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# **Regionalization and Regionalism: The Process of Mutual Interaction**

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Regionalization and Regionalism:

The Process of Mutual Interaction

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### Abstract

This paper analyzes the evolution of regionalism in East Asia and derives implications for the role and influence of the United States and Japan in the region. In the introductory section, this paper identifies three major driving forces and three factors that acted as a brake throughout the evolutionary process of regionalism. Section 1 analyses the regionalization in East Asia to understand the characteristics of the second driving force, intra-regional economic interdependence, which has had a consistent and ever-increasing impact on the shape and nature of the regionalism. Section 2 reveals changing impacts of different factors through an overview of interactions of the driving forces and obstacles through the four distinct periods identified in the introductory section. The concluding section deals with the interaction between the regionalism and the influence of the United States, Japan and China on it.

Key words: Economic integration; Free trade agreement; Japan-Singapore Economic Agreement for a New Age Partnership (JSEPA); Asia Pacific Economic Cooperation (APEC); ASEAN + 3; East Asian Community; Asian financial crisis

JEL classification: F02, F13, F15

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In the past, East Asian governments had distanced itself from preferential trade agreements such as free trade agreements (FTAs) and had not actively pursued other formal institutions for regional integration (henceforth referred to as “*regionalism*”<sup>1</sup>). Since the latter half of 1980s, the region had boasted of dynamic growth and de facto economic integration through market process (henceforth referred to as “*regionalization*”) without such formal institutions. In the wake of the Asian financial crisis, however, the landscape drastically changed. East Asian capitals are now actively exploring bilateral FTAs and even contemplating a vision for “an East Asian community” to promote “peace, prosperity and progress” through “cooperation in the economic, political, security, environmental, social, cultural, and educational arenas.”(East Asia Vision Group, 2001) While the change might look abrupt, it had been gradually prepared before the financial crisis.

This paper analyzes the evolution of regionalism in East Asia and derives implications for the role and influence of the United States and Japan in the region. In doing so, this paper identifies three major driving forces and three factors that acted as a brake.<sup>2</sup> The

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<sup>1</sup> The word “regionalism” occasionally used to emphasize negative, merchantilistic attitude of the members of regional arrangements that narrow-mindedly pursue interests of the region at the expense of other regions or international institutions. In this paper, however, “regionalism” merely refers to institutional frameworks set up by the governments in the region to promote regional economic integration. Various arrangements of regionalism have different levels of commitment by the participating governments. The FTA is a solid form of regionalism. On the other hand, regional consultative bodies that do not involve legally binding agreements but aim at promoting economic integration among the members are a looser form of regionalism.

<sup>2</sup> The analytical framework of the evolutionary process of regionalism in Asia in four states with three driving forces and obstacles is based on the approach taken by Munakata(2002).

assessment of how important each force or factor was at each stage of the evolutionary process helps clarify the degree of influence various actors had in the process and the impact of the evolution of regionalism in turn had on their influence.

The first of the three driving forces is defensive reaction to extra-regional pressures (henceforth referred to as “*defensive regionalism*”). They have two elements. One is growing concern about discrimination caused by preferential trade agreements in other regions such as the European Union (EU), the North American Free Trade Agreement (NAFTA)(and eventually the Free Trade Area of the Americas (FTAA)). East Asian capitals felt pressure to somehow counteract and to strengthen their negotiation leverage by forging a regional grouping on their own. This motivation has steadily strengthened over time as the trend toward regionalism expanded geographically as well as functionally. Another element of the defensive reaction is East Asian frustration with unilateral approaches by the United States and “market fundamentalism” symbolized as “the Washington consensus.” They felt the need for greater negotiation leverage vis-à-vis irreconcilable pressure from the United States and U.S.-dominated institutions. This force does not necessarily work constantly and tends to be driven by particular events, such as trade frictions with Washington or initial mishandling of the Asian financial crisis.

The second driving force is the region’s desire to have an effective mechanism for cooperation to promote de facto integration and to deal with common challenges (henceforth referred to as “intra-regional *economic interdependence*”). East Asian economies have an incentive to reduce transaction costs among neighbors so as to strengthen economic linkages with the high growth areas in the region and to participate in and facilitate dense business networks of vertical intra-industry trade in place. They share such common challenges as rapid industrialization as well as institutional transition from developmental states to more market oriented economies. Similar problems in other countries in the region motivate East

Asian capitals in sharing their experiences in dealing with them. There is also a political incentive to include less developed neighboring countries in the network of economic interdependence so as to promote their economic development and political stability and to maintain harmonious diplomatic relations with them. The political motivation is important in defining the boundary of a particular “region” to be covered by an institutional framework. It is the intensity of economic interaction, however, that drives the substance and the depth of such a framework. As globalization and technological progress accelerated the changes in the regional economic landscape, regional economies came to have stronger incentives to create an effective local mechanism (in addition to global institutions) to provide prompt and focused solutions to immediate regional problems.

The third driving force is *intra-regional competitive dynamics*. East Asian economies compete with each other for foreign direct investment (FDI) and export markets. Once an influential country spearheads in implementing measures to make it more attractive to foreign investors and more competitive in export markets, others are prompted to follow and nullify its advantages. This dynamics would, depending on the situation, motivate East Asian economies to conduct unilateral and voluntary liberalization of trade and investment as well as to conclude preferential trade agreements with economies in and outside the region.

In spite of these forces, the path to creating an institutional framework in this region has never been straightforward due to the following factors.

The first one is the lack of cohesiveness in the region: diversity in developmental stages, political systems, and cultural and religious background as well as the centrifugal force of historical antagonism and political rivalry among regional powers. While some aspects of diversity, such as developmental gaps, are instrumental in promoting interdependence through complementary economic structures, they made it difficult for East Asian economies to pursue institutional frameworks for regional integration at the same pace.

