

Toward an East Asian Economic Community: Opportunities and Challenges

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INTRODUCTION

The Asian economy is in the middle of a historic transition. The center of gravity of the world economy is shifting to “rising Asia” from the “falling West,” heralding the advent of the “Asian Century” or “Renaissance of Asia”.¹ In this trend, East Asian economies have played the dominant role. China, Japan, the Association of Southeast Asian Nations (or ASEAN) ten member economies, India, and South Korea (hereafter Korea) are all located in a broader East Asia. In particular, East Asia’s high-performing miracle economies² after being humiliated helplessly by international hedge funds during the 1997 Asian financial crisis, awakened an “East Asian Identity” by acting collectively to overcome unprecedented regional financial shocks.

¹Asian Development Bank, *Asia 2050: Realizing Asian Century* (Manila: Asian Development Bank, 2011).

²World Bank, *The East Asian Miracle* (New York: Oxford University Press, 1993).

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Since then, East Asian regionalism has ushered in a variety of regional cooperation entities. After seeing the stalled World Trade Organization (WTO) Doha round and proliferation of bilateral and plurilateral free trade agreements, East Asia's intra and extra regional initiatives for the free movement of goods, services, finance, and investments have started to take concrete, formal forms. This process is leading to an East Asian version of a future economic community where a group of individual economies in sub-regions aim to achieve greater integration. However, because countries still pursue active export-oriented development strategies inherited from the past, East Asia's belated regionalism will emphasize historical linkages with the United States and other leading extra regional economies, creating a distinctively "open regionalism."

Rising Asia has been fueled by China's emergence as the second-largest economy in the world. China's rapid growth asserts the need for a new type of major power relationship with the United States. There has been much discussion on how China will use its influence on regional and global affairs. In the past four decades, by becoming a global superpower,³ China triggered the Asian Century. But looking forward, the Asian Century is by no means preordained, given the great diversity in the economic development and management system of Asian economies as well as inherent security conflicts, both internally and externally.

With China's growth in strength and influence, the United States has been pressuring government leaders to assume more global responsibilities. Since China's purchasing power parity or PPP-based Gross Domestic Product (GDP) overtook that of the United States in 2015, according to statistics from the International Monetary Fund (IMF), China has stepped up and assumed responsibility for upholding global economic standards and sustainable peace and security. At the same time, however, it is challenging the United States for regional and global leadership.

³A country must meet three criteria to become a global super economic power. First, it must be large enough to significantly affect the world economy. Second, it must be dynamic enough to contribute importantly to global growth. Third, it must be sufficiently open to trade and capital flows to have a major impact on the global economy. For details of China's rise as a G-2 super economic power, see C. Fred Bergsten, et al, *China's Rise: Challenges and Opportunities*, Peterson Institute for International Economic Policy and Center for Strategic and International Studies, 2008, 9–10.

As a result, the competition for hegemonic leadership in the Asia-Pacific region between China's "Chinese Dream" and the United States' "Pivot to Asia" policy (premised in turn on Japan's return to being a "normal" country) has become intense. In some respects, the two great powers appear to be on a collision course, causing a new wave of nationalism and heightened hegemonic rivalry in the region, including maritime territorial disputes in Asia. Economically, US President Barack Obama holds that the United States, not China, should write the rules for the world's fastest-growing region,⁴ even as the US-led Trans-Pacific Partnership (TPP) negotiations wrapped up in October of 2015. This American posture implies that the United States, together with its allies, especially Japan, will attempt to check China's looming dominance in the Asian Century. This power confrontation, combined with legacies of colonial occupation and subsequent wars in Asia, have brought about the "Asian Paradox," that is, the discrepancy between growing intra-regional economic interdependence on the one hand, and backward political and security cooperation on the other.

Short of war, however, assuredly the Asian economy, with the broadest manufacturing base in the world, a huge consumer market, and the largest population globally, will serve as a robust engine for global as well as regional economic growth. Both rising China and rapidly growing India, with the first and second-largest population in the world respectively, alongside that of the ASEAN states, are expected to lead regional and global growth.

In contrast to other developing countries, East Asia's newly industrializing economies have performed so well that their achievements have often been referred to as the East Asian Miracle. This miraculous growth began in the early 1960s through the adoption of an outward and export-based development strategy basically using the markets of industrialized countries, headed by the United States. Thus, East Asia's high-growth economies, with their open trade orientation, had not felt an urgency to develop systematic intra-regional economic cooperation until the eruption of the

⁴Katz argues that President Obama is hinting at the unspoken risk that China will lead a mercantilist race to the bottom based on subsidized national champion industries, basically state-owned enterprises. For details, see Sherman Katz, *Progress in TPP on Abuses of State Capitalism*, European Council for International Political Economy, ECIPE Bulletin No. 8, 2015, 1–2.

Asian financial crisis in 1997–1998.⁵ Shaped by this history, East Asia's pursuit of a regional economic community is likely to proceed on the basis of an open regionalism to maintain its traditional trade and investment linkages with extra-regional economies. East Asia's roadmap for a regional economic community, therefore, must address its formal free trade issues with key economies outside East Asia.⁶

During the Asian financial crisis, some East Asian economies, including Korea, undertook IMF-led restructuring programs as a condition of financial aid extended by the IMF. This restructuring process expedited a sense of East Asian economic community beyond natural functional integration on the basis of geographic proximity and different factor endowments. The integration process of the European Union and formation of the North American Free Trade Agreement between Canada, the United States, and Mexico also helped East Asia to launch the Chiang Mai Initiative (CMI) in 2000, a regional self-help financial architecture.

The CMI movement ushered in a more systematic concept of intra-regional economic cooperation in East Asia while recognizing the latter's inherent economic linkages with extra-regional economies in the Pacific Rim. For this purpose, East Asian economies have created a complex web of free trade agreements (FTAs) among intra-regional and extra-regional economies to ensure sustainable and robust development not only for individual economies, but also for regional common prosperity. Recently, the most notable in this regard have been the mega free trade deals, such as the Regional Comprehensive Economic Agreement (RCEP) and the TPP, in which major East Asian economies have been involved. Both of these mega free trade deals are likely to shape East Asia's regionalism in the years to come. In addition to trade integration efforts, China launched the Asian Infrastructure Investment Bank (AIIB) in 2015,

⁵The Association of Southeast Asian Nations (ASEAN) was exceptional in that it was launched in 1967 primarily for security reasons during the Vietnam and Cold Wars but gradually developed into an economic cooperation body.

⁶Through the pursuit of "trade for development," East Asia would still benefit more than any other region from global liberalization because of the wide scope of intraregional trade among what are very diverse economies. The potential gains to the region from global liberalization are estimated to be hundreds of billions of dollars by 2015. See Kathie Krumm and Homi Kharas, eds, *East Asia Integrates: A Trade policy Agenda for Shared Growth* (Washington DC: World Bank and Oxford University Press, 2004).

a multilateral development initiative with the ability to significantly impact the evolution of East Asian regionalism.

Given East Asia's ongoing economic regionalism in an unfolding "Asian Century," how can East Asian economies address opportunities and challenges to realize an East Asian economic community? How will competition among the great powers, especially between the United States and China, affect the integration process of the East Asian economic community? What should smaller economies do to prepare for this likely future economic community? This essay attempts to shed light on these questions. Section II describes the concept of economic community, the economic profile of East Asia vis-a-vis other major economic blocs, a functional and natural integration process, and formal integration efforts made, especially after the Asian financial crisis. Section III presents basic characteristics of the two great free trade deals, namely the TPP and RCEP. Section IV discusses the impact of the China-led Asian Infrastructure Investment Bank (AIIB) on East Asian integration in relation to the Asian Development Bank (ADB) and the World Bank. Section V presents alternative scenarios or paths toward an East Asian economic community. Section VI concludes with a summary of policy implications.

CONCEPT OF ECONOMIC COMMUNITY AND EAST ASIA'S FUNCTIONAL INTEGRATION

To discuss integration processes in East Asia, it is first necessary to define the concept of economic community in terms of regional integration. It is also necessary to describe a dynamic change already underway in the regional economic profile of East Asia, in particular, increasingly closer economic interactions between intra-regional economies in the absence of formal integration architecture in East Asia.

