

# East Asian Regional Financial and Trade Architectures

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# Regional Public Goods in Finance and Trade

- For Japan as a regional power, provision of regional public goods is essential.
- Regional public goods in trade: liberal and open trade (eliminate protectionism & lower transaction costs)
- Regional public goods in finance: regional financial stability (regional crisis prevention & prudential regulations)

# Developments in New Regional Financial and Trade Architectures

- Economic Partnership Agreements (EPAs): Singapore (2002), Mexico (2005), Malaysia (2006), Philippines, Thailand, ASEAN, South Korea, Indonesia, Chile etc.
- EPAs including trade facilitation, technical cooperation and investment agreements
- Chiang Mai Initiative and Asian Bond Initiatives (ABF and ABMI)
- Discussions on Asian Currency Unit

# Research Questions

- Why did Japan begin to take regional institutional building initiatives in both trade and finance in the late 1990s into the 2000s?
- How can one compare and contrast the Japanese initiatives in those two issue areas?
- What are the connections and conflicts between the two sets of initiatives?

# Theories of Regionalism: Trade and Finance

- Balassa (1961): five-step approach to integration.
- Theory of Optimum Currency Area (Mundell 1961)
- Domino theory of regionalism (Baldwin 1997)
- Neofunctionalism (Haas 1964) and Liberal intergovernmentalism (Moravcsik 1997)
- ➔ Connection between trade and finance limited and old (only based on European experience), where trade leads financial and monetary integration.
- ➔ Dieter and Higgott (2003): East Asian regional arrangement started from monetary integration

# Expected scenario of regional integration in East Asia

Table 1 Key components of monetary regionalism

	<i>Level 1: Regional liquidity fund</i>	<i>Level 2: Regional monetary system</i>	<i>Level 3: Economic and monetary union</i>	<i>Level 4: Political union</i>
Main component	Creation of a public regional liquidity fund	Introduction of a regional monetary system with exchange rate bands	Permanent fixing of exchange rates and creation of a single currency	Creation of a political union, national political systems continue to exist and cover most issues
Political measures	Creation of a forum for the central banks of the region, i.e. a regional monetary committee	Regular meetings of the regional monetary committee	Creation of common political institutions, establishment of a Regional Central Bank	Creation of supranational institutions in some, defined areas
Additional components (crisis management)	Creation of a private liquidity fund	Expansion of coverage of existing regional liquidity funds		
Additional components (crisis prevention)	Implementation of Universal Debt-Rollover Options with a Penalty (UDROP)			
	Capital controls of the individual countries, in particular on inflows, may continue to exist		Phasing out of capital controls	
Trade components		Facilitation of regional trade by harmonizing norms and standards	Customs Union	Free movement of labour
Macroeconomic policy	Joint monitoring of monetary and fiscal policy; regional surveillance of financial markets	Co-ordination and harmonisation of monetary policy, in particular interest rate policy as well as fiscal policy, in particular on debt levels		

