

East Asian Regionalism at a Crossroads

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I. Introduction

The year 2011 marked the “return” of US high-level strategic attention to East Asia after a decade of war in the Middle East and Central Asia sparked by 9/11. This “pivot toward Asia” was expressed in policy terms by the US stating formally in 2010 that freedom of navigation in the South China Sea was a national interest. Then in 2011, the US joined the East Asian Summit (EAS), signed a defense cooperation agreement with Australia that stations US Marines at Darwin, and re-launched the Trans-Pacific Partnership trade initiative at the APEC summit in Hawaii. In diplomatic terms, 2011 saw the APEC summit in Hawaii, visits to the region by President Obama, Secretary of State Hillary Clinton, and Secretaries of Defense Robert Gates and Leon Panetta, and a step up in US military cooperation with countries in the region.

What gives this US activity meaning is the growing perception not only in the US, but also in East Asia, that China’s growing confidence in its strength (and its expectation of Western decline) is making it both more expansionist and belligerent at the expense of its neighbors. Aside from a rapid build up of its navy, including sea trials of a new aircraft carrier in 2011, Chinese behaviors that created this perception include a new characterization of the South China Sea as a “core interest” (*hexin liyi*), the ramming of a Japanese coast guard vessel by a Chinese fishing trawler in 2010 followed by Chinese demands for

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a Japanese apology and an abrupt cut off of rare earth exports to Japan, brawls between South Korean coast guard sailors and Chinese fishermen in 2010 and 2011 that led to the loss of life on both sides, incarceration of Vietnamese fishermen starting in 2009 and in June 2011 the deliberate cutting of cables deployed by a Vietnamese research vessel, threats of punishment issued to the Philippines if it persisted in its South China Sea territorial claims and desire to upgrade defense cooperation with the US, interference with US naval vessels collecting intelligence in the South China Sea, and China's refusal in 2010-2011 to discuss South China Sea conflicts multilaterally with ASEAN, which violated a commitment China made in the Declaration on Conduct (DOC) in the South China Sea that it signed with ASEAN in 2002.

China's attitude seems to be that its rise is inevitable (which may be true) and that, in view of its growing military and economic leverage, its neighbors have no choice but to accommodate China's demands (which may not be true). If this way of thinking is in fact the case, it would suggest that China's commitment to multilateralism has been tactical rather than strategic, i.e., multilateralism was embraced when China had weak influence and low coercive capacity, but with higher coercive capacity it is more assertive and less willing to bind itself to multilateral processes. However, China may stick with multilateralism when it leads to outcomes that serve its interests.⁽¹⁾

These Chinese attitudes and behaviors emerged in 2009 and they have been jarringly inconsistent with China's rhetoric of a peaceful rise and a "new security concept" that accompanied China's charm offensive in Southeast Asia from 2000-2008.⁽²⁾ During that period, China signed, among other things, the DOC in 2002, the ASEAN-China Free Trade Agreement in 2002, ASEAN's Treaty of Amity and Cooperation (TAC) in 2003, the China-ASEAN Joint Declaration on Strategic Partnership for Peace and Prosperity in 2003, and it signed ASEAN's declaration on a Zone of Peace, Freedom, and Neutrality (ZOPFAN) in Southeast Asia in 2004. However, ASEAN concern regarding China's new unilateral assertiveness became so great that in 2011—from Myanmar to the Philippines—ASEAN members exercised choice and welcomed a greater US

regional strategic presence when President Barak Obama attended the East Asian Summit where the South China Sea situation was the top discussion item.

II. Regional Security Tensions Undermining East Asian Regionalism

This sea change in the region can hardly be blamed on the US. It originated in Chinese behavior toward its neighbors along its East Asian borders from South Korea down to Myanmar. But China's *faux pas* has been a diplomatic windfall for the US, which the US quickly and happily exploited because it shifted Sino-US competition for influence in East Asia from an economic to a politico-military dimension, where China is weakest (relative to the US and its allies). It is on this terrain that the divisive logic of the balance of power could begin to outweigh the integrative logic of comparative advantage to redirect the course of regionalism in East Asia.

1. Comparative Advantage vs. The Balance of Power in East Asia

Like NAFTA and the EU, East Asia relies on the logic of comparative advantage to build regionalism. But the crucial difference is that East Asia has always been divided by the balance of power. Unlike North America or Europe, East Asia is not a security community (where members will not resort to force to settle their differences). This goes a long way toward explaining the shallowness of regional institution building.

The balance of power describes a conflict-prone competition between sovereign, armed, and insecure states. Realists claim this is an eternal truth in international relations, though it may not be a necessary condition according to interdependence theorists,⁽³⁾ democratic peace theorists,⁽⁴⁾ and constructivists.⁽⁵⁾ Regardless, the balance of power is part of the reality today in East Asian relations. There is no binding agreement among states to remain at peace, and there are unresolved conflicts that have led, and could still lead to, the use of force.

In the balance of power, *relative* power is the critical metric because the stronger impose their will on the weaker. The effort to be stronger than others, if

generalized, creates competitive rivalry and the security dilemma whereby the effort of each to be stronger than one's neighbor elicits that neighbor's fear and redoubled effort to strengthen arms. Paradoxically, this dynamic produces arms races and less security for each and all. In game theoretic terms, the competition becomes a zero-sum game (where the marginal gain of one is matched by a marginal loss of another) or a negative-sum game (where interaction leads both sides to lose—but whoever loses less “wins” because they have gained power in relative terms).⁽⁶⁾

Where the balance of power determines behavior, trade will remain limited between competing powers. As Kenneth Waltz and Joseph Grieco explain, the danger of becoming vulnerable to trade sanctions (vulnerability interdependence),⁽⁷⁾ and fear that trade will benefit an adversary more than you,⁽⁸⁾ will severely limit the prospects for cooperation and interdependence. Hence, this fundamentally divisive logic cannot provide the basis for robust regionalism.