Definition of Economic Community

This essay broadly defines economic community as a regional and sub-regional group of economies that aim to achieve economic integration. Regional integration has been defined as the process through which national states within a region increase their level of interactions under common institutions and rules related to economic, security, political, and social and

cultural issues.⁷ Regional integration is organized through supra-national institutional structures or intergovernmental decision-making, or a combination of both. In this context, economic integration involves unifying economic policies through the partial or full abolition of tariff and non-tariff barriers to trade, investments, and factor movement across borders. It ranges typically from preferential trade arrangements, to custom unions, to fuller economic integration with some diverse forms, including capital and labor movement, and finally to a supra-national entity as seen in the European Union.⁸ Due to the information and communication technology revolution, however, an emerging tendency of creating complex webs of FTAs with extra-regional economies and regional value chains has blurred the classical sequencing of regional integration process. The scope and degree of policy harmonization determines various stages of integration. In the course of upgrading and deepening of economic integration, economic communities naturally evolve over time into political unions.

Here, East Asia is defined to include China, Japan, Korea, and ASEAN's ten member economies. When East Asia's formal integration architecture is viewed as an open regional framework, it also includes extra-regional countries like India, Australia, and New Zealand. These sixteen economies (ASEAN, China, Japan, Korea, India, Australia, and New Zealand) are negotiating the RCEP, a free trade mega-deal to discuss ongoing intra-regional integration issues. In October 2015, meanwhile, the twelve Pacific Rim economies concluded the TPP⁹ agreement, hitherto the largest FTA in the world.

⁷For details, see H. van Ginkel, H. and L. Van Langenhove, "Introduction and Context" in Hans van Ginkel, Julius Court and Luk Van Langenhove (Eds.), *Integrating Africa: Perspectives on Regional Integration and Development* (Tokyo: UNU Press, 2003), 1–9.

⁸Bela Balassa provided the sequencing of economic integration from preferential trading area or free trade area, to custom unions, common market, economic union (economic and monetary union), and finally to complete economic integration. See Bela Balassa, "Trade Creation and Trade Diversion in the European Common Market," *The Economic Journal*, vol. 77, (1977), 1–21.

⁹The TPP member countries include the United States, Japan, Canada, Mexico, Australia, New Zealand, Peru, Chile, Vietnam, Malaysia, Brunei, and Singapore. Historically, the TPP is an expansion of the Trans-Pacific Strategic Economic Partnership (TPSEP) Agreement, which was signed by Brunei, Chile, New Zealand, and Singapore in 2005 on the sidelines of APEC meetings but gained great momentum after being joined by the United States in 2008 and Japan in 2013.

In the past half century, East Asian economies outperformed the rest of the world's emerging economies.¹⁰ The first-tier East Asian miracle economies, namely Korea, Taiwan, Hong Kong, and Singapore, had adopted export-oriented, outward-looking development strategies beginning in the early 1960s in contrast to other developing countries. The second-tier high-performing economies, including Malaysia, Thailand, and Indonesia, have also followed a similar export-based path for economic development. These second-tier economies are resource rich, whereas the first tier is resource poor. As a result, they have interacted with each other in ways that deepened trade linkages on the basis of comparative advantage, starting from the horizontal division of labor and moving onto the vertical division, even in the absence of formal integration schemes. Recently, intra-regional trade linkages in East Asia have evolved naturally into formidable global value chains. In addition, functional integration on soft regionalism has been accelerated through various formal free trade deals in the region.

East Asia's Rise as the Driver of World Economic Growth

East Asia in a narrower sense is defined here as China, Japan, and Korea (a grouping referred to hereafter CJK), plus ASEAN. As shown in Table 6.1, East Asia's economic size rose 1.0%, from 23.2% of the world GDP in 1994 to 24.2% in 2014, whereas the NAFTA share declined from 30.4% to 26.3% over the same period. The European Union or EU15 economies' GDP share also dropped from 28.8 to 21.9%. On the trade side, however, East Asia's share of global trade (exports and imports) increased dramatically, from 37.7% to 59.5%, while NAFTA's trade share declined from 38.0 to 30.4% over the same period. This suggests that in the past decade, East Asia has been the main force in global trade expansion, outstripping that of NAFTA and the EU15. In this regard, China in the past four decades has

¹⁰For the high performance of and factors responsible for the miracle East Asian economies in the early 1960s through the early 1990, see World Bank, *The East Asian Miracle: Economic Growth and Public Policy*, *op cit*.

Table 6.1 Economic profile of Major Economic Groups in Global Shares (Unit: %)

<i>Year</i>	<i>Group</i>	<i>Population</i>	<i>GDP</i>	<i>Exports</i>	<i>Imports</i>	<i>Outbound FDI</i>	<i>Inbound FDI</i>
1994	CJK	24.2	21.2	14.2	11.1	14.0	8.0
	ASEAN	8.4	2.0	6.1	6.3	8.0	3.9
	EU15	6.6	28.8	39.3	37.2	30.2	42.3
	NAFTA	6.8	30.4	17.1	20.9	25.2	29.3
2014	CJK	21.2	21.0	18.9	17.3	11.4	19.2
	ASEAN	8.6	3.2	6.8	6.5	10.8	5.9
	EU15	5.6	21.9	28.2	27.3	17.2	19.6
	NAFTA	6.6	26.3	13.1	17.3	13.8	29.1

Source World Bank, World Development Indicators; WTO International Trade Statistics; UNCTAD FDI Statistics, various years

played a critical role in the economic rise of East Asia by exhibiting a 10.0% average annual GDP growth rate since adopting an open door policy in 1978, until 2012.¹¹

On the foreign direct investment (FDI) side, inbound FDI to CJK increased significantly during the two decades between 1994 and 2014 mainly by China's upsurge, jumping from 8.0 to 19.2%. The UNCTAD report indicated that China has surpassed the United States to become the largest FDI recipient in the world. FDI inflows to China reached \$129 billion in 2014 while its FDI outflows recoded \$116 billion. Inbound FDI flows have been increasingly concentrated on the service sector, such as retail, transport and finance, climbing to 55.0%, while that of manufacturing dropped to 33.0% due to rising labor costs.¹²

Intra-regional trade among East Asian economies—CJK, ASEAN, and RCEP—deepened significantly during the period between 1992 and 2014 while the intra-regional trade index of the EU15 declined. The intra-regional trade index of NAFTA has remained almost constant over the same period (Table 6.2).

Noteworthy in Table 6.3 is how Japan and Korea's dependence on intra-CJK trilateral trade increased substantially over the 1992–2014 period while China's index declined significantly through diversifying international trade with the rest of the world. Together, Tables 6.2 and 6.3

¹¹*China Statistical Year Book*, 2012.

¹²For the description of FDI flows and their characteristics in East Asia, see the UNCTAD *World Investment Report* 2015, Geneva: UNCTAD, 2015, 40–45.

Table 6.2 Intra-regional Trade Dependence (Unit: %)

<i>Year</i>	<i>CJK</i>	<i>ASEAN</i>	<i>NAFTA</i>	<i>EU15</i>	<i>RCEP</i>
1992	14.0	18.5	39.7	65.2	35.1
1995	18.6	21.0	42.0	61.7	40.3
2000	20.3	22.7	46.8	60.0	40.6
2005	23.7	24.9	43.0	58.3	43.0
2010	22.1	24.6	40.0	56.1	44.1
2014	19.1	24.0	41.9	54.5	42.6

Source IMF (2015), Direction of Trade Statistics

Table 6.3 CJK Intra-Regional Trade Dependence of China, Japan, Korea (Unit %)

<i>Year</i>	<i>Korea</i>		<i>China</i>		<i>Japan</i>	
	<i>Export</i>	<i>Import</i>	<i>Export</i>	<i>Import</i>	<i>Export</i>	<i>Import</i>
1992	18.4	27.9	16.5	19.9	8.7	12.3
2000	22.5	27.8	21.2	28.7	12.8	19.9
2005	30.1	33.3	15.6	26.9	21.3	25.8
2010	34.3	34.7	12.0	22.5	27.5	26.2
2014	31.0	27.4	10.7	18.0	25.8	26.4

Source World Bank, World Development Indicators; UNCTAD FDI Statistics, WTO International Trade Statistics

show that China's rise as a global trade power has increased not only intra-regional trade linkages in East Asia, but also global trade as a whole.