The second factor is the regions' extra-regional dependence, especially on the United States as well as U.S. focus in Asia on bilateral relationships as opposed to multilateral frameworks (Katzenstein, 1997, 23-27; Hemmer and Katzenstein, 2002) and its displeasure, explicit or not, with Asian frameworks that did not include it as a member. East Asian economies know that they need to anchor U.S. interests in the region since they need the U.S. security presence, U.S. technology and capital, and must accommodate their biggest customer. This element offsets the impact of defensive regionalism. The balance of these two—dependence on the United States and defensive regionalism—has been largely determined by U.S. policy. When U.S. policy accommodates East Asian common interests and demonstrates a strong commitment to regional stability and prosperity, momentum for Asian-only fora through defensive regionalism will likely decrease, and vice versa.

The third factor is East Asian countries hesitation about institutionalization. While they appreciate problem solving, they exhibit inherent skepticism towards rigid, top-down institutions (Katzenstein, 1997, p.27-31). They also tend to prefer consensus building to confrontation. This hesitation has also arisen from the lack of commitment or capacity of some economies to follow through politically unpopular measures. As a result, they tend to avoid institutionalization and opt for easier, more flexible and (occasionally) less fundamental solutions. This hesitation offsets the impact of the intra-regional economic interdependence. The strength of this hesitation changes depending on the nature of the problems they face as well as the availability of alternative solutions. For example, the strong economic performance of East Asian economies until the Asian financial crisis made them confident of their economic dynamism and ability to attract FDI through unilateral liberalization of trade and investment, without depending on legal frameworks such as FTAs (Hashimoto, 1995a; Hashimoto 1995b). The crisis, however, crashed this confidence. On the other hand, when they are faced with serious regional problems that require effective solutions that are not

provided by other fora, institutionalization would gain momentum, including legally binding agreements that constrain sovereignty and may have discriminatory effects vis-à-vis non-members. The hesitation also moderated over time as the political voice of the private sector that had benefited from liberalization strengthened. As East Asian economies became more mature in dealing with regional frameworks and began to appreciate the efficacy of institutional agreements in sending positive signals to foreign investors and giving political momentum to domestic reforms, they overcame knee-jerk rejections of institutionalization and started choosing the most effective ways to solve particular problems. Nevertheless, the lingering lack of willingness or capacity to thoroughly implement tough measures will put the brake on the pace and dilute the substance of future institutionalization efforts.

An overview of interactions of these driving forces and obstacles through the four distinct periods identified in Section 2 reveals changing impacts of different factors. The role of the United States or of Asian governments' reaction to perceived U.S. policy intentions changed from the decisive factor to one of the influential factors in determining the shape of regional economic institutions involving East Asia. At the same time, as the region became more exposed to the force of globalization and integrated through business activities including those of U.S. corporations (i.e. regionalization), the role of intra-regional economic interdependence became more prominent.

The next section analyses the characteristics of the regionalization in East Asia, which, has had a consistent and ever-increasing impact on the shape and nature of the regionalism. Section 2 reviews the four distinct stages of the evolution of the regionalism referred to above. The concluding section deals with the interaction between the regionalism and the influence of the United States, Japan and China on it.

## 1. The State of Regionalization in East Asia

## 1) Forces and actors

Regionalization in East Asia has largely been driven by competitive activities of businesses and governments under the pressure of globalization and technological progress. Global businesses have an economic incentive to choose the most suitable locations for particular operations in order to make the entire production process more efficient. The technological progress in transportation, information and communications enabled more effective integration and management of production networks at a distance from headquarters and expanded the freedom of choice for global businesses as to where to locate what kind of operations. Individual talent and capital are also freer to go wherever they can maximize their value. The larger freedom in business locations causes unattractive places to suffer from industry hollowing-out and brain drain. Host governments, in turn, came under strong pressure to compete with each other for foreign direct investment (FDI), as well as productive resources such as individual talent and capital, as an important driver of economic growth and development. Global institutions such as the World Trade Organization (WTO) and the International Monetary Fund (IMF) have also pushed host governments to liberalize their economies. These dynamics, while not unique to Asia, prepared the environment conducive to the creation of production networks that drove regionalization in Asia.

The sharp appreciation of the yen after the Plaza Accord in 1985 triggered the process of regionalization in Asia. It prompted Japanese firms to relocate their labor-intensive production process to lower cost countries, causing a surge in export-oriented FDI to the countries of the Association of Southeast Asian Nations (ASEAN). Manufacturers in newly industrializing economies (NIEs) such as Korea and Taiwan followed suite as they suffered from the subsequent appreciation of their currencies against the U.S. dollar. In 1992, when Deng Xiaoping clarified the important role of special economic zones during his south China



tour, China started to attract FDI, putting competitive pressure on ASEAN countries. The flow of FDI had accumulated manufacturing capacity in the region.

In the 1990s, world business leaders increasingly perceived East Asian economies as attractive investment destinations not only for export-oriented operations but also for operations targeted at the local markets. Particularly in the latter half of 90s, the information technology (IT) boom and fierce competition under the shorter lifecycle of technologies and falling prices prompted Western newcomers to use Asian production capacities for greater production speed and price competitiveness. In the wake of the Asian financial crisis, lower price of corporations and deregulation of foreign capital accelerated cross-border M&As in the region. China's accession to the WTO made it particularly attractive as an FDI destination as investors expected improvements in its investment environment. Thus, in the 1990s and especially since late 90s, FDI from the U.S. and Europe increased relative importance in such sectors as automobiles, electronics, distribution, and finance in Asia (METI, 2001, 6-9; 22-25). At the same time, Asian economies –not just Hong Kong, the largest source of FDI to China, but also Taiwan, Korea and Singapore –increased FDI in China (JETRO, 2003a, 181-187).

## 2) Characteristics

One of the most significant characteristics of regionalization of trade and investment in Asia is the dominant role of production networks. Technological innovations and the elimination of trade and investment barriers referred to above helped reduce the cost and enhanced the availability of “a service link” –“a composite of activities such as transportation, insurance, telecommunications, quality control, and management coordination to ensure that the production blocks interact in the proper manner” (Arndt and Kierzkowski, 2001, 4). This opened up new opportunities for “fragmentation” –“the decomposition of production

into separable component blocks connected by service links” (Arndt and Kierzkowski, 2001, 10) across national frontiers. In particular, the sophistication of the system to numerically control manufacturing processes lowered the skill levels needed to perform certain steps of the manufacturing process and expanded the room to locate those steps in developing economies.