The integrative logic of comparative advantage liberated from the constraints of the balance of power can support a flourishing regionalism. According to the economic concept of comparative advantage, factors of production are distributed unevenly among states. One is led by economic self interest to trade goods one is better at producing (given one's factor endowment) in exchange for goods produced by other countries within trading distance that are scarce because one has a harder time making them (due to one's factor endowment). Simple trade of this type produces an immediate gain in welfare because you export an abundant good and import a scarce good.

Once established, trade leads actors to specialize in production for export, which increases efficiency and develops an international division of labor (i.e., interdependence). With access to a larger international market, new economies of scale and further opportunities for specialization and growth can be exploited. Thus, in game theoretic terms voluntary trade is a positive sum game (where all parties gain from interaction).

Robert Keohane has explained how, even in a realist world, this integrative logic can lead to institutionalized governance in international relations. Providing

that the gains of cooperation outweigh the costs of organizing and sustaining it, *and so long as actors do not view others as security threats*, arrangements to cooperate and share the resulting gains can become institutionalized features of international order.⁽⁹⁾

Since the end of WW II, the strategic and economic predominance of the US in East Asia deterred great power war and introduced general stability. But Cold War bipolarity divided the region and even individual nations (China, Korea, and Vietnam). There were “limited wars” in Korea and Vietnam, and US strategic predominance merely kept a lid on intra-East Asian rivalries and conflicts; it did not resolve them.

Nevertheless, East Asian states willing to live within the US security order were able to freely develop the integrative logic of comparative advantage. They were able to rely on exports to rich western markets despite the trade friction that East Asian mercantilism produced.⁽¹⁰⁾ China under Deng Xiaoping’s leadership aligned with this hegemonic system and prospered, and today the only East Asian country still excluded is North Korea. Thus, stable American hegemony has allowed trade to freely develop both within the region and between East Asia and western markets.

When economic partners neither threaten each other nor object to the prevailing security order, cooperation that produces unevenly distributed gains is not a critical problem. But if a partner becomes a potential threat to one’s vital interests, then the divisive logic of the balance of power becomes paramount. Logic dictates that, if one has choice, one will not cooperate with potential enemies leaving them with greater power or leverage over oneself. If or when the balance of power logic takes over, weaker states will want to, or be forced to, bandwagon (i.e., become subordinate allies) with strong states. And adversaries will want to limit trade and cooperation with each other, thus polarizing the region. This could slow East Asian regionalism, or even end it in its present form.

2. Western Models of Regionalism

Regionalism refers to the political construction of institutionalized cooperation by agents in states within a shared geographic space to achieve shared interests, e.g., enhanced prosperity and/or security. But there is no single model or formula for this process.⁽¹⁾ The geographic scope of regionalism is determined by the interplay of physical geography, contingent functional factors (e.g., economic relations), and subjective factors (e.g., commonalities and differences rooted in historical experience, religion, language, or institutions). The institutionalization of regionalism may be formal or informal, and the issue focus may vary (e.g., trade, security, or environment).

East Asian regionalism has always straddled the competing logics of the balance of power and comparative advantage. In addition, it has a radically different economic and political developmental trajectory from that of the West. And its geography is more far-flung and diverse. For these reasons, regionalism that developed in the advanced west has only limited utility for understanding the kind of regionalism we see in East Asia. The deviation of the Asian model from Western models may be viewed as a failure by those who believe that the EU or NAFTA provide models that should be copied by others. But East Asian regionalism is better viewed in its own right as a success against long odds. Let us first briefly review the western models before turning to the features of the East Asian model.

(1) Western Economic Models of Regionalism

The basic economic models of regionalism are provided by NAFTA (a *free trade agreement*) and the EU (which began as a *customs union*). Both aim to develop comparative advantage and higher national welfare by promoting the integration of separate national markets first of all through regional trade liberalization. Both models subsequently moved to include investment liberalization, but NAFTA has not followed the EU in embracing labor mobility and political integration. In the NAFTA model, liberal democratic states adopt a legal framework for liberalization but retain their sovereign national identities

(i.e., individual tariff schedules and investment rules) toward third parties. The free market and liberal state are the key mechanisms and politically, things are managed through inter-governmental coordination and national legal regimes without supranational authority or political institutionalization.

In the customs union model, states in pursuit of collective economic advantage agree to a common external tariff in addition to internal free trade.⁽¹²⁾ This means economic community and pooled sovereignty, which leads to a supranational external identity and supranational institutional development. As a new supranational interest and identity forms, the logic of *fiscal federalism* took hold to drive the development of decentralized *multi-level governance*. Fiscal federalism is the notion that societal collective interests naturally become differentiated at the local, provincial, national, and supranational regional (e.g., EU) levels. Centralized national governments cannot efficiently and effectively provide public goods and services to meet collective needs (ranging from street cleaning to pan-European money and defense systems) that form at these different levels. Therefore, one has to decentralize and delegate governance powers to political authorities located at these different levels to register and meet existing needs efficiently.⁽¹³⁾ To do this, the EU has developed what has been called multi-level governance, which refers to an interdependent structure of supra national, national, regional, and local authorities joined in an interactive process of negotiation that allocate governance responsibilities among them.⁽¹⁴⁾ The strength of Western Europe's tradition of social democracy, with its emphasis on meeting social welfare needs through government, made multi-level governance the main path of institutional development for European regionalism. Supranational federal authority (e.g., the European Central Bank) is an aspect of the evolution of this larger governance structure. As this regional governance mechanism develops, new spatial variation and functional collective need may emerge that requires redefinition of governance actors and agendas.⁽¹⁵⁾

(2) Western Political Models of Regionalism

There are three political models of regionalism that anchor western thinking about regionalism. *Neo-functionalism* follows the rationalist logic of economic self-interest to describe how functional cooperation in the EU widens and deepens as the experience of cooperation redefines the knowledge and interests of actors. Societal actors in different states see benefit in new cooperation (e.g., a bigger internal market), as do EU officials who have an organizational interest in starting new cooperation policies and structures. National officials are persuaded by political pressure and technical advice from experts to delegate authority upward “beyond the nation-state.” This new cooperation initiative may then “spill over” into adjacent functional areas as new problems and opportunities arise that can be addressed by further cooperation. The process repeats to drive a widening and deepening of cooperation.⁽¹⁶⁾

The other two models are rooted in the idea of political community, which is a matter of individual and collective identity. It points to loyalty, trust, and obligation in order to preserve one’s community.