East Asian economies historically followed the East Asian flying geese model led by Japan until the early 1990s. But China's sustained growth, based on export-oriented manufacturing and infrastructure investment, upgraded East Asia's economic profile globally. With China's recent and rapid rise in wages, labor-intensive manufacturing activities by multinational firms began to shift to India, Vietnam, and Myanmar.

China's rise as the world's highest economically performing country over the past two decades has also brought an urgency of territorial rescaling and trans-border linkages to the cities and regions of Northeast Asia. The emergence of mega-regions along China's coastal area triggered major territorial and structural adjustments in all the countries and sub-national regions or inter-local cities, as evident in the Pan Yellow Sea

circle, Mekong delta, and Pan East Sea circle.¹³ As participants in this bottom-up integration process, most economies in East Asia have been involved in developing supra-regions within national boundaries as well as cross-border regions. This approach reflects the changing paradigm of regional policies within nation-states in response to increasing economic globalism and regionalism.

Given the other top-down ongoing bilateral, sub-regional, and regional trade integration efforts, East Asian economies have woven complex free trade agreements. By 2013, RCEP member states had enacted no less than 156 FTAs with global trading partners to ride on the winds of prevailing regionalism.¹⁴

As an urgent reaction to the Asian financial crisis in 1997–1998, East Asia institutionalized a self-help mechanism for financial aid through the CMI. This began as a series of bilateral currency swap arrangements after ASEAN plus CJK met in 2000 in Chiangmai, Thailand, at an annual meeting of the ADB to manage a regional liquidity shortage and to facilitate collaborations with other international financial arrangements and organizations like the IMF.

The CMI draws from a foreign exchange reserves pool worth US\$120 billion at the beginning of 2010. But that pool was expanded to \$240 billion in 2012. Thus, East Asia created a financial integration mechanism ahead of formal trade integration. After being shocked by the sudden outflow of international hedge funds during the Asian financial crisis, East Asian economies agreed to set up a formal regional financial institution. The CMI did not live up to expectations during the 2008 global financial crisis.¹⁵ As a result, policymakers realized the CMI needed a reserve pooling arrangement to multi-lateralize the initiative, as shown in Table 6.4. Hence, the CMIM (CMI multi-lateralization) was founded to increase its bailout capacity when critically needed.

¹³For details, Choong Yong Ahn, “Can Asia save the Sinking world Economy?” *Global Asia*, vol. 52, No. 4, Winter (2011) 34–45.

¹⁴See Asia Development Bank, Asia Regional Integration Center, *ADB Integration Indicators*, (Manila: Asian Development Bank, 2013).

¹⁵For example, instead of seeking CMI liquidity provision, Korea and Singapore used the U.S. Federal Reserve as their way of securing liquidity.

Table 6.4 Contribution and maximum benefit amount for CMI multi-lateralization

<i>Nation</i>	<i>Contribution</i>		<i>Maximum benefits</i>	
	<i>Amount (US\$ billion)</i>	<i>Share (%)</i>	<i>Ratio (times)</i>	<i>Amount (US\$ billion)</i>
Korea	19.2	16.0	1	19.2
China (including Hong Kong)	38.4	32.0	0.5	19.2
Japan	38.4	32.0	0.5	19.2
Total	96.0	80.0	–	57.6
Big				
Indonesia	4.77	3.97	2.5	11.92
Malaysia	4.77	3.97	2.5	11.92
Thailand	4.77	3.97	2.5	11.92
Singapore	4.77	3.97	2.5	11.92
Philippines	3.68	3.07	2.5	9.2
Total	22.76	18.9	–	56.9
Small				
Brunei	0.03	0.02	5	0.15
Cambodia	0.12	0.10	5	0.6
Laos	0.03	0.02	5	0.15
Myanmar	0.06	0.05	5	0.3
Vietnam	1.00	0.83	5	5.0
Total	1.24	1.0	–	6.2
ASEAN Total	24.0	20.0	–	63.1
Grand Total	120.0	100	–	120.7

Source http://en.wikipedia.org/wiki/Chiang_Mai_Initiative

EMERGING GLOBAL VALUE CHAINS

Over the past 30 years, growing technological progress and the related complexity of production processes, trade liberalization, and lower transportation and communication costs have reshaped the landscape of global trade. In particular, production has become increasingly fragmented as a result of growing regional and global value chains (GVCs), with components and parts crossing numerous international borders as market forces dictate.¹⁶ This trend has resulted in faster growth in intermediate inputs than in the trade of final goods. This new pattern of production has also been prevalent in Asia. The IMF provided empirical evidence that, from

¹⁶For details about the Global Value Chain phenomenon, see IMF, *Regional Economic Outlook: Asia and Pacific, Stabilizing and Outperforming Other Regions*, World Economic and Financial Survey, April 2015, 73–92.

1995 to 2013, Asia's trade in intermediate goods grew by a factor of six, while trade in final goods grew almost four-fold. This trend in Asia compares with fourfold and threefold increases of trade in intermediate and final goods, respectively, in the rest of the world.¹⁷

IMF evidence also suggests that integration into GVCs brings benefits to participating economies beyond those traditionally associated with international trade in final goods. This outcome was made feasible by exploiting finer competitive advantages and economies of scale and scope. The rise of GVCs has two important macroeconomic implications. One relates to the increase in interconnectedness among countries. The other relates to the impact of the exchange rate, which could be dampened or amplified depending on an economy's position in the GVC because the import of intermediate goods in a GVC are also inputs into exports. A standard GVC encompasses a number of production stages, from upstream product conception to midstream assembly and finally downstream branding and marketing.

Given the growing interconnectedness of countries through GVCs and joint ventures, free trade deals have reinforced trade and intra-regional cross-border FDI flows in East Asia to take advantage of geographical proximity, differential factor endowments, and the attractiveness of huge consumer markets. Yamano *et al.*¹⁸ show the Asian trade network is increasingly fragmented and results in higher dependence on supplies of goods and services between ASEAN and East Asian countries on the basis of the OECD input-output Bilateral Trade Databases.¹⁹ As a result, the production fragmentation of major companies on the one hand, and cross-border investments in the form of joint ventures among multinational firms and local ones on the other, have been more visible. This pattern is likely to be a characteristic of a viable East Asian economic community.

¹⁷See IMF, *Regional Economic Outlook: Asia and Pacific, Stabilizing and Outperforming Other Regions*, World Economic and Financial Survey, April 2015, 73.

¹⁸Norihiko Yamano *et al.*, "Fragmentation and Changes in the Asian Trade Network," Economic Research Institute for ASEAN and East Asia (ERIA), Policy Brief, No 2011-01, January, 2011.

¹⁹For details, see Norihiko Yamano *et al.*, "Fragmentation and Changes," 2011, *op cit*, 1-7.

Joint ventures among multinational companies originating in different countries have also become more common and aim to realize win-win solutions in global competitions. Despite ongoing diplomatic uneasiness about historical issues between Korea and Japan, the companies of the two countries have continued to conduct joint investments to maximize their complementarity. Participation in GVCs and joint ventures have been an important driving force to increase FDI across nations, especially in East Asia.

The case of Japan's Fuji Xerox participating in GVCs in Japan, Korea, and China is illustrated in Fig. 6.1. The mother company in Japan specializes in product design and research and development (R&D) whereas subsidiary companies in Korea and China produce input devices and output devices, respectively, while carrying out related R&D. Final assembly occurs at three locations and final goods are stored in the Singapore distribution center to meet demand in ASEAN and other regional economies. In the process of deepening GVCs, both input and output devices in finer technological segmentation increasingly cross the borders of the three countries.