In addition, the “modularization” of the architecture of products, which is to break up a product into subsystems or modules that have common design rules and thus can be designed independently yet function together as a whole, became prevalent in the electronics industry (Baldwin and Clark, 1997). Modularization opened up new opportunities for suppliers at arms lengths to participate in existing production networks. This further increased the flexibility of choosing the location of production blocks. Modularization, which has lowered the level of coordination necessary to integrate various parts into a final product, also made the assembly a low value added step (so-called “smiling curve” phenomenon)(RIETI, 2002), prompting foreign companies particularly in the business of electronics manufacturing service (EMS) to set up assembly factories in China with an inexhaustible supply of cheap labor as well as a cluster of suppliers of low-cost electronics parts (Kuroda, 2001, 79-133; Kwan, 2002). This accelerated China’s integration into regional production networks and increasingly made it a new link in them.

Thus, the accumulation of FDI led to dense production networks within the region, where parts and components go back and forth among factories in the region for numerous processing and assembly tasks with a tight schedule and a low inventory before being shipped to the final markets. This operation of the production networks has significantly boosted intra-regional trade (METI, 2002, 15-16), particularly that of intermediate goods (such as parts and materials) which grew faster in the 1990s than that of finished goods (METI, 2001, 10-11). The regionalization has turned East Asia into a tight network of economies that

operates as the factory of the world, which major economies in the world such as the United States and Europe have come to capitalize on to provide their industries with more efficiency and their people with lower living costs.

While businesses have larger freedom in choosing the locations of various production blocks, there are industrial clusters where certain types of industries are concentrated. Once an industrial cluster is formed, “agglomeration” of industries in that location tends to be accelerated as far as such “centripetal forces” as good access to markets (backward linkages) and suppliers (forward linkages) outweigh such “centrifugal forces” as immobility of necessary production factors and higher costs due to congestion (“the interaction among scale economies, transport costs and factor mobility” determine the balance)(Fujita, Krugman and Venables, 2001, 11; 346). Larger freedom in choosing the locations of various production blocks seem to have affected this balance and helped new industrial clusters emerge in a relatively short period of time in a location that does not have an existing technological or industrial base but has other advantages such as cheap labor, low costs of building new factories and easy accessibility. (Kuwahara-a) In this new environment of “more fluid agglomerations”(Kuwahara-a), government policies have larger impact on the formation of industrial clusters. Developing economies in Asia have new incentives to improve the attractiveness of their industrial sites through such measures as building transportation and communications infrastructure, liberalizing trade and investment regulations, providing tax incentives to FDI, and providing better opportunities for education and training for local workforce. In addition to seeking to form industrial clusters on their own, Asian governments also adopted policies to strengthen the linkages with high growth areas in their neighborhood. In the 1990s, the governments of more developed members of the ASEAN, urged by private companies that had increased their roles in the economies of those countries, consciously adopted policies to create complementary relationship within ASEAN and with

the emerging economies such as China and Vietnam in order to capitalize on their growth potential and to position their countries as a hub in the region (Kuwahara-b). The rise of China will continue to prompt ASEAN countries to create industrial structures that are complementary to China but could be competitive with each other. This characteristic of the regionalization has motivated governments in the region to become attractive to FDI, and to integrate them with the centers of growth in the region, further accelerating the process of regionalization.

Another characteristic of regionalization in East Asia is the highly uneven degree of integration in East Asia among the different types of products. The electronics industry has spearheaded in regionalization (METI, 2002, 15-17) due to the increase in “vertical intra-industry trade” and intra-product trade of intermediate goods. On the other hand, sectors with higher cost of service links (caused by, for example, the protection by host and investing countries) or sectors where the production process is not amenable to fragmentation, lag behind. Agricultural produce, for example, is the case in point (Fukao, Ishido and Ito, 2003). On the other hand, Fukao et al (2003) shows that, in Europe, where barriers to intra-regional trade are much lower due to institutional market integration, the shares of vertical intra-industry trade and horizontal intra-industry trade are higher not only in the trade in electrical machinery and general and precision machinery as in East Asia but also in the trade of many other manufacturing products such as chemical products, transportation machinery, wood and paper products. The difference between Europe and East Asia suggests that East Asia has large room for expansion of intra-industry trade in various products (Fukao et al, 2003). The fact that Japanese farmers are more eager to expand export as they see opportunities to sell high-end fruits and rice to increasingly affluent Asian consumers suggests that two-way trade or intra-industry trade will expand even in agricultural produce (Mainichi Shimbun, July 5, 2003; Yomiuri Shimbun, July 7, 2003).

Last but not least, the third characteristic of Asian regionalization is East Asian exports' dependence on final demand from industrial countries. Monetary Authority of Singapore (2003, 64-65) estimates that, in 2001, approximately 78% of export of East Asian economies excluding Japan (non-Japan Asia) was directly (64% of total) or indirectly (after further processing within non-Japan Asia) (14% of total) bound for markets outside the region, using the detailed 1995 Asian Input-output (I-O) tables by Institute of Developing Economies (IDE), the Japan External Trade Organization (JETRO). Kim (2002) points out that the export growth of non-Japan Asia<sup>3</sup>, particularly that of the more developed Asian electronics exporters (Korea, Taiwan, Singapore and Malaysia) has been tightly correlated to U.S. investment in information technology and estimates that Asia's domestic demand, on average, accounted for only one-fifth of the total export growth of non-Japan Asia in the 1999-2000 cyclical expansion. The integration of export-oriented Asian economies is substantially different from that in Europe or North America where the most important markets for the participating economies are within the region. East Asia's extra-regional dependence suggests that the economies in the region have a strong incentive to remain open to other regions of the world. This incentive has informed their efforts for institutionalizing regional integration, the immediate goal of which is not to become a self-contained market but rather to make production networks in the region more competitive and to become a more attractive investment destination.