Realism explains the creation and development of NAFTA and the EU in terms of *inter-state bargaining*. NAFTA is simply the US imposing its preferences on smaller, dependent neighboring economies. Germany and France, whose national interests in securing their own peace and prosperity are served by an economic alliance within a NATO security structure, drive the EU process. This pair then attracts surrounding smaller states seeking shelter and national benefit under a Franco-German condominium.⁽¹⁷⁾

Karl Deutsch made the first sustained theoretical attempt to apply the notion of political community to the development of the European and NATO regionalism. His concept of *transactionalism* was that integrating national systems of mass communication could lead to a redefinition of loyalties and political community from the nation-state level to a European or trans-Atlantic community.⁽¹⁸⁾ This focus on identity formation and its redefinition through social transactions in order to get beyond nation-state rivalry has been revived and expressed in a different lexical format by constructivists today⁽¹⁹⁾ and has

been applied to ASEAN.⁽²⁰⁾

(3) The Western Idea of Regionalism

The primary policy goals are free trade and market integration. These goals are made possible by the more fundamental institutional and societal characteristics of the advanced west. In geopolitical terms, North America and the EU are not just a security community (i.e., conflicts of interest among members leading to war is not conceivable), but prior to economic regionalism the regions were already integrated into a security alliance led by the US (i.e., NATO). Because members were already military allies the gain of one was a gain for all, so the integrative logic of comparative advantage had free rein with little concern for relative gain.⁽²¹⁾

Moreover, in historical perspective, North America and Western Europe enjoy a mature stage of capitalism with financial, production, and consumer markets—as well as political, economic, and social elites—that have been intimately connected for at least a century. Free trade is an unquestioned shared norm because, sharing a position as early industrializers and international lenders at the developed core of a globalized economy, North America and Western Europe stand to gain the most from this policy.

In institutional and societal terms, in the West business and financial interests dominate democratic systems and state institutions because they are well organized and well funded interest groups,⁽²²⁾ and their interests are in line with the advanced West's comparative advantage, i.e., the West is capital abundant and benefits from exporting capital and capital intensive products.⁽²³⁾ With the welfare state redistributing part of net national gains from trade to domestic interests hurt by free trade, the post WW II liberalization agenda had a stable domestic political basis.⁽²⁴⁾ European and US corporations successfully pushed for market integration in their respective regions to benefit from the larger markets that would result, and governments complied.⁽²⁵⁾ Political legitimacy and the rule of law were well established.

These convergent factors mean that political, economic, and social norms

that support regional market integration based on free trade have been ascendant for decades. The FTA and customs union models of regional integration have not threatened the vital interests of any veto-wielding political interests in the West, and they promote the interests of society's most powerful pressure groups. With mature legal and bureaucratic institutions managing liberalization, Western regionalism yielded substantial and ongoing short-term gains for key domestic stakeholders to keep the process moving forward with relative efficiency. And with rising wealth and the welfare state prevalent in western countries, the resulting structural adjustments have not produced massive economic and social dislocations that could threaten systemic stability.

However, none of this is true in East Asia.

3. East Asian Regionalism

(1) Security

The foundation upon which western models of regionalism have been built does not exist in East Asia. In geopolitical terms East Asia could not be more different from the region encompassed by NATO.

First, there is a strategic dividing line drawn though East Asia to the extent that US military allies and cooperation partners assist the US effort to maintain strategic dominance against those in the region who resist it. And US allies are not aligned with each other multilaterally as in NATO, but are isolated in dyadic alliances with the US (“hub and spokes alliance structure”) with no US need to resolve differences between the Asian allies.⁽²⁶⁾

Second, with respect to boundaries, there are unresolved national (re) unification issues in the Korean peninsula and the Taiwan Strait. And there are territorial disputes in Northeast and Southeast Asia that affect almost all countries.⁽²⁷⁾

Third, security has a domestic component absent in the West. The Declaration of ASEAN Concord (1976) used the term “resilience” to mean security in a more holistic and comprehensive sense.⁽²⁸⁾ It represents the ability to manage the internal and external problems —both military and non-military—

that ASEAN's fragile post-colonial states faced during nation building.⁽²⁹⁾ Resilience was a term coined in Indonesia to explain why external and internal security and stability missions were equally important in army doctrine.⁽³⁰⁾ The internal and external dimensions have been linked because there are many cases where internal tensions and conflicts have the potential to draw in external actors to challenge state sovereignty.⁽³¹⁾

Finally, there are pre-existing historical and cultural animosities dividing states that interact with current domestic tensions, unresolved territorial disputes, and economic competition to make stability fragile. Thus, any talk of a regional security community as a present reality is premature, to say the least.

(2) Security vs Trade

The dilemma of security versus trade is that East Asian countries need to pursue trade and investment expansion but commitment in this direction, if pursued too far, can threaten security. The security question is rooted in external and internal factors.

In external relations, the absence of a security community where the physical and economic security of each member is a shared concern means that each actor must limit its exposure to risks and costs associated with economic interdependence. For example, after China cut off exports of rare earth minerals of critical importance to Japan's advanced industries in response to the arrest of a Chinese ship captain, will Japan want to deepen its reliance on China? In the absence of genuine trust and security in regional relations, how far can a state—even one as stable as Japan—prudently commit to regional economic interdependence? In this setting, regionalism has not, and cannot, replicate the deep and strongly governed interdependence in North America and Western Europe, which have long constituted a security community. In East Asia, the absence of trust, the real possibility of armed conflict among members, and deep unresolved animosities continue to limit cooperation.