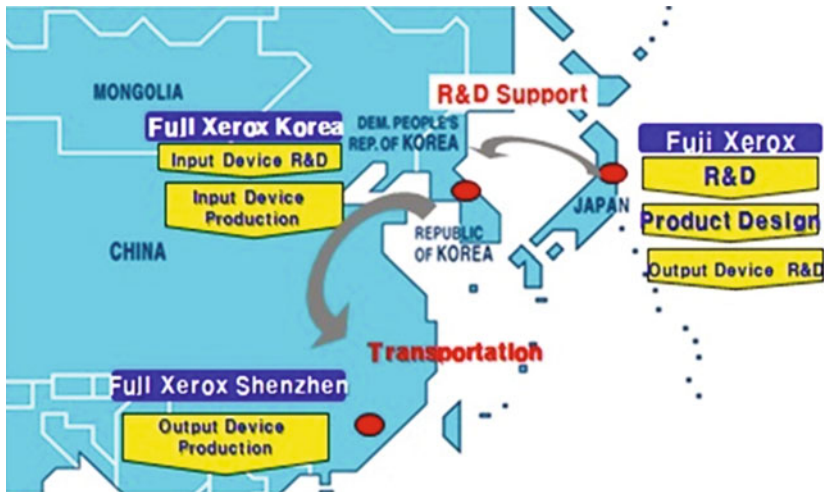


Fig. 6.1 Global Value Chains in Northeast Asia: The Case of Fuji Xerox. *Source* PPT material on “Aftercare Services and FDI Inducement in 2012” Office of the Foreign Investment Ombudsman, KOTRA, Korea

Table 6.5 Joint Ventures between Korean and Japanese Parts and Materials Companies

<i>Company</i>	<i>Project</i>	<i>Amount (US\$ million)</i>	<i>Period</i>
Samsung Electronics	Joint Plant for High-Tech Touch	120	July 2011
Sumitomo Chemical	Panel & LED Parts		
Hyundai Motors	R&D Center for Automotive	54	Feb 2011
DENSO	Parts (HV module)		
SK Global Chemical	Joint Plant for Paraxylene &	550	2011–
JX Nippon Oil & Energy Corp	Lubricating Oil		2012
Samsung Electronics	R&D Center for OLED	340	May 2011
Hodogaya Chemical	Materials		
Hyundai Oil Bank	Joint Plant for BTX (Aromatics)	250	2010–
COSMO OIL			2012
GS Caltex	Joint Plant for LIB Anodes &	9	2011
JX Nippon Oil & Energy Corp	Carbon Materials		
POSCO	Joint Plant for Artificial Graphite	170	Early 2012
Mitsubishi Chemical	(Pitch Cokes)		
GS Caltex	Joint Plant for High Purity	25	Early 2012
Tokai Carbon	Isotropic Graphite		

Source FDI report, Invest Korea, Korea Trade-Investment Promotion Agency, 2011

It is noteworthy that, amid recent diplomatic and security conflicts between Korea and Japan, some of their leading conglomerates agreed to develop joint ventures in the electronics, chemicals, and energy-related industries, as shown in Table 6.5. The motivation for corporate connectivity through joint ventures with sizable investment is to combine mutual strengths to increase overall market shares, which generates a win-win outcome for both countries.

EAST ASIA'S EXTRA-REGIONAL DEPENDENCE

Until the mid-1990s, East Asia's economic rise was aided by the United States' "unlimited" absorption of East Asia-made products through its free trade regime and vast consumer market. The United States' trade with

Table 6.6 US Trade with China, Japan, Korea, and ASEAN (Unit: US \$ billion)

<i>Year</i>	<i>China</i>		<i>Japan</i>		<i>Korea</i>		<i>ASEAN</i>	
	<i>Export</i>	<i>Import</i>	<i>Export</i>	<i>Import</i>	<i>Export</i>	<i>Import</i>	<i>Export</i>	<i>Import</i>
1990	4.8	15.2	48.6	89.7	14.4	18.5	28.0	23.6
1995	11.7	45.6	64.3	123.6	25.4	24.2	59.8	50.3
2000	16.3	100.0	65.3	146.6	27.9	40.3	81.0	51.6
2005	41.8	243.5	55.4	138.1	27.7	43.8	94.0	61.0
2010	91.9	365.0	60.5	120.6	38.8	48.9	100.3	84.0
2011	104.0	399.4	65.7	128.9	43.4	56.7	105.6	94.1
2012	110.5	425.6	70.0	146.4	42.3	58.9	92.2	109.3
2013	122.0	440.4	65.1	138.5	41.6	62.2	92.8	115.1
2014	124.0	466.7	67.0	133.9	44.5	69.6	89.2	128.4

Source IMF, Direction of Trade Statistics and International Trade Statistics of Korea International Trade Association, Various Years

Japan, Korea, and ASEAN until the mid-1990s was substantial, but recorded a sizable deficit against its major Asian trading partners. Thus, it became critical for East Asian economies to adjust to long-standing global trade disparities by striking an optimal balance.²⁰

Given the ongoing new normal phenomenon where East Asian economies have become more robust and powerful, the United States has shifted its foreign trade and security focus to Asia through its “Pivot” or rebalancing towards Asia, especially vis-a-vis rising China in the G2 framework.

Today, China is the largest trading partner of the United States. It has the largest US dollar denominated foreign exchange reserves, amounting to US\$3.5 trillion in December 2015. China has registered phenomenal economic growth in the past 40 years, averaging nearly 10.0% a year. At the nuclear-security summit in early 2010, President Obama hoped to ensure another 50 years of growth between the two countries.

²⁰For details on the trade imbalance issues between the United States and major Asian economies, see Choong Yong Ahn, “Can Asia save the Sinking world Economy?” *op cit*, 2011, 34–45.

EAST ASIA'S FREE TRADE MEGA DEALS

Since the WTO began to implement the Doha Development Agenda in 2001, regionalism has emerged—whether in the form of bilateral FTAs or plurilateral FTAs with a small and large number of economies. Regionalism generates like-mindedness to pursue international free trade and cross-border investment, not only in East Asia, but also with the rest of the world. According to the regional trade agreement (RTA) database of the WTO, the number of RTAs notified to the WTO has increased rapidly since the early 1990s, reaching 612 cases as of April 2015. Until the early 2000s, East Asia was referred to as an “FTA Vacuum,” but since the second half of the 2000s, bilateral and sub-regional FTAs numbered forty two by the end of 2014.²¹ As noted earlier, by expanding small free trade deals into bigger ones, two mega free trade deals in the Asia-Pacific region have emerged: TPP and RCEP.

Conclusion of TPP Negotiations

On October 5, 2015, after 7 years of negotiations, 12 Pacific Rim countries concluded the TPP, a trade agreement concerning a variety of liberalization policies and measures. TPP's stated goal had been to “promote economic growth; support the creation and retention of jobs; enhance innovation, productivity and competitiveness; raise living standards; reduce poverty in member countries; and promote transparency, good governance, and enhanced labor and environmental protection.” In 2013, the twelve TPP member states accounted for 36.8% of world output, 25.3% of world trade, and 11.4% of the global population. It is by far the largest trading bloc in the world.

After seeing how the progress of the EU integration process led to the current supra-national architecture and launch of NAFTA in 1994, then Prime Minister of Malaysia Mohamed Mahathir called for economic unity among East Asian economies by proposing the idea of the East Asian Economic Caucus, excluding the United States from economic cooperation with ASEAN, China, Japan, and Korea. An attempt to isolate the United States amid East Asian regionalism and functionally deepening

²¹For details, see Misa Okabe, “Impact of Free Trade Agreements on Trade in East Asia,” Economic Research Institute for ASEAN and East Asia, Working Paper, January 2015, 28–29.

integration through rising China was a wake-up call, causing the United States to pivot towards Asia and rebalance its Asian posture. As a result, the United States aggressively concluded the TPP to bind closer to some of its strongest allies in Asia, such as Japan and some ASEAN members.

Among other things, the TPP agreement contains measures to significantly lower tariffs and non-tariff barriers in an effort to sustain an open and competitive global economy.²² The agreement also contains provisions to further improve trade and investment liberalization. The United States government has considered the TPP the companion agreement to the proposed Transatlantic Trade and Investment Partnership (TTIP), a broadly similar agreement between the United States and the European Union.

The National Foreign Trade Council (NFTC) of the United States assesses that the TPP can be a major step forward in establishing rules-based international trade, opening foreign markets, and enhancing economic growth for the United States and its Pacific Rim trading partners. It will also provide major new market opportunities for goods, services, and investment, reducing barriers to trade and investment and enhancing disciplines over state-owned enterprises that compete with private companies. The TPP chapter on state-owned enterprises (SOEs) is a vivid illustration of the open and competitive nature of the new trade rules. The SOE rules, all enforceable through dispute settlement, require new obligations essential to avoiding the abuse of state capitalism through the provision of subsidies and government control and non-commercial assistance to SOEs.²³ At this point, the new SOE rules are hardly acceptable to China, where SOEs still occupy 40 percent of its investments and two-thirds of its exports.