### 3) The role of Japanese business networks

Some argue that Japanese manufacturers, supported by the Japanese government, tried to extend their strong relational ties into Asia and that "the regionalization of Japanese

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<sup>3</sup> Non-Japan Asia includes China, Korea, Taiwan, Malaysia Singapore, Thailand, Indonesia and the Philippines.

manufacturing has helped block or inhibit structural change” and “is merely preserving the status quo.”(Hatch, 2002) Is the role of Japanese business networks an exception to the largely market-driven process of regionalization in East Asia?

In fact, regionalization of Japanese manufacturing has generally taken place as a rational reaction of the more outward-looking segments of the Japanese economy to the pressure of global competition, not as a way to preserve the status quo or to export the Japanese model to Asia. This does not mean that all their investment decisions were sound. Many Japanese investors made bad decisions particularly during the economic bubble in the late 1980s. Unprofitable investments, however, were mostly retrenched in the wake of the Asian financial crisis, if not before. The long-term relationship between Japanese manufacturers and their suppliers, which Hatch (2002) calls “relationalism,” has also been based on economic incentives. They have been dismantling the relationship where it ceased to serve the purposes. Delays in the needed changes were due to inertia, not because of some policy intention to preserve relational ties in Japan. On the other hand, businesses have preserved and adjusted the relationship where it continues to make an economic sense.

In this connection, Fujimoto (2002) articulates an important distinction between the “Japanese supplier system” and the “keiretsu network”. The Japanese supplier system is supported by three distinct characteristics; long-term business relationship, competition among a small number of suppliers for continuous buildup of capabilities, and outsourcing of interrelated works so that suppliers can improve capabilities to integrate those works and thus to become better equipped to improve product performance. The keiretsu network, on the other hand, is characterized by equity held by and executives sent from the parent company, but it does not necessarily have the functional characteristics of the Japanese supplier system. According to him, the Japanese supplier system is well suited for products of “integral architecture,” typically the automobile, where the integration of various modules of the

product design or the production process is crucial for the performance of the product, and, therefore, its competitiveness. Fujimoto finds that, the essential characteristics of the Japanese supplier system have remained intact in the automobile industry in the latter half of 1990s, when “keiretsu” relations were gradually disintegrated in the Japanese corporate world (Kuroki, 2002).

Moreover, Japanese production networks, once extended to Asia have been going through significant changes in order to adapt to the local situation. For example, while the first-tier part suppliers rarely supply parts to only one assembler even in Japan (Fujimoto, 2002, 175), it becomes more important for the part suppliers to deal with various assemblers operating in Asia to achieve the minimum efficiency scale. Furthermore, Japanese production networks do not consist exclusively of firms owned by Japanese corporations. For example, Japanese firms in China are increasing their procurement from Taiwanese, or local Chinese suppliers as the quality of their products improve (Kuroda, 2001, 86-94). Lack of discretion on the part of local subsidiaries, however, has often caused delay in procurement from local suppliers. The Japanese firms are increasingly aware of the problem of slow decision making that prevents them from keeping up with rapidly changing business environment in host countries.

Japanese firms operating in Asia are also aware of necessity to attract highly competent local employees. According to a survey conducted in China, college students attach importance to opportunities for development and growth rather than the level of the salary in choosing their jobs (ChinaHR.com, 2003). Kwan (2003) quotes this survey and argues that Japanese firms are not popular among Chinese students because local employees cannot expect promotion. This creates a vicious cycle where the inability to attract competitive local human resources, in turn, makes it difficult to promote local employees to managerial positions and to delegate decision-making authorities to local managers, and thus

makes that company less attractive to competent and ambitious people. A study by JETRO (2003) suggests that Japanese companies recognize this problem. The study shows that Japanese subsidiaries in Asia recognize that they need to promote local employees, rather than rely on the expensive Japanese expatriates, to the management positions in order to enhance their competitiveness. Nevertheless, many of the Japanese firms have not been able to move as fast as they wish. For example, it is said that many Japanese firms tend to hesitate to promote local personnel to the top management position of local subsidiaries worrying about possible difficulties in communications between headquarters in Japan and overseas subsidiaries due to language barriers or the lack of cultural understanding. The slow pace of change reflects their anxiety about the lack of needed organizational capacities, which could not be enhanced overnight, not a misguided intention to preserve the Japanese failing model by extending it in Asia.

It should also be noted that Japanese subsidiaries in Asia did not react to the Asian financial crisis in a uniform way. Fukao (2001) demonstrates with his empirical study on Japanese subsidiaries' response to the Asian financial crisis that the larger the value-added per worker of a local subsidiary of a Japanese manufacturer, the more likely it was that the affiliate maintained its workforce, and vice versa. It also shows that the greater the vertical corporate network the parent company had in the same host country; the more likely it was that its subsidiary kept its workforce. These results suggest that a subsidiary was more likely to receive assistance from its parent or firms within the same corporate network, when it had valuable skilled workforce and/or when it was an important part of an active production network in the host country. The result clearly suggests that keiretsu networks were not something to be preserved at any cost but have been in fact going through various changes. The assistance by the Japanese government to help Japanese corporations maintain their operations in Asia in the wake of the crisis did not intend to nor could override business



decisions to withdraw from non-viable operations.

Japanese production networks continue to evolve and transform, as Japanese manufacturers struggle to adapt their corporate strategies and capabilities to the competitive reality, agile or not. The role of Japanese production networks does not constitute an exception to the market-driven nature of the process of regionalization.

## 2. The Evolution of institutionalized economic integration in East Asia

Regionalism in Asia has evolved since the mid-1980s in four distinct periods. Different forces identified in the introductory section came into play at each stage and determined the developments in a particular period, while forces that had been ignored or frustrated in a particular period caught up and affected the ensuing developments. The influence of the U.S. policy of promoting globalization in general and liberalization of trade and investment in Asia in particular, was initially decisive but reduced its relative weight as a result of its success --as it awakened the regional capitals to adapt to globalization in ways that would suit their social and economic conditions. In addition, the lack of consistent policy attention of the United States to this part of the world, and to their developmental needs in particular, helped diminish U.S. influence in designing regional institutions in East Asia. At the same time, Japan, that had set off, in the latter half of 1980s, the regionalization and, in late 1990s, the regionalism of East Asia, found itself under increasing pressure from the rest of East Asia to restructure its domestic economy and actively integrate itself in the region.