Internally, most East Asian states are still in a fragile process of political and economic development. Sovereignty and non-interference are primary state

concerns. Nevertheless, stability and legitimacy depend on their ability to raise millions out of absolute poverty, and so they need to aggressively promote trade, though not exclusively through liberalization for reasons already discussed. These governments are like bicycle riders who need to peddle to keep from toppling over, but at the same time, they cannot pedal too fast and risk an accident. That is, they cannot risk experimenting with radical liberalization that may have profound and unforeseeable consequences for their political survival.

These external and internal security constraints preclude the deep political compromises and commitments needed for member states to pool their sovereignty or to hand their fates over to the free rein to market forces as has occurred in Europe and North America. Therefore, rather than being flaws, the informality and shallowness of East Asian regionalism should be viewed as answers that enable the successful pursuit of deeper interdependence. These institutional arrangements have supported remarkable growth in trade and GDP and have maintained dialog and cooperation through unexpected contingencies in internal and external security conditions that could have broken more rigid and ambitious legal and bureaucratic structures.

(3) East Asia in the Global Economy: Dependent Interdependence

Intra-regional trade (non-oil) in East Asia (APT + Hong Kong + Taiwan) reached 52.1 percent in 2006/07,⁽³²⁾ which was higher than NAFTA (40 percent). This degree of interdependence invites APT efforts to manage it, but fears that these efforts could become exclusionary are unfounded.⁽³³⁾ Final exports to Japan, Europe, and the Americas were about 60 percent of developing Asia's total exports last year.⁽³⁴⁾

Dependence on the West for growth has increased both regional interdependence and the need to manage it (through APT). A "trade-triangle" has formed as regional production networks oriented East Asian country exports to China to feed its factories, which in turn export mostly to western OECD countries. This deepened interdependence and APT stabilizes and allows the further development of regional production networks.⁽³⁵⁾

(4) Diversity

In historical and cultural perspective, the region is hugely different from the West where there is a shared Christian religious heritage, languages with a common root in Sanskrit, and a political civilization organized around democracy and the rule of law rooted in ancient Greece and Rome. With the exception of Japan, East Asia contains peoples with diverse ethnic identities, religions, and political traditions divided into territorial units by pre-modern empires or Western colonial powers with little regard for actual cultural geography. These territorial units were decolonized and/or experienced revolutions to produce modern states during turbulent, and often bloody, events only after WW II. Again, with the exception of Japan, industrial capitalism took root, if at all, only after WW II. National elites oriented toward the cultures of their former colonial masters have been strangers to each other until recently.

With respect to geography, economy, and social development, there is perhaps the greatest diversity of any region on the planet. On the northern boundary is sub-arctic Siberia and the Russian Far East; on the south are equatorial regions in the southern hemisphere; on the eastern boundary are the Japanese, Philippine, and Indonesian archipelagos; and a continental land boundary with South and Central Asia is on the west. Through the middle of the region runs a division between poorer continental nations and more prosperous littoral and island nations.

Annual per capita income in 2010 was \$41,900 in Singapore and only \$760 in Cambodia.⁽³⁶⁾ Inequality is not only extreme between countries, but also within countries. The income ratio of the highest 20% to the lowest 20% of the population in Malaysia was 11.3 (2009) and for China it was 8.3 (2005).⁽³⁷⁾

(5) Developmental Need

China is at the heart of the region but it is still far from western levels of economic maturity. It had a per capita figure of \$4260 in 2010 and it has an institutional legacy of a communist command economy still to resolve.

Absolute poverty and the delivery of basic services are still predominant

issues in the region. In the two most populous East Asian countries, the population living on \$2 or less a day was 36.3% in China (2005) and 50.6% in Indonesia (2009). In comparison, the percentage living in poverty in the US today is 12.7%. But this refers to a single person earning less than \$10,890 a year that will receive state funded social welfare benefits. Thus, one may see why delivering strong sustained growth that alleviates poverty (which implies a strong role for the state) is a primary political aim.

(6) Developmental States

With respect to the state in East Asia, due to its fragility and the general need to catch up to the West in economic and political development, its priority has been the goal of development rather than the process of liberal democracy. Chalmers Johnson gave the first detailed analysis of the critical relationship between rapid economic growth and the legitimacy of the state in East Asia and other scholars have elaborated the theme.⁽³⁸⁾ The key political traits of what might be called East Asian developmentalism have been: development before democracy; policy making by a professional bureaucracy insulated from civil society by a political elite; and the exclusion of independent critics, labor, and consumer interests in order to speed capital formation and growth. Ideologically, nationalism is used to unify disparate interests and justify state dominance over civil society. Reviewing East Asia's record of development, Joseph Stiglitz and Dani Rodrick have noted that governments in East Asia had success in speeding capitalist development because they did *not* heed neoliberal orthodoxy, i.e., they did not implement a narrow deregulation and liberalization agenda.⁽³⁹⁾

Political and developmental factors help to explain why. East Asian states are often ethnically divided and have arbitrarily drawn boundaries inherited from the recent colonial past. Governments may lack a credible ideological justification to rule. Those in power may not have genuine democratic popular consent to rule. Hence, liberal freedoms, democratic elections, and an independent judiciary with the rule of law can be scarce. These states achieve societal cohesion and political legitimacy through performance—putting more

food on the table for the people, creating more wealth for national elites, and generating more resources for the state. In most countries, business and financial classes have been subordinated to bureaucratic and political elites. They are unable to make their preferences into state policy because democratic norms and institutions, which limit the power of the state and favor agenda setting by organized interests in civil society, tend to be weaker than in the West. This does not mean, however, that states are unfriendly to business. States know they must use the market to get development, and so the key has been to bracket market activities with policies to spur growth while maintaining stability and legitimacy.