As investment has become a steadily more important part of international trade, investor protections have proliferated. A key provision in the TPP and other major US agreements includes “Investor State Dispute

²²Reflecting the United States Tobacco Association’s concern, the TPP agreement can opt out of tobacco-related measures.

²³China’s competition law gives immunity to SOEs who break the law if the SOEs are vital to the Chinese economy, China’s SOEs are shielded by unpublished government budgets, internal instructions, oral directives, and a law that treats can treat commercial information as state secrets. For details, see Sherman E. Katz, *Progress in TPP on Abuses* 2015, *op cit*, 1–2.

Settlement“ (ISDS). It is meant to provide investors with some recourse if a host government wrongs them. It is particularly valued by businesses in countries where the judicial system is weak or corrupt. The early resolution of areas for improvement identified by the US business community is likely to speed up approval by Congress in 2016.

At present, the TPP without China has benchmarked in many aspects the degree and scope of liberalization contained in the already effective Korea-US FTA. But it also upgraded or added some trade rules such as TRIP protection, labor standards, environmental protection, and management of state-owned companies. As a result, the TPP can serve as a strong foundation for other high-quality trade agreements going forward in the twenty-first century.

Acceleration of RCEP Negotiations

As the TPP progressed, another regional mega deal in the Asia-Pacific region, RCEP, gained new momentum with China's enthusiastic support. RCEP is a proposed free trade agreement between the ten member states of ASEAN and the six states with which ASEAN has effective FTAs (Australia, China, India, Japan, Korea, and New Zealand). RCEP negotiations officially began in November 2012 at the ASEAN Summit in Cambodia. According to 2013 statistics from the IMF and UNCTAD, RCEP accounted for 48.7% of the world population, 29.0% of the global GDP, and 29% of world trade. That is far bigger than the population of TPP member states and slightly bigger than the TPP's trade volume, although its GDP share is lower than that of the TPP, at 37.0%.

Compared with the TPP, RCEP has a much looser and lower level of trade and investment liberalization schemes. The agreement will cover trade in goods and services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement and other issues. As expected, ASEAN will be in the “driver's seat” of this multilateral trade arrangement (though the idea was initially suggested by Japan), and has been repeatedly endorsed by India. The joint statement issued at the end of the first round of negotiations also reiterated “ASEAN Centrality”²⁴

²⁴As ASEAN continues to outreach multilateral trade and investment liberalization deals with non-ASEAN states, ASEAN's position should remain the basic guideline and principle.

in the emerging regional economic architecture. After seeing the progress of the TPP, and in response to the United States' aggressive leadership in pushing through the TPP as a check to China's rise, China became very enthusiastic about the RCEP deal. At the launch of negotiations on November 20, 2012, the leaders of each relevant country endorsed the "Guiding Principles and Objectives for Negotiating the RCEP." At present, RCEP without the United States has also been under negotiation largely by earlier ASEAN member states, but later reinforced China's leadership. Given the absence of the United States in RCEP and of China in the TPP, the two mega deals in East Asia appear to counterweigh each other's influence in regional integration.

On the intra-regional trade side, East Asia as a global manufacturing powerhouse has not fully used its potential for inborn regional supply chains compared to other regional integration efforts observed in the EU. Thus, along with the TPP, RCEP has been a possible pathway to a free trade area of the Asia-Pacific, and a contribution to building momentum for global trade reform. Both RCEP and the TPP have involved negotiations with multiple parties and sectors.

Given the ongoing slow growth and underemployment as a "new normal" and rising economic interdependence between the United States and China, if both the TPP and RCEP eventually converge, they may become building blocks toward an early realization of an overarching Free Trade Area of the Asia-Pacific (FTAAP) through trade and investment.

Intersection Economies of TPP and RCEP

There are several economies that belong to both TPP and RCEP. The intersection economies include Japan, Australia, New Zealand, Singapore, Brunei, Vietnam, and Malaysia as shown in Fig. 6.2. Korea, together with Indonesia, Thailand, Philippines, Taiwan, and Colombia, having expressed their intention to join the TPP after the effectuation of the treaty by the founding twelve members, may play a role of synthesizing key elements of the TPP and RCEP to prevent a direct confrontation between two competing great powers. In particular, ASEAN and Korea can play the role of trustworthy brokers between China and the United States by linking the TPP and RCEP.

In December 2015, Korea—having a high-standard FTA with the United States—became the first Organization for Economic Co-operation and Development (OECD) economy with which China has an effective FTA.

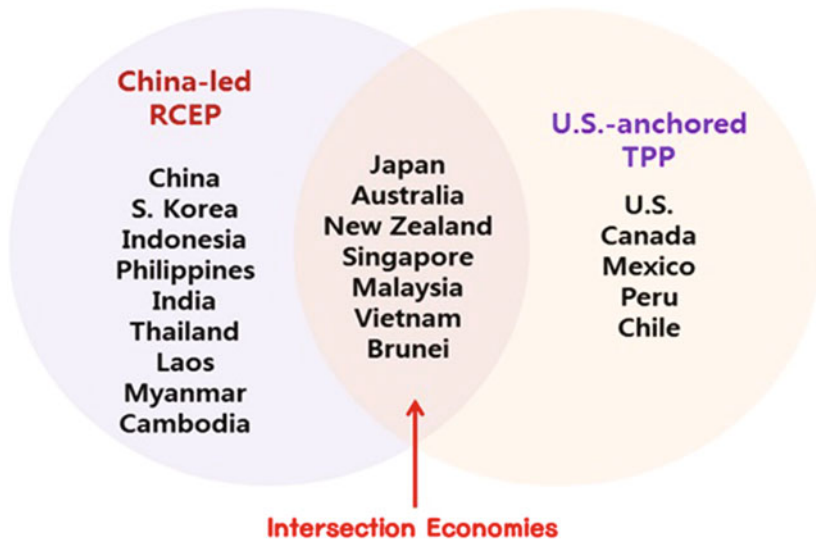


Fig. 6.2 Convergence of US-anchored TPP and China-led RCEP

While implementing the Korea-China FTA, Korea should be able to push for upgrading, for example, China's trade-related intellectual property regime, transparency and the disclosure standard of state-owned enterprises, and ISD-related measures. They have been on the priority agenda whenever the United States has had a bilateral trade dialogue with China.

East Asia's New Financial Architecture AIIB

In April of 2014, China proposed establishing the AIIB, an international financial institution focused on solely supporting infrastructure construction in the Asia-Pacific. To China, the World Bank and the Asia Development Bank (ADB) failed to deliver on large projects meant to transform less developed parts of Asia, resulting in an estimated \$8 trillion for needed projects in rails, ports and power plants.²⁵ China proposed

²⁵Both the World Bank and ADB aim to fight poverty and improve living standards through funding in areas like education, infrastructure, agriculture and health. Both have faced criticism for moving too slowly and for bureaucracy. For details, see *International New York Times*, "How China bypassed U.S. fears to form a World Bank rival," December 7, 2015, 15.

doubling the registered capital for the AIIB from the initially proposed \$50 billion to \$100 billion to induce more prospective founding members. As a result, the China-led proposed initiative won the endorsement of thirty-seven regional and twenty non-regional Prospective Founding Members, of which many are American allies despite the United States' opposition to joining the AIIB.

The AIIB could allow Chinese capital to finance various infrastructure projects along "one belt, one road," ambitiously extending the policy of the New Silk road into the near and Middle East as well as into Africa. The China- proposed AIIB attempts to link the countries that were on the ancient Silk Road routes—the land and ocean-based ones—through transportation and infrastructure networks. Many speculate that China, through the AIIB initiative, also intends to counter-balance the US-led IMF, World Bank, and Japan-led ADB in global financial affairs. The AIIB scheme will allow China to promote the use of the renminbi in international investment and finance, turbocharging renminbi usage by emphasizing the role of the Chinese currency as a vehicle to raise capital in overseas financial centers.²⁶

In response to China's invitation to join the AIIB, most regional key economies like India, Indonesia, the rest of the ASEAN member states, Korea, and Australia became regional members. Major non-regional members include the United Kingdom, Germany, France, and Italy. However, the United States, Japan, and Canada did not join the AIIB and regard it as a rival for the IMF, World Bank, and ADB. China regards the three major financial institutes as dominated by developed countries, serving primarily American, European, and Japanese interests. The Chinese government has been frustrated with what it regards as the slow pace of reforms and governance and wants greater input in the three global financial institutions.²⁷

²⁶See *The Financial Times*, "One Belt, One Road set to turbocharge renminbi usage" November 30, 2015.