### 1) 1st Period: Competition and Interaction among Various Proposals

The first period, between 1985 and 1992, saw active competition among different regional framework proposals. It is in this period that the regionalization discussed in the

previous section formed the force of “intra-regional economic interdependence.”

The first actual stimulus for institutionalized economic integration, however, came from the United States in the form of an unofficial proposal of an ASEAN-US FTA (the account of Singaporean scholar and diplomat Tommy Koh, quoted in “The Negotiator,” *channelnewsasia.com*, November 23, 2002). ASEAN was not ready. In the late 1980s, the ideas of bilateral FTAs with Japan, ROK and Taiwan considered in the U.S. policy circles (USITC, 1988; USITC, 1989), while not official, arouse considerable concern among Asian and Pacific policy makers due to “America’s proclivity toward unilateral trade actions” (Funabashi, 1995, 108). They were also concerned about the regionalism in Europe and North America.

These concerns, together with the rapid economic growth and the regionalization in East Asia, prompted Japan (MITI, 1988; 1989) and Australia to come up with the idea of what later became the Asia Pacific Economic Cooperation (APEC). Unlike MITI’s proposal, the Australian proposal initially did not include the United States and Canada. Also, it was more focused on trade liberalization, whereas MITI’s idea was more focused on enlarging the economic pie through growth rather than simply liberalizing markets (Funabashi, 1995, 66). The two countries did not iron out the substantive difference and instead concentrated on soliciting support for the launch of the ministerial meeting.

In the meantime, the U.S. policy circles had also become more open to the idea of a multilateral forum on economic issues in the Asia Pacific region (for example, Shultz, 1988). Secretary of State James A. Baker, III in the first Bush administration had also been considering a multilateral framework on economic issues (personal interview, a former U.S. State Department official, Washington, D.C., October 2003). After Australia accepted the U.S. request for its participation, Secretary Baker expressed his support for “a new mechanism for multilateral cooperation among the nations of the Pacific Rim.” (Baker, 1989)

Thus, the first APEC ministerial meeting was held in Canberra in November 1989.

In late 1990, frustrated by the difficulties in concluding the Uruguay Round of trade negotiations and APEC's apparent inability to check North American regionalism, Malaysian Prime Minister Mahathir Mohamad proposed an "economic bloc" "consisting of ASEAN, Indo-China, China, Taiwan, Hong Kong, South Korea and Japan" "to countervail the other trade blocs" (*New Straits Times*, December 11, 1990; *Business Times*, December 11, 1990; Youngblood, 1991)). After Japan's immediate rejection of the notion of a "bloc" and China's suggestion that the initial cooperation should be "loose" (*Japan Economic Newswire*, December 13, 1990), Malaysia clarified that the proposal was "a looser Asian economic grouping", consistent with the GATT (Youngblood, 1991). After consultation among the ASEAN members (AEM, 1991), the proposal was renamed the East Asian Economic "Caucus" (EAEC) to avoid further misunderstanding. Despite these efforts for moderation, the proposal met strong objections from Washington (Yoneyama, 1990) as something that "draws the line down the Pacific" (State Department, 1991) and undermine APEC.

While East Asian policy makers did not have compelling interests to promote this idea as they felt the need to anchor U.S. interest, the strong U.S. reaction left them with a feeling that they should be able to choose for themselves with whom they meet and talk. There was also a feeling that the U.S. reaction was hypocritical given the regionalism it promotes within its own hemisphere (Bush, 1990). The U.S. response on this point was that the proposed NAFTA would "not establish common barriers to those outside," (Baker, 1991a) and therefore would not become a "bloc." It was not clear, however, why a consultative body would undermine APEC when sub-regional FTAs such as NAFTA would not (State Department, 1991).

While Malaysia struggled to gain support for its EAEC proposal, ASEAN started a

new economic integration initiative, the ASEAN Free Trade Area (AFTA)<sup>4</sup> in 1992.

Concerns about the competition for FDI with Eastern European countries and China and the possible loss of ASEAN identity and bargaining power as APEC became more established prompted ASEAN members to agree on the first framework of comprehensive regional economic integration in East Asia.

In 1991, China, Chinese Taipei and Hong Kong simultaneously joined APEC and significantly boosted the importance of APEC (Baker, 1991b, 6).

Under the Clinton Administration, the United States renewed its interest in opening up Asian markets through APEC. This began the transition to the second period.

In this period, the main driving force was the defensive regionalism. The intra-regional economic interdependence stimulated the recognition of the need for some form of cooperation to deal with common challenges, but did not play a large role at this point. At the same time, all the three obstacles (the lack of cohesiveness, the U.S. displeasure about Asian-only framework, and avoidance of institutionalization) were at work.

One characteristic of the regionalism in this period is the little focus on substance despite an impulse to get together. With no region-wide framework in place, there was a tendency to try to find a single formula that would accommodate everybody's agenda and to focus on its membership.

## 2) 2nd Period: Primacy of APEC

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<sup>4</sup> The Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area was signed at the Fourth ASEAN Summit held in Singapore on 27-28 January 1992.

The second period started in 1993 when the United States chaired APEC and ended in 1997 with the Asian financial crisis. In this period, APEC came out as the primary vehicle for regional cooperation. Strong U.S. leadership (Clinton, 1993) enhanced the momentum for APEC and overcame the residual resistance to pursue trade liberalization within APEC. The United States hosted the first leaders' meeting in Seattle. The Eminent Persons Group tasked to draw up a vision for APEC even suggested a possibility of creating an APEC FTA (APEC-EPG, 1993, 1994, 1995). However, there was no agreement to form an APEC FTA because of East Asian economies' concern about preferential trade arrangements, as well as trade liberalization at a pace set by negotiations. Instead, the leaders adopted the Bogor goal of liberalization in 1994 (APEC, 1994) and the Osaka Action Agenda (APEC, 1995), choosing a mechanism based on members' voluntary efforts and peer pressure to achieve the ambitious target.