(7) Policy Implications

Liberalization demanded by the West is not uppermost on the development agenda of developing countries. Today, developing countries can expect little benefit from further liberalization demanded by rich countries because the rich countries are already liberalized in these areas, and the narrow free trade agenda crowds out their own development priorities.⁽⁴⁰⁾

Liberalization by developing countries can promote trade and growth, but so can other measures, e.g., more public investment in infrastructure, investment in human capital, better public administration, or trade facilitation (i.e., reducing existing information and transaction costs through things like streamlined visa and customs procedures or export promotion). In developing East Asia, infrastructure, human capital, and institutional assets that have long existed in the West, and are required to make liberalization work properly, are in short supply and become trade bottlenecks, and in some developing areas they still need to be created out of whole cloth. Without trade-associated measures in infrastructure, institutional, and human capital development, liberalization simply may not work in attracting new trade and investment. If improvements in trade-associated areas can make trade simpler and cheaper to carry out, trade will grow without new liberalization measures.

And liberalization, if heedlessly pursued without the proper infrastructure and institutional groundwork, may be costly to states. For example, when states

lack environmental management capacities, foreign investors may extract natural wealth leaving behind a wrecked ecosystem and little lasting benefit. And one need only recall that the Asian Financial Crisis, which has been blamed on reckless premature financial liberalization approved by the IMF,⁽⁴¹⁾ resulted in political instability in Thailand, Indonesia, and Malaysia, and drastically lowered growth and welfare throughout the region with negative knock-on effects in Russia and Brazil.

Nor is integration desired, if this means the loss of national sovereignty. The fragility of states, and their desire for consolidation, means that regionalism will be a state-driven and state-centric process, featuring cooperation rather than EY-style federation or NAFTA-style homologation (i.e., adopting a homogeneous, seamless legal commercial and investment code binding all states).

Many still use NAFTA and EU norms as the benchmark for success and criticize East Asian regionalism for clinging to state sovereignty and not making free trade a paramount concern. They fail to understand the many reasons why liberalization and sacrifices of sovereignty cannot be the sole focus at the region's present stage of economic, social, and political development, and why it cannot be the sole measure of success.⁽⁴²⁾ In East Asia, success is not policy, but actual outcomes: trade growth and rising living standards under conditions of political stability in the region. The actual record in this regard is quite good given all the underlying obstacles to peace and development. As a region of developing countries, the East Asian process of regional integration described later is functionally broader than trade liberalization, more politically constrained, more diverse, and more state-centric than the NAFTA and EU models. But it is no less successful in its own terms. Before describing it, we need to understand why a great power does not lead it.

4. The Failure of Big Powers to Lead

Leadership in institutionalizing cooperation requires someone to have superior power and resources, as well as the motivation and political ability to coordinate interests and broker deals within a group.⁽⁴³⁾ The problem in East Asia

is that the three potential leaders—the US, Japan, and China—have competing visions as indicated below. No one has been able to persuade the remaining two to yield, so conventional regional leadership has not emerged.

(1) The Failure of the US Vision in APEC

APEC is a summit meeting process that was created in 1989 and, as a lineal descendent of earlier initiatives such as the Pacific Free Trade and Development (PAFTAD), Pacific Basin Economic Community (PBEC), and Pacific Economic Cooperation Conference (PECC) meetings, it was intended to create a trans-pacific trading community. The US pushed to impose its vision of a legally binding free trade agreement modeled on NAFTA inside APEC. It managed to secure the Bogor Declaration in 1994 committing members to trade liberalization, but the US failed to overcome Asian reluctance to make binding and politically risky liberalization commitments.⁽⁴⁴⁾ In 1997, APEC was a useless bystander during the Asian Financial Crisis. In the aftermath of these failures, APEC’s agenda has become diversified and diffuse. The lack of consensus within APEC, and the loss of East Asian confidence in the Washington Consensus policies of the IMF during the Asian Financial Crisis, shifted the focus of region building to the APT. Writing just before the Obama Administration began to push the TPP, Ralph Cossa noted that the US “prefers that pride of place go to pan-Pacific institution building, ... Clearly APEC and ARF should have priority over ... pan-Asian community building.” However, he reckoned that, “the APT appears destined to be the primary vehicle for community building, ... Perhaps it is time for the United States to take the next step in demonstrating its commitment to regional prosperity and stability... [by] underscoring its support for Asian community building.”⁽⁴⁵⁾

(2) The Failure of Japan’s Vision of Regionalism

Japan had a competing vision of Asia-Pacific regionalism based on the so-called flying geese model of East Asian development.⁽⁴⁶⁾ It called for Japanese-led policy coordination among East Asian governments to design orderly export-

oriented growth strategies targeting the US market. The US hegemonic system provided East Asia with security, technology, capital, and a market for East Asian exports. The East Asian nations led by Japan would coordinate trade, investment, aid, and technology transfer so that industrial production would be relocated within East Asia as countries developed and their comparative advantage changed. Thus, as Japan (the lead goose) developed new industries it would send older industries to Taiwan or Korea (geese flying in the second rank). Taiwan and Korea would gain new industries and export their older industries to ASEAN countries and China who were geese flying further back in formation. This vision entailed managed trade rather than free trade and informed Japan's attempts to lead in regional forums. For different reasons China and the US objected to this vision. And the development of complex intra-regional production networks that efficiently exploited changing comparative advantage without this kind of management system undermined this vision.⁽⁴⁷⁾ The last serious attempt Japan made to implement this vision occurred during the Asian Financial Crisis when it proposed to set up an Asian Monetary Fund to rescue the region and provide an alternative to dependence on the IMF, but its initiative met the resistance of the US and China.⁽⁴⁸⁾

(3) The Absence of Chinese Leadership

China has not put forth a clear vision of East Asian regional order relating internal and external actors across functional areas. Rather, its approach has been to focus primarily on the ASEAN Plus One process with China, especially the China-ASEAN Free Trade Area (CAFTA) through trade liberalization, the construction of trade infrastructure links, technical aid, and the increasing use of the RMB in trade. The next broader East Asian focus has been APT.⁽⁴⁹⁾ China does not show much enthusiasm for larger regional frameworks such as APEC or the EAS, though it voices support for ASEAN initiative in building regionalism.⁽⁵⁰⁾ As for leadership style, China is not providing public goods to attract neighbors' allegiance. Rather, it is using access to its growing economy and its growing military power to create leverage in discussions with individual

neighbors.