²⁷Until March 2015, China in the ADB had only a 5.47 percent voting right, while Japan and the United States have a combined 26 percent (13 percent each) with a share in subscribed capital of 15.7 percent and 15.6 percent, respectively.

Through the AIIB, China has offered countries in the Asia-Pacific region an alternative to infrastructure loans from the World Bank and ADB. In effect, China is directly challenging the power and influence of the United States in the fields of finance and banking at both the regional and international level.

According to the Asian Development Bank Institute, Asia requires an infusion of \$8 trillion from 2010 to 2020 for infrastructure investment to maintain the current economic growth rate. China claims that the AIIB will have well-balanced, wide-ranging projects, from energy resources, electricity, and transport, to irrigation infrastructure. Its membership is also said to be open to members from the World Bank and ADB. Due to its refusal to release basic data, erstwhile, Chinese ally North Korea applied to join, but was rejected by China.

The AIIB reflects China's newfound international clout by having fifty-seven prospective members. The UN has also addressed the launch of the AIIB as "scaling up for sustainable development" to support improved global economic governance. For the AIIB to foster economic connectivity and a new type of industrialization in Asia, the AIIB should meet global best practices with high standards, particularly related to governance and environmental and social safeguards.

In the years to come, AIIB-sponsored infrastructure projects in South and Central Asia are expected to contribute to a significant increase in investment opportunities in Asia. New investment opportunities arising from the AIIB would be mutually reinforced by the freer flow of cross-border investments as stipulated by the TPP and RCEP. Infrastructure development in Asia on a vast scale is expected to become a new source of regional growth and dynamism.

THE BUMPY ROADS TOWARD AN EAST ASIAN ECONOMIC COMMUNITY

In the past three decades under the *General Agreement on Tariffs and Trade* (*GATT*) led by the United States and WTO, East Asia (ASEAN plus CJK), especially the four dragon economies (Korea, Taiwan, Hong Kong, and Singapore), achieved the "East Asian economic miracle" by adopting an export-oriented development strategy. They enjoyed "unlimited" access to the US market in the post-WWII years and later took advantage of their own geographical proximity and high growth to become more connected and interdependent functionally.

As noted in Section I, since the Asian financial crisis in 1998, East Asian economies have developed an “East Asian Identity.” The self-help mechanism among East Asian economies such as CMI was launched to avoid the recurrence of the financial contagion triggered by extra-regional shocks. The scheme has introduced the advent of hard regionalism in the forms of various FTAs in East Asia.

Although East Asia then experienced a wave of hard regionalism in the form of FTAs, the region still suffers from serious caveats when it comes to economic cooperation. Despite being immediate neighbors, the leaders of China, Japan, and Korea (CJK) met for the first time in history only after the Asian financial crisis in 1998. The three countries still share vivid memories of devastating wars fought against each other, colonial occupations, and ideological confrontations during the Cold War and subsequent accumulated mistrust.

Any long-term outlook of East Asian integration will be affected greatly by how the bilateral relationship between the United States and China evolves in the years to come. Will these great powers, veritable economic superpowers, collide or collaborate, or will they take a mixed stance in pursuit of their own national interests? In this context, the future role of Japan as the third-largest economy and one of the United States’ most important allies will complicate further the picture of East Asian integration.

Recently, three great institutional mechanisms have been established to alter the economic and diplomatic landscape in the Asia-Pacific rim. One is the US-anchored TPP and the other is the China-centered RCEP and AIIB. Are the three great international institutions—the TPP, RCEP, and AIIB—going to counterweigh each other in a competition for hegemonic leadership in the Asia-Pacific or collaborate to generate synergies?

Given the rivalry for regional hegemonic leadership between the United States and China, the paths to an East Asian economic community hold both challenges and opportunities. And, given the bilateral trade and investment linkages between the United States and China, the rivals may agree on certain bilateral and global agendas while opposing each other for mutual containment.

We might consider three distinct approaches to envisage the future of an East Asian economic community. First, we assume the direct military confrontation over the South China Sea between China and the United States—occasionally allied with Japan and India—continues to contain or isolate China in the Asia-Pacific region and globally. Second is a current

status quo approach with US policy focused on mildly engaging and containing China in the Asia-Pacific region and globally. Third is a more aggressive and concerted approach, which will be nurtured in the search for mutual growth and benefits by the United States, China, Japan, and middle powers like Canada, Australia, Korea, and Indonesia.

A Zero-Sum Game with Military Confrontation

Whether the roads toward an East Asian economic community are bumpy or smooth depends on how the United States, along with Japan, designs regional security architecture vis-a-vis China's military assertiveness. In recent years, China has been transforming reefs in the Spratly archipelago into artificial islands and has built airfields and other facilities on them. This activity has caused a sense of regional alarm in much of East Asia about China's intentions and freedom of navigation and overflight in a waterway through which most of East Asian maritime cargo passes. President Obama said at an APEC sideline meeting between the United States and ASEAN leaders in November of 2015, "For the sake of regional stability, we agree on the need for bold steps to lower tensions, including pledging to halt reclamation, new construction, and militarization of disputed islands in the South China Sea."²⁸ The United States appears committed to not allowing China to proceed unchallenged with a takeover of one of the busiest and most strategic areas of water in the world.

However, China insisted that it has undisputed sovereignty over most of the South China Sea, which overlaps with four ASEAN countries. There is also an unresolved territorial dispute between China and Japan over the Sengaku islands (known as the Diaoyu Island in China) in the East China Sea. As a consequence of unresolved territorial disputes, any military collision escalating into warfare between two superpowers and between China and Japan might completely jeopardize East Asia's ongoing economic integration, one that is framed in an open regionalism.

Given this security conflict between the United States and China, the United States could pursue a strategy to transform its security alliance with Japan, India, Australia, and Canada into an economic alliance. As a result, the TPP without China and RCEP without the United States could

²⁸"China must stop land reclamation in South China Sea-Obama." November 18, 2015, at: <http://www.bbc.com/news/world-asia>.

proceed their own way as they stand now. In this view, the United States continues to intentionally contain China's economic rise through its new trade rules as contained in the TPP and its influence on the IMF, World Bank, and ADB. The United States could strengthen the trade-related aspect of intellectual property rights, SOE-related rules, and new labor and environmental standards, which China cannot accept at this juncture.

Under this extreme bipolar confrontation in a competition for outright hegemonic leadership, a number of East Asian economies, which are deeply interconnected with the two super economic powers, are likely to be pushed off-balance in pursuing their own integration efforts. Given their interconnectedness due to existing trade linkages in the traditional open regionalism with the United States and already ongoing functional integration as evident in the looming GVCs in the region, this extreme zero-sum approach is not likely to happen.

*Status Quo Approach with Mild Engagement and Mild Containment
in the Medium Term*

This scenario assumes that military confrontation, such as the maritime disputes in the South and East China Sea between the United States together with Japan and China, will not worsen. If there is a mechanism to prevent potential warfare among major powers in the region, the current status quo in which the United States and China sit in the driver's seat of the TPP and RCEP, respectively, would be maintained without riding together in each other's integration vehicle. The status quo scenario is plausible because on the trade side, both the United States and China have been increasingly interdependent, as shown in Table 6.7. In the past 25 years, the share of US imports from China had increased from a mere 3.1% in 1990 to 20.0% in 2014 while the share of US exports to China rose from a mere 1.2% to 7.6% over the same period.