While APEC became the primary economic forum in the region under strong U.S. leadership, it did not fulfill most of the expectations that its members had at the forum's inception.

First, APEC was not effective in checking the regionalism in America (Summit of the Americas, 1994), not to speak of that in Europe. In addition, U.S. unilateral approach to trade frictions had "added to Asian ambivalence about the United States" and the tensions between the United States and Asian countries, notably Indonesia, over human rights, worker rights, press freedom and so on made Asian countries view the U.S. role in APEC warily (Manning and Stern, 1994, 86).

Second, U.S. desire to open Asian markets was eventually frustrated. The implementation of the Bogor goal was left to voluntarism and peer pressure. The United States failed in its attempt, through the initiative of Early Voluntary Sectoral Liberalization (EVSL), to change the modality of trade liberalization in APEC from voluntarism to tariff

negotiations.

Third, the Asian desire for an effective framework of cooperation was not satisfied either. Economic cooperation was given a lower priority in APEC. Project proposals proliferated with few efforts to systematically follow up on them. Frustration culminated when the EVSL was determined to be the primary item on the 1998 APEC agenda in late 1997, shortly after the eruption of the Asian financial crisis. In the meantime, Japan and ASEAN developed a cooperative framework between them. In 1992, the ASEAN Economic Ministers (AEM) and the Japanese MITI Minister started to hold meetings (AEM-MITI) on the fringe of AEM meetings. The chief objective was to promote the integration within ASEAN. MITI provided technical assistance to the projects under this framework to complement existing assistance on a bilateral basis (MITI, 1993). This framework, however, was not effective in reducing Japan's tariffs on its sensitive items that ASEAN economies hoped to export more.

In the meantime, rapid economic growth in Asia and the establishment of APEC stimulated European interest in Asia. ASEAN played a coordinating role in launching the Asia Europe Meeting (ASEM) (1996). ASEM opened up a new opportunity for East Asian countries to meet in preparation before meeting with European counterparts, though Chinese Taipei and Hong Kong were not included due to the political issues on the ASEM agenda. While these forums were not necessarily successful in achieving specific, substantive results, they satisfied Asian countries' desire to try out various types of forums and further promoted mutual understanding among them.

The fundamental problem of APEC was that it grew too fast without solidifying its core objectives. The lessons from APEC experiences are that they cannot expect APEC to solve all the problems and should have complementary forums, consisting of smaller members whose interests converge.

At the same time, APEC has incubated regional cooperation in Asia. It has brought governments and businesses together in the region through many meetings and projects. It has made them aware of common problems, new means of cooperation as well as different priorities. All these experiences laid the groundwork for the next period.

In this period, the same driving forces that had brought about APEC in the first period were at work: a shared desire to enhance leverage against the European Community to prompt it to come forward and conclude the Uruguay Round, Asian and Australia's desire of countering (in the case of APEC, by co-opting) U.S. unilateralism, protectionism, and intra-hemispheric regionalism, Asian desire to deal with the challenges of development and increasing interdependence as well as U.S. and Australian desire to liberalize Asian markets to further gain from the deepening interdependence. However, the United States was less patient than it had been in the first period. It was less prepared to accommodate the diversity of the region and the time needed to build a sense of community before achieving tangible results they wanted (personal interview, a former U.S. State Department official, Washington, D.C., December 2003). This impatience eventually heightened Asians' weariness toward the U.S. leadership in APEC and prepared for the surge of defensive regionalism in the third period.

### 3) 3rd Period: Dawn of East Asian institutions

The transition to the third period started with the Asian financial crisis that erupted in July 1997. It changed the landscape and mindset of regional economies in several ways and brought about a major turning point for the development of the regionalism in Asia.

First, East Asian countries were reminded of their interdependence by the "contagion" of the currency crisis. In addition, they perceived that the United States and the International Monetary Fund (IMF), which in itself is seen as a tool of U.S. international economic policy,

exacerbated the hardship of the countries hit by the crisis. This perception, combined with the fact that U.S. hedge funds substantially profited from the massive selling of Asian currencies, hurt the U.S. image in the region (Munakata, 2003). The experience of the Asian financial crisis convinced East Asian countries that they had to protect their own interests since global institutions under the U.S. leadership could not always be counted on. This conviction prompted them to build up foreign reserves and to initiate regional cooperation to promote financial stability in Asia and later nurtured a more comprehensive idea of regional integration. Stronger intra-regional economic interdependence and defensive regionalism were at work.

Second, there was a loss of self-confidence in Asia's economic dynamism and a rising anxiety about the regionalism elsewhere. The Asian crisis brought down regional domestic markets and focused countries in the region on exports. They became serious about overcoming the discrimination caused by FTAs that they did not belong to. They started to seek FTAs that would strengthen their relations with major markets of the world, not FTAs among those hit by the crisis. This attempt in turn reminded them, especially small and medium-sized economies, that their bargaining power largely depended on the attractiveness of the entire region to which they belong. This seemed to create increased momentum for FTAs among neighboring economies (Nikkei Business, 2000). Loss of confidence in Asia's economic dynamism thus strengthened defensive regionalism and reduced the hesitation about institutionalization.

Third, the crisis aroused a sense of urgency regarding economic reform. To obtain necessary financing from the IMF, it is necessary to implement agreed-upon reform measures. Foreign investors also watched with keen interest how far the governments were willing to go. The need to restructure domestic economies and attract FDI came heighten their interest in FTAs that would lock in domestic reform in legally binding agreements with foreign countries.



Thus, the hesitation about institutionalization substantially weakened.

Fourth, the influence of ASEAN was substantially reduced. China's relatively stable economic performance throughout the crisis and the surge of FDI into Korea contrasted sharply with the collapse of domestic demand and slow progress of economic reform in ASEAN. The shift of gravity to Northeast Asia prompted Singapore to go it alone without the other members in strengthening relations with countries outside ASEAN. Singapore's move set off intra-regional competitive dynamics and further reduced Asian countries' hesitation about institutionalization.