# Origins of Japan's Leadership in Regional Finance and Trade

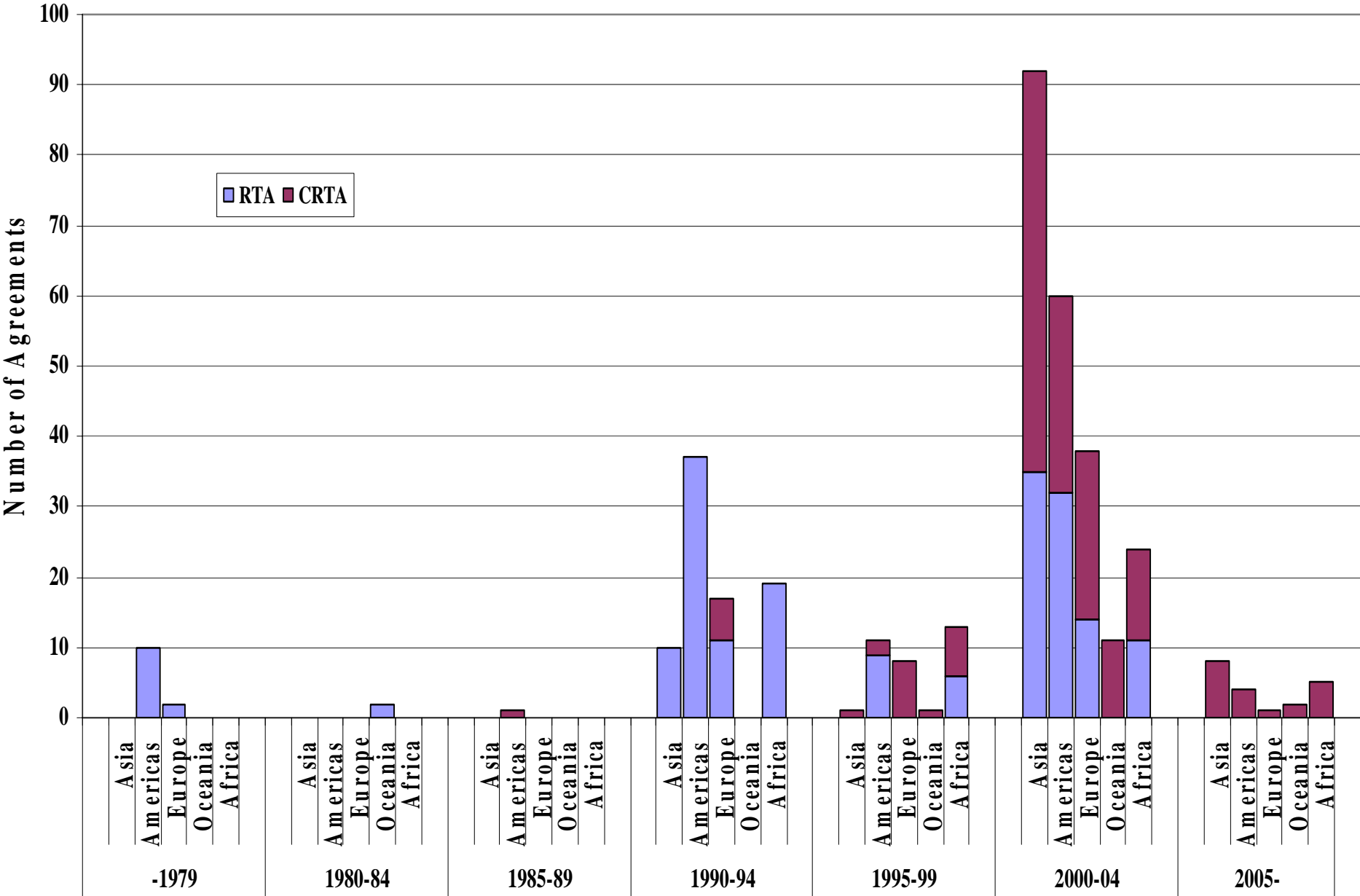
- Policy reaction to changing global trade architecture (WTO, APEC and FTAs)
- Policy reaction to the increasing economic integration in the region led by trade and investment (Regional Production Network)
- Policy reaction to the Asian Financial Crisis
- Strategic reaction to the US policies, the rise of China, and the success of European integration
- Reactions to and/or In pursuit of domestic economic maturity (Naiatsu)

# Characteristics of Japan's Regional Trade Goods

1. Bilaterals first, multilaterals second
2. North/South FTAs including cross-regional FTAs
3. Preferential trading with small economic partners
4. Pushed by the threat of trade-diversion, and the need of sheltering sensitive sectors
5. EPAs versus FTAs