There are also significant financial linkages between China and the United States. It has also been argued that the enormous capital flowing from China was one of the causes of the global financial crisis of 2008–09. China had been buying huge quantities of dollar assets to keep its currency value low and its export economy humming, which caused American interest rates and saving rates to remain artificially low. These low interest rates, in turn, contributed to the US housing bubble because when mortgages are cheap, house prices are inflated as people can afford to borrow more. This sequence suggests that the United States and China are

Table 6.7 USA—China Trade Dependence (Unit: US \$ billion, %)

<i>Year</i>	<i>US Exports to China</i>		<i>US Imports From China</i>	
	<i>Value</i>	<i>Share of China Total Exports</i>	<i>Value</i>	<i>Share of US Total Exports</i>
1990	4.8	1.2	15.2	3.1
1995	11.7	2.0	45.6	6.1
2000	16.3	2.1	100.1	8.2
2005	41.8	4.6	243.5	14.6
2010	91.9	7.2	365.0	19.1
2011	104.0	7.0	399.4	18.1
2012	110.5	7.1	425.6	18.7
2013	122.0	7.7	440.4	19.4
2014	124.0	7.6	466.7	19.9

Source Korea International Trade Association, Trade Statistics, Various Years

interlocked in global and mutual financial flows. As a result, the two countries are also at risk of engaging in currency wars with the US dollar and Chinese yuan, which is likely to affect the regional and global economy.

To the extent that the United States and China are interlocked on the trade as well as financial side, a single minded zero-sum game by each side is not likely to be played out to produce catastrophic consequences on the global economy. Therefore, amid the hegemonic leadership competition, the two economic superpowers may be forced to remain committed to the status quo without provoking direct military actions against each other.

An Aggressive Convergent and Coordinated Path Toward an East Asian Economic Community

This view assumes the TPP and RCEP interact to become mutually reinforcing parallel tracks for regional integration. If the United States and China establish a mutually beneficial solution on regional and global affairs, one can expect a more aggressively convergent path toward East Asian integration. For this convergence to happen, both the United States and China should take a more inclusive and accommodative stance to embrace each other in the formation of ongoing institutional architecture. Down the road, China should join the TPP and the United States should join both RCEP and the AIIB to further an East Asian economic community.

To amalgamate the TPP and RCEP in the future toward a fuller and larger East Asian economic community, the quality of the RCEP in terms of liberalization and facilitation of trade and investment, and new rules on labor, state owned enterprises, environment, and ISDs, etc., must be introduced or upgraded to match the liberalization level as stipulated in the TPP.

In the course of generating synergistic linkages between the TPP, RCEP, and AIIB, Japan and middle powers like ASEAN, India, Canada, Australia, and Korea can play an effective role. In particular, the roles of Japan and ASEAN are becoming critical. Recently, Japan, under Prime Minister Shinzo Abe's strategy of transforming the nation into a "normal state," has sided fully with the United States to view the TPP not only as its most important security ally, but also "economically" to counterbalance rising China's pursuit of hegemonic power in East Asia. One thing is clear for Japan: "Abenomics" is more likely to succeed in a freer and expanded East Asian economic integration.

The ten ASEAN members launched the ASEAN Economic Community (AEC) in December of 2015 with 622 million people and a combined GDP of US\$2.5 trillion. With the launch of the AEC, ASEAN is now moving one step closer to a European-fortress type community. ASEAN is also strategically significant because of its size, dynamism, and its leading role promoting Asian economic and security architectures. The US view on this development is that AEC would not only help integrate its member economies in the strategic region, but improve regional stability despite the question of the effectiveness of ASEAN centrality.

A newly launched AEC can play a catalyst role to bring the TPP and RCEP together. The regional value chains of ASEAN and CJK are likely to gain momentum as Vietnam, Myanmar, Laos, and Cambodia continue to pursue active liberalization policies to accommodate FDI with a cheap wage advantage and natural resource endowments. Table 6.8 shows that outbound FDI to ASEAN from CJK has been on a great upsurge. The reverse FDI flow is also becoming significant.

Korea, as Asia's fourth-largest economy, is located in the middle of four global powers. ASEAN and Korea together can play a critical role in combining the TPP and RCEP down the road and in mitigating ongoing political tensions among big powers. Korea effectuated the Korea-China FTA with ratification by the National Assembly in December of 2015. It is China's first FTA with an OECD economy. Although Korea missed the opportunity to join the TPP, as one of the founding states while already

Table 6.8 Bilateral FDI Flows between ASEAN and CJK (Unit: US \$ million, % of country's total figure)

<i>Year</i>	<i>Inbound FDI from ASEAN to</i>		<i>Outbound FDI to ASEAN from</i>	
	<i>Japan</i>	<i>Korea</i>	<i>Japan</i>	<i>Korea</i>
1995	40.2(15.7)	2831.2(14.4)	3987.1(17.6)	614.6(19.0)
2000	8225.9(0.9)	17,128.5(11.2)	207.1(0.7)	523.4(9.9)
2005	3223.0(18.4)	6414.0(5.5)	5001.8(11.0)	749.8(10.3)
2010	-1358.9(-)	16,355.8(12.5)	8929.7(15.6)	4438.0(18.0)
2014	9077.2(18.9)	17,857.0(9.4)	20,367.1(17.0)	4110.8(15.4)
<i>Year</i>	<i>Inbound FDI from ASEAN to</i>		<i>Outbound FDI to ASEAN from</i>	
	<i>China</i>		<i>China</i>	
2006	3351.1(4.6)		325.9(1.5)	
2008	5461.0(5.0)		2279.7(4.1)	
2010	6323.7(5.5)		3938.1(5.7)	
2012	7073.0(5.8)		5540.8(6.3)	
2014	6299.8(4.9)		7371.0(6.0)	

Source Korea's Ministry of Trade, Industry, and Energy, Korea's EXIM: JRTRIO, and OR Bank, China CEIC

having effective bilateral FTAs with all the initial signatory countries of the TPP except Japan and Mexico, it has already expressed interest in joining the TPP. At present, Indonesia, Colombia, Thailand, the Philippines, and Taiwan have also expressed interest in entering the pact. Once Korea joins the TPP, Korea is likely to contribute to an amalgamation of the TPP and RCEP. Korea can play a linchpin role through its established FTA leadership, with the already effective US-Korea Free Trade Agreement (KORUS) FTA and, more importantly, Korea's effective FTA with China. To meet TPP standards beyond the KORUS FTA, Korea needs to carry out another round of comprehensive reforms in the labor, finance, education, and public sectors as it did during the Asian financial crisis to draw IMF standby credit under stringent conditions. The reforms Korea undertook helped it realize a gold standard FTA with the United States.

Given the complexity and time-consuming process of formulating a formal, top-down integration architecture, East Asian countries need to do preparatory work, tackling the easy things first. These include stronger and effective measures for trade facilitation, such as e-customs services, rule of origin verification, intellectual property rights protection, supply chain solutions, port-centric management, and effective aftercare services for

FDI, which could also be pursued at APEC or other multilateral regional fora.

The promotion of intra-regional tourism and student exchanges could also be very effective for job creation and enhancing mutual cultural understanding. The increasingly prosperous population in East Asia should be viewed as a good source for regional tourism development. An early version of an open-sky agreement for low-cost carriers needs to be explored.

Additionally, an intra-regional coordination mechanism needs to be developed to prevent natural disasters and to handle them effectively once they occur due to weather anomalies. East Asian economies should begin to collaborate more effectively on non-traditional security issues, including nuclear safety, energy security, green growth strategies, and cyberspace problems.

In the long term, many experts claim that a TPP without China is doomed to only a limited success given the increasingly interdependent economic linkages between the United States and China. The two countries might work together to ensure job creation and sustainable growth not only for themselves, but the regional and world economy through concerted policy dialogues. For this purpose, the two mega blocs of the TPP and RCEP should be amalgamated to realize a multilateral liberalization regime toward DDA under the WTO. To facilitate the convergent path, though very slow in progress, CJK FTA negotiations need to be accelerated to provide new momentum for Asia-Pacific-wide economic integration.

All the negotiating members of both the TPP and RCEP, except India, constitute the Asia-Pacific Economic Cooperation (APEC) entity. In fact, seven economies are intersection countries belonging to both the TPP and RCEP. APEC envisions a free trade-oriented Asia-Pacific economic community. In 1994, all APEC leaders at Bogor, Indonesia, adopted the Bogor goals, which aimed for free and open trade and investment in Asia-Pacific by 2010 for developed economies and by 2020 for developing economies. Although the APEC process has been slow and non-binding, the United States, China, Japan, and the remaining APEC member states have been fully committed to APEC's ideal for an Asia-Pacific community, specifically a Free Trade Area of the Asia-Pacific (FTAAP). It is critically important to sustain this vision and to see it realized via the amalgamation process outlined above.