Fifth, Asian countries' perception of Japan changed. Japan lost its attractiveness as an economic model (Prestowitz, 1997). The threat of Japanese economic dominance in the region disappeared. Now, Asian countries feared that the Japanese business commitment in Asia might decrease. They were also concerned that Japan's economic crisis might deepen the Asian crisis. Asian and U.S. senior officials called on Japan to take the responsibility of supporting the Asian economic recovery (Rubin, 1998; Summers, 1998). From the outbreak of the crisis, Japanese manufacturers tried to maintain their offshore operations in the region and well-trained local employees. The Japanese government took various measures to aid the crisis-hit countries as well as Japanese companies (Munakata, 2001). Asian countries, however, seemed to expect of Japan not just to provide assistance but also to expand imports through economic recovery. Thus, the resistance to an increased Japanese role in the region was replaced by the expectation that Japan should lead the region out of the crisis and spearhead regional efforts to create stable economic environment.

Washington became disappointed by the loss of the momentum of APEC. The economic crisis dampened U.S. enthusiasm in Asia. The focus of U.S. trade policy shifted to the negotiations on China's WTO accession. Washington also renewed its interest in FTAs and floated a "P5 (Project 5)" initiative, a proposal for an FTA among five "like-minded"

countries (the United States, Chile, Singapore, Australia and New Zealand). These developments convinced Asian capitals that APEC should not be the only regional framework in Asia and there could be other forums that did not involve the United States.

The common experience of these changes fostered an interest in regional cooperation and removed two taboos: East Asia-only forums and preferential trade agreements. Suddenly, there was enormous excitement to try various alternatives.

“ASEAN + 3,” comprising of the governments of ASEAN members, China, Korea and Japan, had its first informal leaders’ meeting in December 1997. After the failure of an Asian Monetary Fund, as discussed above, East Asian countries started to develop a network of currency swap agreements through the “Chiang Mai Initiative”.

ASEAN + 3, however, lacked enough cohesiveness to pursue all-East Asian FTA, though they later started discussions on such a proposal. The bilateral FTA seemed to be a more practical vehicle of liberalization, a more effective way of avoiding marginalization, and a more focused approach to problem solving.

It was Japan and Korea that first triggered the trend for FTAs. The two countries, changed their long-standing policy of exclusive multilateralism and adopted a multi-track policy, where bilateral and regional preferential arrangements complement the WTO. Korea chose Chile as its first FTA partner and launched negotiations in September 1999.

In the meantime, New Zealand proposed to Singapore a bilateral FTA in June 1999 and the two countries launched negotiations in September 1999. Singapore, now ready to negotiate FTAs independent of ASEAN, proposed to Japan to explore an FTA in December 1999.

Japan’s decision to negotiate an FTA with Singapore on October 22, 2000 had an energizing effect in and outside the region. Singapore actively explored the possibility for FTAs with the United States, Europe, China and India. The United States and Singapore

unexpectedly announced their intention to negotiate on a bilateral FTA on November 16, 2000, at the margin of the APEC leaders' meeting. As Asian countries started to pursue FTAs, the US "hub and spoke" approach ceased to be a common concern. Singapore's moves, while resented at first, stimulated other ASEAN members to explore FTAs, both collectively and individually, with other countries.

In summary, the decisive factor in the third period was once again defensive regionalism. At the same time, the contagion of the crisis brought home to East Asian countries the high degree of their interdependence. The freedom of experimenting various forums turned the attention of East Asian capitals to the substantive issues they were to deal with in each forum, and further enhanced the role of intra-regional economic interdependence.

#### 4) 4th Period: FTA Bandwagon

The fourth period is characterized by China's new confidence towards regional cooperation and the intra-regional competitive dynamics it accelerated. Beijing had begun paying more attention to Asia since the early 1990s as a way to secure benign international environment that would allow China to focus on its domestic economic development. In addition, positive experiences of participating in the APEC processes helped China gradually overcome its long-held fear that multilateral frameworks could reduce China's freedom and damage its interests (personal interview, a Chinese official, October 2003).

It was in the wake of the Asian financial crisis, however, that China became more confident and proactive, and the transition to the fourth period started. In mid-1998, China succeeded in projecting an image of a responsible regional power by not devaluing the renminbi, albeit for its own interest (Segal, 1998; G. Baker, 1998). This episode made Beijing further confident in its ability to positively shape the regional environment. It actively participated in the ASEAN+3 meetings, reversed its initial cautious attitude to the

AMF proposal (Sakakibara, 2000, 182-189) and supported the Chiang Mai initiative at the ASEAN+3 Finance Ministers Meeting. Furthermore, its accession to the WTO significantly heightened its sense of being a responsible great power.

From the late 1990s to early 2000, China's anxiety about its security environment spurred its efforts to improve its relations with its neighbors. Sino-U.S. relations became tense in the aftermath of the bombing of the Chinese embassy in Belgrade in 1999. The first Bush administration's initial policy of treating China as a strategic competitor further alarmed China and prompted it to take precautions against possible U.S. attempts to encircle and contain China (Fong, 2003).

In the area of trade policy, China had wearily watched its neighbors shifting their focus to FTAs just when it was preoccupied with the negotiations to accede to the WTO (Tsugami, 2003, 210-213). At the same time, China felt a heightened sense of anxiety among ASEAN economies about their economic future. Their developmental stages are close to that of China and their export structures overlap with that of China. An FTA with ASEAN would demonstrate China's willingness to let ASEAN gain from China's economic growth and help alleviate ASEAN's anxiety about China's rise. An FTA with ASEAN would be easier for China than those with developed economies (Munakata, 2003) and help China quickly catch up with the regional trend towards FTAs.

One month after Japan and Singapore announced the launch of FTA negotiations, China's Premier Zhu Rongji proposed to have experts from ASEAN and China jointly look into the possibility of establishing a free trade area between them. Since China completed major negotiations for its accession to the WTO in 2000, it has become markedly more active in engaging in regional frameworks. Thus, China's proposal for an FTA with ASEAN marked the start of the period of FTA bandwagon.