5. At a Crossroads: The Coming Irrelevance of ASEAN-Plus?

As China challenges the strategic status quo, the long subordinated balance of power logic is rising up. Thus, East Asia is approaching a crossroads: will it continue to travel down the path of economic integration guided by APT, or will balance of power politics cripple this process?

As mentioned above, China's more assertive actions since 2009 have led its neighbors to believe that China may become a military and economic security threat. In particular, China presented the "9-dashed line" map to claim sovereignty over the entire South China Sea in 2009 despite its violation of the principles inherent in, and the rights granted to littoral states by, the UN Convention on the Law of the Sea. Moreover, China has used fishing, coast guard, and energy development activity to contest existing administrative control in disputed maritime territories and strategically sensitive areas in the Yellow, East, and South China Seas. It has stopped abiding by its commitment in the China-ASEAN DOC in the South China Sea to discuss problems multilaterally. Only very recently has it returned to multilateral discussions with ASEAN after suffering diplomatic setbacks, particularly at the 2011 East Asian Summit when outside powers (e.g., the US) were included in discussions of these disputes over Chinese objections. This behavior has affected the fundamental nature of China's relations with its maritime neighbors, as well as with the US Navy, which guards freedom of navigation and claims the right of innocent passage for its warships in East Asian waters.

However, as mentioned above, East Asian regionalism is adapted to this kind of strategic environment. Its informality, shallowness, and flexibility have an advantage: they permit continuity of cooperation processes despite political tension and outbreaks of conflict between members that would wreck highly obligated, legalistic, rule-enforcing organizations. Continuity of the ASEAN-Plus informal dialog process is important because it permits neutral parties to continue cooperation and to take an interest in brokering settlement. The

process reminds all that everyone loses trade and growth when conflict breaks out, including the conflict parties. In addition, conflict parties will lose trust and political influence among third parties who suffer economic losses as a consequence of conflict.

(1) The Trans-Pacific Partnership Initiative and Rising Strategic Rivalry

The APT process would be very difficult to stop because it is flexible and the need for confidence building and continuing development in East Asia is so great. But it could be sidetracked by something that serves these same ends more attractively. The most likely threat in this regard is the Trans-Pacific Partnership (TPP) Agreement being led by the US. The TPP revives the old (and failed) US vision for APEC. The US wanted, and still wants, a “high-quality” free trade agreement that subsumes East Asia in a larger legally binding trans-pacific framework. The TPP agenda goes well beyond trade to include new kinds of intellectual property and investment protections.

What gives the US new hope for this trans-pacific agenda is that it may now be able to get around the objections of other big powers. It excludes China, which for reasons of political and economic fragility discussed above would never agree to the radical new liberalization measures in the TPP. As for Japan, last year at the Hawaii APEC meeting Japanese Prime Minister Yoshihiko Noda stated that Japan would negotiate to join the TPP. If Japan joins TPP, then South Korea would have an incentive to join TPP. South Korea ratified an FTA with the US in 2011 but it still lacks an FTA with Japan and other members.

ASEAN may not like the idea of giving up the centrality of the ASEAN-Plus process, nor would it like the NAFTA-like rules of the TPP, but joining TPP will not require quitting APT, and ASEAN members will decide on an individual basis whether or not the TPP is worth pursuing. For members who felt threatened by China, TPP might be worth joining if it made US protection more likely.

A consolidated TPP with Japan, Korea, and East Asian developing countries as members would give these countries better access to the US market than

China would have. China would remain an attractive growing market and strong exporter, but some intermediate trade and investment currently flowing to factories in China could be redirected to TPP members better able to export directly to the US. These members would likely welcome this change. A robust TPP could also make it easier for the US to target China with trade sanctions over, for example, an undervalued exchange rate or predatory trade practices. Thus, China's position as the focus of East Asian production networks producing finished goods for the US and the EU could be weakened.

(2) TPP and the Security Environment in East Asia

TPP would not end the pursuit of comparative advantage in the region. US initiative would simply reconfigure it aided by the unease caused by China. As discussed above, a security community provides the strongest foundation for economic regionalism, and division caused by the security dilemma will destroy it. In 2011 the US renewed its commitment to a strong military presence and freedom of navigation in East Asia. In effect, the US offers a security community as the basis for regional economic integration, as well as insurance against a belligerent China. The US provision of security only distracts from East Asian regionalism if neighbors see China as a threat. However, they now do. So, as a provider of security on top of enhanced export opportunities, the US through TPP may draw energy and attention away from APT. Smaller countries do not have to make a choice between TPP and APT, but they will have to decide how to prioritize these initiatives.

In sum, the new relationship between the balance of power and comparative advantage that emerged in 2011 will not kill regionalism, but it has the potential to redirect its path onto a trans-pacific axis as countries seek a US counterweight to an assertive China.

(3) The Japan Factor in 2012

If Japan gives priority to the TPP over APT, then the APT process would almost certainly become secondary in the region. Japan is a key US ally, so this

is not hard to imagine happening. However, the declining economic prospects of the West also have to be weighed by Japan. After a formal study commissioned by the Northeast Asian Summit in 2009 strongly recommended in December 2011 going ahead with a Northeast Asian FTA, the Northeast Asian summit is expected to approve a formal effort to negotiate a Northeast Asian FTA including China, Japan, and South Korea in May 2012. The potential trade and growth gains for all from this are substantial, and the subsequent step would be the consolidation of an East Asian FTA including the ASEAN countries. This would be a timely boost to growth prospects.