CONCLUSION AND POLICY IMPLICATIONS

Despite inherent security interests and long-standing territorial conflicts among East Asian economies, we have seen deepening functional integration in a form of soft regionalism, as exemplified in the ever-expanding regional and global value chains. As an important first step toward an East Asian economic community, formal region-wide integration architecture is highly desirable beyond that resulting from an ongoing natural integration process. The concluded TPP agreement now awaits ratification in the twelve founding countries. Another mega free trade deal in Asia, namely the RCEP, was also urged to be concluded in 2016 by the leaders of ASEAN at the 27th ASEAN summit held in November 2015. On top of the two free trade mega-deals, there is China's initiative for "One Belt, One Road" and the newly formed AIIB, both of which are expected to boost trade and investment links between China and Southeast and Central Asia. Once the three institutions connect and converge, fresh and expanded business opportunities are likely to emerge in East Asia and all of Asia. All stakeholders would welcome these developments to overcome the increasingly structured "new normal" symptoms such as simultaneous low growth and low employment.

In order to address serious global issues and to successfully pivot towards Asia, the United States needs to find a collaborative strategy with China when it comes to shared goals on climate change, anti-terrorism, trade, foreign investment, intellectual property rights, etc. As former US Secretary of Treasury Lawrence Summers wrote in 2015,²⁹ "The emergence over the past year of a major Asian trade integration effort (the TPP) in which China does not participate, and a major financial institution (the AIIB) in which the United States does not participate, is hardly auspicious. John Maynard Keynes asserted in *The Economic Consequences of the Peace* that the primacy of economics, observing the perils of the future, lies not in frontiers and sovereignties but in food, coal, and transport."

If the United States and China play out a zero-sum game to maximize their own national interests at each other's expense by containing or isolating each other, the two separate mega-blocs, TPP and RCEP, are likely to generate an unstable world economic system in terms of trade, investor

²⁹See Lawrence Summers, "Grasp the Reality of China's Rise", *The Financial Times*, November 9, (2015), 7.

state disputes, IPR, and exchange rate alignment as contained in the TPP. As a consequence, the full potential effects of the new trade rules of the TPP would not be realized.

Though different in motivations and political consequences, these concerted regional efforts can inject new momentum into the broader and deeper liberalization of trade and investment. If an original ASEAN initiative, RCEP, about which China has been very enthusiastic, is concluded, it would be highly desirable to link it with the TPP. It is evidently clear that without RCEP members, the TPP would not have its desired outcome.

The TPP without China and RCEP without the United States are only partly formed entities. If combined, the two free trade blocs might lead to the realization of an APEC Free Trade Area and ultimately, an East Asian Economic Community. This outcome would enable states to revisit the ambitious WTO Doha round, which has been helplessly stalled for nearly two decades.

Despite being immediate neighbors and sharing a long history, it is an irony that the leaders of the three core economies of East Asia—China, Japan, and Korea—met for the first time only after the Asian Financial Crisis in 1998, as mentioned earlier. A formidable trust-building process must be worked out among the countries. Additionally, this process is likely to help North Korea—the only closed country disconnected from the East Asian economic community—adopt an open-door policy and jump on the regional integration bandwagon.

A grand design for an East Asian Economic Community is not preordained. Two fundamental requirements are in order. First, East Asian economies need to undertake comprehensive internal reforms in conformity with global standards and to enhance their competitiveness as knowledge-based economies. A variety of free trade deals and multilateral funding schemes in Asia requires each country to upgrade its economic system to meet high global standards. Membership for the free trade deals and related financing schemes serve as effective external pressure for a country to carry out economic reforms toward a more open, competitive, and transparent system. Second, mutual trust and confidence building among the two superpowers, the United States and China, and among CJK must be cultivated not in a zero-sum, but positive sum game. In this regard, regional powers in Asia should engage in closer and reliable dialogues to weave stronger long-term bonds.

Respect for neighbors, harmony in community life, and mutual learning have been at the core of the Asian values that have prevailed throughout

the long history of Confucian culture in East Asia. Mutual trust and mutual learning, so highly valued in Confucian teaching, is an essential cornerstone for cooperation and public infrastructure and indispensable for peace.³⁰ A genuine trust-building process in once war-torn East Asia requires a consistent and inclusive approach and the objective recognition of accurate history so that the next generation can move forward. In this context, major regional powers need to be non-aggressive, non-assertive, and non-coercive to move an East Asian economic community forward through deepening mutual trust.

THE TRUMP ERA

The inauguration of Donald Trump as President of the United States deserves an epilogue. With his election campaign promises, the appointment of hawkish anti-trade personalities to key government trade posts, and his inaugural address, Mr. Trump has invoked a new wave of protectionism and unilateralism to safeguard American jobs and interests—to put “America first.” He indicated that hefty tariffs and a “big border tax” would be imposed on American companies planning to manufacture abroad, including in free-trade neighbor Mexico. It appears he will maintain a confrontational relationship with China to correct a trade imbalance that is in China’s favor. He also seems ready to brand China as a currency manipulator. Most importantly, Mr. Trump has made it very clear he will scrap the much-heralded Trans-Pacific Partnership (TPP) to protect American jobs and to ensure his mercantilist protectionist populism.

With a view of the world in which China’s gain is America’s loss, the Trump administration at this point appears likely to follow a zero-sum bipolar confrontation scenario between the United States and China toward an East Asian Economic Community, as described in this essay. If Trump’s anti-globalization policies are put into effect and the United States

³⁰East Asia’s new development paradigm can be formulated in the concept of mutual learning from both the strengths and weaknesses of diverse development models. East Asia has neglected too long inherent wisdoms that are contained in its miracle models. For mutual learning from different development models, see Choong Yong Ahn, “A search for robust East Asian development models after the financial crisis: mutual learning from East Asian experiences” *Journal of Asian Economics*, 12 (2001), 419–443.

heads toward a collision course with China, the impact on the economic integration outlook for East Asia and Asia-Pacific would be far-reaching. But will Mr. Trump's drastic shift to protectionism persist?

The departure of the United States from the concluded TPP has shattered the ideal of an enlarged, upgraded, and open regionalism in the Asia-Pacific. It is likely to cause serious setbacks to the implementation of a new set of trade rules that will set the tone for renewed regional multilateralism. Without the United States leading efforts to conclude an ambitious TPP with the highest global standards, which the Obama administration did, and to adopt a "Pivot to Asia Policy," China is likely to take advantage of the U.S. leadership vacuum in Asia and establish itself as an economic hegemon in the unfolding Asian Century. It is also likely to push harder for the early conclusion of the Regional Comprehensive Economic Partnership to maintain its high-growth regime and to have greater influence on the Asian economy.

As President Xi Jinping emphasized at the Davos forum in early 2017, China has advocated active trade liberalism as a means of boosting global economic growth and well-being. It is ironic that China, with its socialist legacy, supports trade liberalism while the free trade champion that is the United States is resorting to protectionism. Evidence suggests that political campaign rhetoric is one thing and implementation is another. To follow-up on campaign promises, the Trump administration may take harsh trade-restrictive actions, such as anti-dumping measures, countervailing duties, and safeguards to target specific countries. In the short run, this might succeed in bringing tangible benefits to the United States in terms of job creation and trade-balance equilibrium. However, the founding spirit of the TPP may soon return after it becomes clear that protectionist measures in zero-sum mercantilism eventually harm the overall economic efficiency and consumer welfare gains of all countries. Furthermore, the United States cannot afford to shun the obvious attractions in the most rapidly growing and increasingly affluent Asian market.

Though we may see slower progress toward an East Asian Economic Community in the Trump era, market forces embedded in the 4th industrial revolution are expected to call for enhanced interconnectedness among East Asian economies for everyone's gain. In this regard, each East Asian economy needs to upgrade its economic system to robust global standards, which would facilitate deep economic integration. The road may be bumpy, but East Asian economies will move steadily to a freer trade regime, which would eventually lead to an East Asian Economic

Community. With multilateralism now under threat from various corners, East Asia needs more than national policies. East Asian countries must recognize the invaluable contributions of the international liberal economic system that led to the “East Asian Miracle.” They need to adapt the system to current needs and realities and to mitigate the negative consequences of globalization and openness, such as social and income inequalities. While building an East Asian Economic Community, East Asia needs to collectively turn the emerging tide against globalization and open trade by reshaping institutions of regional and global governance.