgrave, 2006); J. Ravenhill, “The new bilateralism in the Asia-Pacific,” *Third World Quarterly*, vol.24, no.3 (2003) 299–318; V. H. Tran and C. Harvie (eds), *Regional Trade Agreements in Asia* (Cheltenham: Edward Elgar, 2007).
- 91 The China-ASEAN FTA is seen as “bilateral” here, because ASEAN has signed the pact as a unified body. This is also true of the expected Japan-ASEAN FTA and South Korea-ASEAN FTA.
- 92 “The Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China,” 29 November 2004 (<http://www.aseansec.org/16647.htm>).

- 93 For political and economic considerations behind China and ASEAN's decision, see Cai, "The ASEAN-China Free Trade Agreement," 395–400.
- 94 AFP (2 June 2009).
- 95 See, for example, M. Kawai and G. Wignaraja, "A Broad Asian FETA Will Bring Big Gains," *Far East Economic Review*, vol.171, no.3 (April 2008) 46–8.

## Chapter 6 Conclusion

- 1 But Bruce Russett and Susan Strange (1987) provide a different story of the relative decline of American hegemonic power. See B. M. Russett, "The Mysterious Case of Vanishing Hegemony; or, Is Mark Twain Really Dead?" *International Organization*, vol.39, no.2 (1985) 207–31; S. Strange, "The Persistent Myth of Lost Hegemony."
- 2 K. A. Froot and D. B. Yoffie, "Trading Blocs and the Incentives to Protect: Implications for Japan and East Asia," in J. A. Frankel and M. Kahler (eds), *Regionalism and Rivalry: Japan and the United States in Pacific Asia* (Chicago: The University of Chicago Press, 1993), pp.125–56; J. Goto and K. Hamada, "EU, NAFTA, and Asian Responses: A Perspective from the Calculus of Participation," in T. Ito and A. O. Krueger (eds), *Regionalism versus Multilateral Trade Arrangement* (Chicago: The University of Chicago Press, 1997), pp.91–117; and G. R. Saxonhouse, "Trading Blocs and East Asia," in J. de Melo and A. Panagariya (eds), *New Dimensions in Regional Integration* (New York: Cambridge University Press, 1993), pp.22–51.
- 3 For more discussion on this issue, see Doner, R. F., "Japanese Foreign Investment and the Creation of a Pacific Asian Region," in J. A. Frankel and M. Kahler (eds), *Regionalism and Rivalry: Japan and the United States in Pacific Asia* (Chicago: The University of Chicago Press, 1993), pp.159–216; V. Simone, *The Asian Pacific: Political and Economic Development in a Global Context*, 2<sup>nd</sup> edition (New York: Addison Wesley Longman, Inc., 2001), pp.383–91; and S. Urata, "Changing Patterns of Direct Investment and the Implications for Trade and Development," in C. F. Bergsten and M. Noland (eds), *Pacific Dynamism and the International Economic System* (Washington, D.C.: Institute for International Economics, 1993), pp.273–97.
- 4 For detailed discussion, see Chapter 5 of this book.
- 5 According to Beeson, different from its support of Western European integration, Washington's strategic interests were seen as actually benefiting from a divided Asian region. Beeson, *Institutions of the Asia-Pacific: ASEAN, APEC and Beyond*, p.8.
- 6 For a more detailed discussion on the issue of the AMF, see R. Higgott, "The Asian Economic Crisis: A Study in the Politics of Resentment," *New Political Economy*, vol.3, no.3 (November 1998) 340–6.
- 7 ADB, *Asian Development Outlook 2002* (New York: Oxford University Press, 2002), p.164.
- 8 Also see Kawai and Wignaraja, "A Broad Asian FTA Will Bring Big Gains."
- 9 See, for example, N. V. Long, "The East Asian Crisis: Some Historical Roots," *New Political Science*, vol.21, no.3 (1999) 395–404.

- 10 A. Singh and B. A. Weisse, "The Asian Model: A Crisis Foretold?" *International Social Science Journal*, no.160 (June 1999) 203–15.
- 11 See Higgott, "The Asian Economic Crisis," 333–55.
- 12 C. F. Bergsten, "Toward a Free Trade Area of the Asia Pacific," Remarks at the APEC CEO Summit, Santiago, Chile, 19 November 2004 (<http://www.iie.com/publications/papers/bergsten1104.htm>).

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