Thus, Japan will be straddling two critically important trade negotiations in 2012. Whichever way it throws its weight will likely determine the future course of regionalism. It would prefer not to have to choose because China is Japan's biggest trade partner, while the US its next biggest, but the sharpening strategic rivalry between the US and China might make it a difficult balancing act. However, Japan also has leverage in this situation and can influence the final form these agreements could take.

III. Western Financial Crises Reinforcing East Asian Regionalism

1. Anatomy of the Euro Crisis

First, the Wall Street generated financial crisis of 2008-09 almost destroyed the global financial system, and though the catastrophe was avoided, one cannot say the US has recovered. Household and government debt has increased, and the need to repair balance sheets inhibits future lending and consumption growth.

Then in 2010-2011, the Euro zone financial system teetered on the brink of collapse. It began with the 110 billion Euro bailout of Greece in May 2010. This was followed by the 67.5 billion Euro bailout of the Irish government in November 2010. In May 2011 Portugal got a 78 billion Euro bailout. Europe's crisis came to a head in July 2011 with the second Greek debt crisis that required an additional 109 billion Euro bailout. The Greek government's payments obligations—to lenders and to Greek citizens—was still unsustainable after

a year and a half of adjustment. So in February 2012 Greece was given an additional 21 billion Euro loan.

As in previous sovereign debt crises, in Europe panicked lenders demanded painful cuts in government social welfare spending, or they would demand repayment of maturing loans and cease new lending. Greece's democratic government has faced a dilemma as it searched for ways to cut its payments obligations: Greek voters refused to agree to all the cuts in social welfare spending that lenders were demanding, and lenders refused to ease Greece's loan repayment obligations. This left Greece unable to make the loan payments coming due.

To avoid government default, as was customary in these cases, the EU stepped with official funds to temporarily bridge the funding gap to buy time and broker an agreement. However, in 2011 the Greek funding gap was too large for the EU to handle. Without spending cuts and loan forgiveness, Greece would have to default and/or leave the Euro. The consequences would be dire for European banks, other highly indebted Euro zone countries, the Euro currency, and the EU itself. A compromise was reached, but more risk-averse lenders began presenting demands to Italy, Belgium, Spain, and France. These governments face rising borrowing costs and existing public spending and debt repayment obligations that may outweigh their revenue prospects, and they face the same political dilemmas with voters and creditors with insufficient EU funds to provide a bailout.

Stopgap measures have put off the day of reckoning in the Euro zone but today, the fundamental issues remains unresolved. The required spending cuts and tax rises needed to ensure solvency will depress growth. This reduces revenue prospects, making the need to borrow persistent. Thus, beyond the short term, the outlook for Europe is not very good, though on a day-to-day basis things today may appear normal.

(1) Doubt about the EU Model of Integration

This story can be traced back to the creation of the Euro as a currency

to replace EU member national currencies, and it serves as a warning to East Asia not to follow the same path. In brief, a single common currency replaced national currencies. National governments lost the power to set monetary policy and gave it to the European Central Bank (ECB), which set monetary policy in the entire Euro zone to optimize conditions at the productive core of Europe's economy, i.e., Germany. But the fiscal organization of Europe remained autonomous and decentralized at the nation-state level, and levels of economic activity and development were quite varied from country to county within the wide Euro zone.

The benefits of a single currency were well advertised—elimination of currency exchange rate risk, and the reduction of currency conversion costs in cross border trade and investment transactions, and the full integration of a continental market. And the benefit of an ECB-run monetary policy keyed to the highly advanced and fiscally conservative German economy was low inflation and lower borrowing costs for everyone using the Euro. However, the problem of preserving national fiscal sovereignty in the wider context was not understood.

The problem is that democratic governments have to shape fiscal policy in accordance with local economic and political conditions. Countries in the Euro zone periphery tended to be less developed, with more labor-intensive production technologies and more powerful labor unions. As advanced manufacturing and finance companies based in the core took over peripheral markets, local jobs, profits, and tax revenues were lost. Yet peripheral countries were led to believe they would share in the Euro zone's wealth gains after they joined the Euro zone.

As growth slowed and unemployment rose, labor demanded that their national governments ease the pain of structural adjustment. This meant more social welfare spending. National governments were also expected to stimulate growth and jobs. But national governments in economically distressed areas could no longer adjust monetary or currency exchange rate policy to stimulate economic activity. The core, which enjoys prosperity and prefers low inflation,

sets euro zone monetary policy; monetary easing to boost jobs on the periphery is not permitted. And because peripheral governments can no longer use currency devaluation to restore competitiveness, the only tool they had left was fiscal stimulus, i.e., spending without raising taxes, because taxes would defeat the purpose of stimulus spending.

National fiscal sovereignty in the Euro zone meant two more things. First, there was no federal Euro government to tax wealth accumulating at the core to finance peripheral states. Second, governments could borrow as much as banks were willing to lend. So distressed states borrowed to finance greater spending. And banks were willing to lend freely at low cost because they believed the Euro core (in effect, Germany) would bail out these governments if they got too deeply into debt.

As banks and distressed governments acted out this scenario, collectively, the debts accumulated by these countries have become so big that the whole Euro zone enterprise as presently constituted has become untenable. After the incompatibility of national fiscal sovereignty with the Euro became clear, the Euro zone began to contemplate eliminating national fiscal sovereignty. But this idea is not politically consistent with European social democracy and once voters understand what this step would mean, they will reject it. And it will probably not change the dismal sovereign debt outlook.