# The Number of RTAs & CRTAs by Region and Time



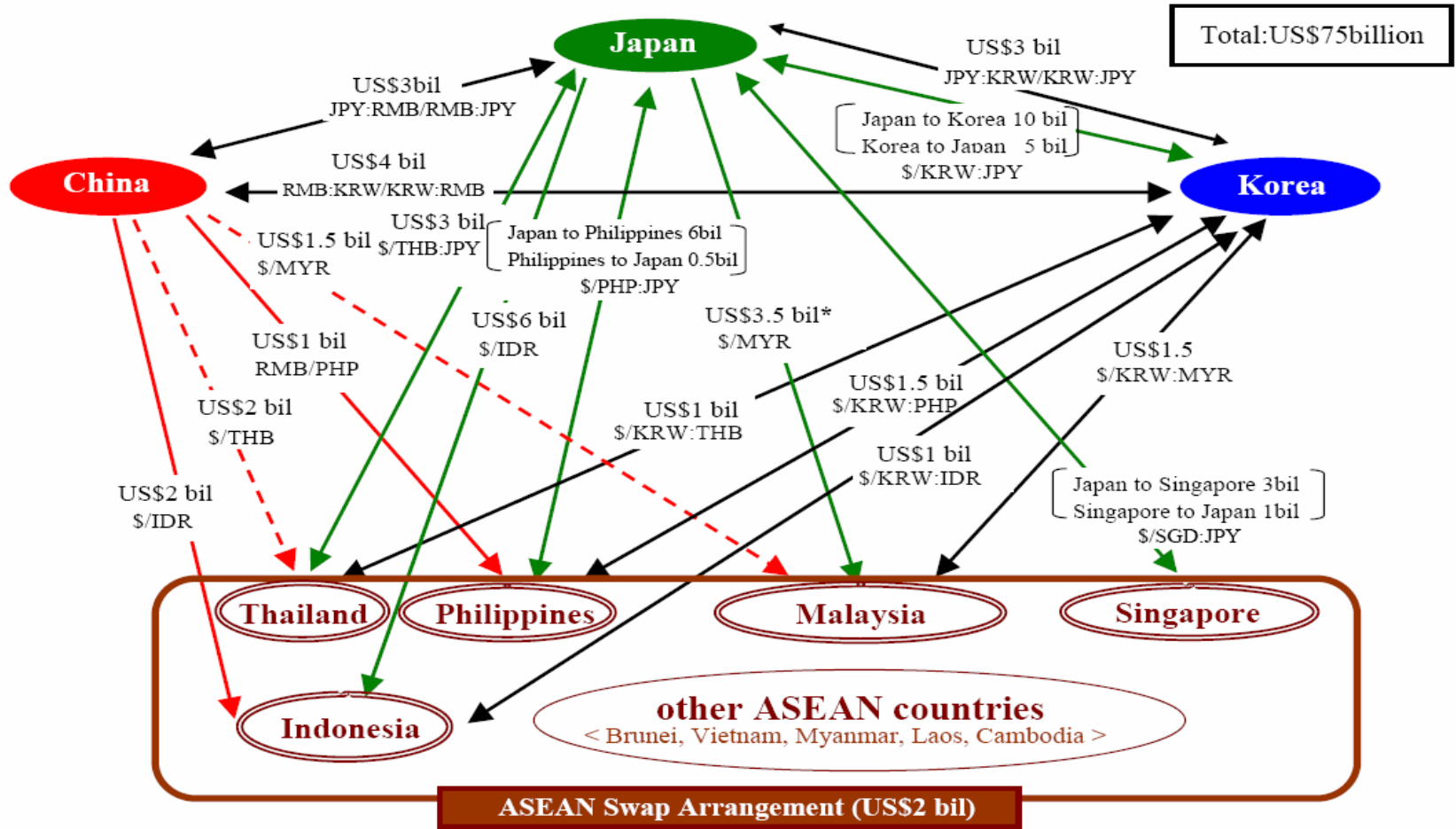
## What is distinctive about an EPA?

	<b>Japan-Singapore</b>	<b>Japan-Mexico</b>	<b>NAFTA</b>
<b>Common new issues</b>			
Investment	○	○	○
Government procurement	○	○	○
Competition policy	▲	▲	▲
Intellectual property	○	○	○
Temporary entry business people	○	○	○
Customs procedures	▲	▲	▲
Environment	N.I.	N.I.	■
Labor standards	N.I.	N.I.	■
Finance	▲	▲	○
<b>Japan's new issues</b>			
Paperless trading	▲	N.I.	N.I.
Mutual recognition	○	N.I.	N.I.
Science and technology	▲	▲	N.I.
Human resource development	▲	▲	N.I.
Small and medium enterprises	▲	▲	N.I.
Improvement of the business climate	N.I.	▲	N.I.

