Formal East Asian Economic Integration Still Far Away

East Asian regional economic integration, be it “market-driven” or “functional”, has enveloped both Southeast and Northeast Asia. It is however important to underscore that unlike Southeast Asia, Northeast Asia remains loose and unorganized. By default and not by design, Asean has emerged as the “hub”, despite being relatively small and weak, with the more advanced Japan and Korea and much bigger China serving as “spokes”.

Of the various processes of regional integration, market integration is the most important in both the Asean (Association of South-East Asian Nations) and the wider East Asian contexts. The establishment of regional production networks and supply chains by East Asian multinationals has contributed much to increased intra-regional, intra-industry and intra-firm trade in the region. Likewise, American and Europeans investments in the region, too, have generated intra-regional specialization.

The rise of China has altered the East Asian equations in a variety of ways. Without a doubt, it was the China factor that expedited the Asean integration process. The diversion of foreign direct investment (FDI) from Asean to China and the loss of Asean’s export market share to China have forced ASEAN to quicken the pace of AFTA so as to create a single Asean market large enough to be an attractive destination for FDI. An integrated Asean market was seen as a counterweight to China’s huge market, notwithstanding the fact that China is more than twice the size of Asean in terms of population and GDP (gross domestic product).

China’s northeast and southeast linkages have grown enormously in recent years. Japanese and Korean investments in China have increased by leaps and bounds, and this has caused China’s trade links with Japan and Korea grow stronger and stronger. Asean investments in China have also increased sharply, while China has emerged as a major trading partner for Asean. The composition of Asean-China trade has also changed dramatically with intra-industry trade accounting for a growing share of the total, which was previously dominated by primary products. All these have increased the contagion risks for East Asia as a whole in the event of a financial crisis.

The 1997-98 Asian financial crisis has also played a key role in the East Asian economic integration process. This crisis did serve as a catalyst that triggered major changes that contributed to the integration process in the East Asian region. The fact remains that the crisis had caused East Asia and Asean to run into each other’s arms. Many had thought the crisis would derail the regional integration process, as countries in the region would be preoccupied with domestic problems. On the contrary, the sense of insecurity had brought them together as never before.

Financial integration has been the weakest link, especially for Asean. Even in the wider East Asian context, the picture is still pretty much the same. The post-crisis financial cooperation in the guise of the Chiangmai Initiative smacks of purely bilateral arrangements. All this is unsurprising, as regional financial integration is fraught with difficulties. For starters, financial integration can meaningfully take place only at a fairly advanced stage of regional economic integration preceded by real sector integration. Besides, the highly sensitive question of loss of sovereignty weighs more heavily in the case of monetary and financial integration, for which East Asian countries are not ready at all. What is more, financial integration is easier among a fairly homogeneous group of countries, which is not the case for East Asia. However, as financial cooperation requires a critical mass, as it tends to work more effectively in a wider grouping than in a smaller one, an East Asia wide regional financial arrangements would stand a better chance than a narrow Asean scheme.

The new trend towards bilateral free trade agreements (BFTAs) may scuttle the integration process, if they turn out to be “stumbling blocks” rather than “building blocks” for East Asian economic regionalism. The bilateral approach runs the risk of fragmenting the regional market, creating trade distortions. While BFTAs may increase the intra-regional connectivity, the end result may well be just hubs-and-spokes. In particular, the complex rules of origin that these trade agreements entail can be very troublesome for manufactures and customs officials. To be sure, East Asia would benefit from a network economy with total inter-connectivity, which bilateral trade agreements on a selective basis cannot provide. East Asia has a long way to go before it can transform into a truly regional network economy.

The fact remains that the Northeast Asian nations, caught in a geopolitical web, are unable to relate themselves as comfortably, in the functional sense, to one another as they could with their Southeast Asian counterparts. The chances of Northeast Asia organizing itself like Southeast Asia, again in the functional sense, are therefore very slim. There is too much distrust in Sino-Japanese and Korean-Japanese relations even for the powerful market forces that tend to drive them closer to each other. Seen in these terms, Asean+3 (Asean plus Japan, China and South Korea) is really no more than Asean 10+1+1+1. This raises disturbing questions about the practicality of an East Asian Free Trade Area (EAFTA) in which the economies of Japan, Korea and China would integrate with one another, as they would with Asean, in a functional fashion. The EAFTA idea is thus likely to remain elusive for a long time, barring a major global or regional economic meltdown that would force Northeast Asia to bury the hatchet, in which case the centre of gravity will shift from the southeast to the northeast in the East Asian nexus.

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