In the meantime, Europe is looking to Asia for a short-term bailout. Yet there is something unseemly in asking a country like China, where the 2010 per capita income was \$4,260, to bail out Greece or Italy where the per capita incomes in 2010 were around \$30,000 and \$35,000 respectively.

2. Lessons for East Asia?

The story of the Euro crisis contains certain negative lessons for East Asia. Above all, East Asia will avoid a single currency. That is because, to avoid the problems discussed above, East Asian states will not hand monetary and fiscal sovereignty over to an East Asian central bank or federal government.

(1) Global Economic Structure

Western consumption has underwritten the East Asian strategy of export-led industrialization. But after the financial crises of Wall Street in 2008 and the Euro zone of 2011, and with the rise of the East Asian share of global GDP (to around 30 percent), a new relationship is needed. East Asia can no longer rely on exporting goods to North America and Europe to drive growth because the outlook for western income and consumption growth is poor, and East Asian production and export capacity has grown too large. Shifting toward a domestic consumption led growth model is a key agenda item for East Asia—China most of all. Here, the key will be shifting China’s growth dependence away from exports toward domestic consumption. This creates a new agenda of policy coordination as China attempts to manage this delicate process in coordination with regional economic partners.

(2) Global Monetary and Financial Arrangements

The IMF proved itself unable or unwilling to effectively manage currency stability in East Asia in 1997 and so the APT process devised the Chiang Mai Initiative. The 2008 Wall Street crisis pushed APT to expand this bilateral currency swap arrangement into a shared currency pool under the Chiang Mai Initiative Multilateralization (CMIM).⁽⁵¹⁾ The IMF in the midst of the Euro crisis today remains preoccupied with saving the EU. It gives less attention to sustaining growth in the developing world than most East Asian states would like. After these disappointing turns, East Asia wants a change in the management of the global monetary and financial system and it is more willing to contemplate regional solutions to insulate it from instability in the US and the EU.⁽⁵²⁾

Another issue is that structural trade deficits and financial weakness in NAFTA and the EU are putting upward pressure on the RMB and Japanese yen, and at the same time, are devaluing the dollars and Euros being held in central bank reserves. And the use of US and euro financial systems to implement economic sanctions on countries that are key resource suppliers

to East Asia gives the region an incentive to create alternative currency payments mechanisms. This is prompting China to expand use of the RMB as international money with major trade partners, and today 11 percent or more of its trade is transacted in RMB. With up to 60 percent of its trade with China still denominated in dollars, Japan is now looking to transact more of this trade in direct currency exchange. The Asian Development Bank, in association with APT, is focusing on the possible use of an Asian Currency Unit to reduce dependence on external currencies in intra-regional trade, and reduce exchange rate risk and transaction costs.⁽⁵³⁾ The value of the ACU would be determined by a basket of regional currencies, and could be used to settle intra-regional payments transactions, or at least be used as a technical indicator to facilitate monetary policy coordination. But the problems revealed by the euro-crisis warns against the single currency solution.

It seems odd that East Asia, where the bulk of global saving occurs, and where the potential for productive investment is greatest, still relies heavily on western financial markets to direct East Asian savings into investment in the region. Hence, APT, supported by the Asian Development Bank, has sponsored the Asian Bond Market Initiative (ABMI) since 2003 and in other ways seeks ways to develop regional financial markets.⁽⁵⁴⁾

(3) Global Economic Governance

The G-20 widens participation in global economic governance at the discursive level. East Asian members in the G-20 are China, Japan, South Korea, and Indonesia. They do not articulate an agreed East Asian perspective in this forum as Europe can through the G-20 seat occupied by the EU. However, they share East Asia's position in the global economic structure (as the largest originator of trans-regional exports, the largest source of global savings, and the center of global growth), and so they must figure out how to use their presence in the G-20 to advance their collective interest in this setting. In particular, the G-20 agenda has been preoccupied with saving the EU, but observers in East Asia are conscious of the opportunity cost of spending money to bail out

EU members that could be used to finance badly needed and highly profitable investments in East Asian growth.⁽⁵⁵⁾

IV. Conclusion

East Asian regionalism is at a crossroads in 2012 due to two key developments. One is that China's assertiveness is cracking East Asian solidarity and pushing some East Asian countries toward more engagement with the US pivot to the detriment of the APT process. However, fragile economic conditions in the US and Europe give East Asia incentives to reduce dependence on the US and build East Asian cooperation. How this tension will be resolved is hard to predict. The assertiveness of China (if it persists), and how Japan prioritizes the Northeast Asian FTA and TPP negotiations, will be important factors in determining which path the region will take.

The other big development is the Euro crisis, and the problems of global economic governance highlighted by this crisis. The consequences of the Euro zone's radical surrender of national economic and financial sovereignty contain lessons that reinforce the current agenda of state-centered East Asian regionalism. In particular, East Asia will want to protect national economic sovereignty, and pursue a broad agenda of development cooperation. It will step up monetary and currency cooperation to seek alternatives to the weakening dollar and the euro to serve international money functions within the region, though not aiming for a single Asian currency as it might have done before the Euro crisis. And it will look more urgently to develop regional financial markets. Due to failing growth in the West, East Asia will have to look more seriously at an East Asian FTA and ways to shift toward a more consumption driven economy in China in order to improve long-term regional growth prospects; and East Asia will begin to articulate a desire to change the discursive and institutional aspects of global economic governance.

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East Asian Regionalism at a Crossroads

<Summary>

David Arase

This paper deals with two questions. One is how the competing logics of the balance of power vs. comparative advantage will determine the course of East Asian regionalism. This discussion suggests that the new regional security agenda accompanying China's recent policy choices, combined with fresh US attention to the region, have the potential to change the course of regionalism from an East Asian focus to a trans-pacific focus. The other question is how the Euro crisis may affect the course of East Asian regionalism. It is suggested that the Euro crisis contains many negative lessons that, unlike the new Asian security agenda, will tend to reinforce the current model of East Asian regionalism.