# Characteristics of Japan's Regional Financial Goods

1. From emergency funding and liquidity mechanism to permanent regional monetary arrangements
2. Monitoring and surveillance and the IMF-link
3. Regional context of ASEAN+3 and/or ADB
4. Challenge of dollar-dependence in East Asia
5. Mainly government-led initiative, little actions from the Japanese financial sector

# The Agreement on the Swap Arrangement under the Chiang Mai Initiative (as of May 4, 2006)



\* Including New Miyazawa Initiative  
 [ The agreement between Japan and Malaysia: US\$2.5 billion under the New Miyazawa Initiative  
 US\$1 billion under the Chiang Mai Initiative ]

Note: Total amount does not include New Miyazawa Initiative and ASEAN swap arrangement.

# Currency Denomination of Japan's Foreign Trade by Region

	1995		1998		2001		2002		2003		2004		2005	
	Yen	Other	Yen	Other	Yen	Other	Yen	Other	Yen	Other	Yen	Other	Yen	Other
<b>Exports (%)</b>														
<i>All Regions</i>	<b>36</b>	64	<b>36</b>	64	<b>36.1</b>	63.9	<b>36.7</b>	63.3	<b>39.3</b>	60.7	<b>40.1</b>	59.9	<b>38.4</b>	61.6
North America	<b>17</b>	83	<b>15.7</b>	84.3	<b>13.2</b>	86.8	<b>12</b>	88	<b>12.5</b>	87.5	<b>12.9</b>	87.1	<b>12.3</b>	87.7
Western Europe	<b>34.9</b>	65.1	<b>34.9</b>	65.1	<b>33.5</b>	66.5	<b>28.5</b>	71.5	<b>27.3</b>	72.7	<b>29.3</b>	70.7	<b>29.3</b>	70.7
Southeast Asia**	<b>44.3</b>	55.7	<b>48.4</b>	51.6	<b>50</b>	50	<b>46.6</b>	53.4	<b>44.9</b>	55.1	<b>45.5</b>	54.5	<b>48.8</b>	51.2
<b>Imports (%)</b>														
<i>All Regions</i>	<b>22.7</b>	77.3	<b>21.8</b>	78.2	<b>23.5</b>	76.5	<b>25.5</b>	74.5	<b>25.3</b>	74.7	<b>23.8</b>	76.2	<b>22.1</b>	77.9
North America	<b>21.5</b>	78.5	<b>16.9</b>	83.1	<b>20.8</b>	79.2	<b>19.8</b>	80.2	<b>19.1</b>	80.9	<b>20.7</b>	79.3	<b>22.8</b>	77.2
Western Europe	<b>44.8</b>	55.2	<b>44.3</b>	55.7	<b>49.7</b>	50.3	<b>31</b>	69	<b>32.3</b>	67.7	<b>34.1</b>	65.9	<b>32.4</b>	67.6
Southeast Asia**	<b>26.2</b>	73.8	<b>26.7</b>	73.3	<b>24.8</b>	75.2	<b>27.5</b>	72.5	<b>28.1</b>	71.9	<b>27.2</b>	72.8	<b>26.7</b>	73.3

# Connections & Conflicts between Trade and Finance

- A) Though always referred as “two wheels of a vehicle,” no explicit policy link between the two
- B) Possible connections:
  - \* Exchange rate instability under expanded trade (utility of ACU/CMI)
  - \* Liberalization of financial services and capital account under US-Singapore FTA
- C) Possible conflict:
  - \* Liberalization versus stability under limited institutional capacity and surveillance
  - \* Embedded mercantilism in East Asia

# Conclusion

- In the global institutional context: with international institutions (WTO, IMF)
- In relation to the US trade and financial strategies
- In relation to China's trade and financial strategies
- Implications on East Asian Community