Since its proposal to ASEAN in November 2000, China has moved swiftly. In

October 2001, China and ASEAN completed the joint feasibility study for an FTA, and in November 2001, China persuaded ASEAN to agree to establish an ASEAN-China Free Trade Area within ten years. For most of ASEAN members, China's exports present a competitive threat. Therefore, China's offer of "early harvest," where China would reduce tariffs of interest to new ASEAN members early on, was important in getting ASEAN on board. In November 2002, China and ASEAN signed the Framework Agreement on ASEAN-China Economic Cooperation that would establish a free trade area by 2010 for the older ASEAN members and 2015 for the newer members. In October 2003, beginning with Thailand, China started to implement the so-called early harvest measures to eliminate tariffs on some fruits and vegetables.

In the meantime, Japan and Singapore concluded the negotiations in October 2001. While Japan's exclusion of most of the agricultural produce invited the criticism from other countries, it was more than an FTA and also had the elements of broad economic cooperation to reduce transaction costs and expand bilateral exchanges. Japanese officials tried to come up innovative elements of the agreement, hoping to create a model that FTAs with other countries could adopt. The agreement went into force on November 30, 2002. Japan also started negotiations with Mexico in 2002 and Korea in 2003.

In January 2002, Japanese Prime Minister Koizumi Junichiro made a trip to ASEAN countries, signed the Economic Partnership Agreement with Singapore and proposed an Initiative for Japan-ASEAN Comprehensive Economic Partnership. It is widely perceived that the agreement between China and ASEAN to negotiate an FTA prompted Japan to move in the same direction (People's Daily Online, October 10, 2003). In October 2003, Japan and ASEAN signed the Framework for Comprehensive Economic Partnership between them and plan to start negotiations in 2005. On a bilateral level, Japan is going to start negotiations with Thailand, Malaysia and the Philippines in early 2004.

Washington also began to pay more attention to the region. China's rise with its confident regional diplomacy and Japan's stagnation indicated a potential shift in the regional balance of power. At the same time, a weakened ASEAN led to increased security concerns about its turning into a hotbed of terrorism. In October 2002, the U.S. President Bush announced the Enterprise for ASEAN Initiative (EAI) (White House, 2002). In May 2003, the US-Singapore FTA was signed. In November 2003, President Bush announced his intention to launch FTA negotiations with Thailand (White House, 2003).

Thus, China's activism has stimulated competitive impulses in East Asia.

Bilateral FTAs provided Asian economies with effective measures to address specific problems without having to wait for a consensus in a larger group, where not all the members share the same sense of urgency regarding particular problems. Previously, the forum came first and the substance was taken up only when it fitted the forum. Now, substance comes first and the forum is tailored to deal with the substance. Thus, multi-layered approaches where bilateral, regional and global frameworks are developed in parallel have been firmly in place in East Asia.

In this period, competitive dynamics became the conspicuous force. Under the surface, however, intra-regional economic interdependence seems to have become the dominant force. So far, competitive dynamics has stimulated constructive responses from each other and has remained within the range that it would accommodate and nurture intra-regional economic interdependence. At the same time, the rise of China, the availability of the WTO dispute settlement mechanism and the availability of various alternatives including FTAs substantially diminished defensive regionalism at this point, while this motivation is still at work particularly in the area of financial cooperation. The balance between intra-regional competitive dynamics and defensive regionalism does not seem to have found a stable equilibrium and would change depending on how major powers

interact.

### 3. The impact of regionalism on the influence of major powers

The previous section revealed the shifting impact of driving forces and obstacles of regionalism identified in the introduction. Defensive regionalism that had been primary throughout the first three periods significantly weakened in the fourth period. Intra-regional economic interdependence consistently grew in importance. Competitive dynamics that had been largely limited to the interaction within ASEAN, emerged in the third period when bilateral FTAs became prevalent and has become an important factor in the fourth period.

This concluding section deals with the question of how this evolutionary process of regionalism in turn affected the United States, Japan and China and their influence on the shape of the regionalism in Asia.

The United States promoted globalization and prepared an environment conducive to regionalization in Asia. The U.S. markets, its technology and capital supported Asian export-oriented development. When Asia increasingly looked like an attractive center of economic growth in the future, the United States started to explore multilateral institutional framework for this region, which would secure U.S. access to regional markets and give the United States a meaningful leverage against the European Community. The U.S. influence was decisive and APEC became the primary forum for Asia. This success, however, did not last very long. Perceived U.S. indifference to developmental concerns, the U.S. pursuit of the regionalism in its own hemisphere, and the U.S. attempt to introduce tariff negotiations in APEC through EVSL bred discontent among Asian economies with the U.S. leadership in APEC. The surge of defensive regionalism in the wake of the Asian financial crisis further diminished the U.S. influence on Asian regionalism. In the fourth period, the U.S. policy

attention came back to the region in response to the competitive dynamics. Since the terrorist attacks on September 11, 2001, however, Asian countries perceive that the United States has been largely preoccupied with the war against terrorism and not been paying as much attention to the region as China has.

Given the constraints of policy resources that could be constantly devoted to local issues in Asia, its prevalent skepticism towards the efficacy of development assistance and its occasional impatience with the gradual process of institutional changes, it may be difficult to expect the United States to maintain constant attention to the entire region. Then, the United States may have relatively less influence on the specific shape of the regional economic order in Asia. Nevertheless, it will remain the only superpower that can shape the regional developments critical to its national interests. In addition, through selective involvement, the United States can also support building blocks of regional arrangements that could serve as a model of advanced rules beyond the WTO and reliable implementation on which to build larger institutions. Moreover, the United States seems to have become more willing to pay attention to developmental concerns when it is serious about getting an FTA deal with developing countries (USTR, 2003a; 2003b; 2003c). The United States could show this willingness in dealing with Asia, U.S. influence on the process and shape of Asian regionalism would strengthen. Thus, how regionalism in Asia will affect US policy towards Asia and how that will in turn affect US influence on Asian regionalism still remain to be seen.

The impact of Asian regionalism has been the strongest and the most profound on Japan. Japan spearheaded the regionalization process, contributed to the creation of APEC and encouraged the role of ASEAN as a cohesive regional entity.

There is, however, a large limitation to Japan's approach. Japan's external policy was constrained by its "dual structure" of competitive industries and protected and inefficient



industries with the former relied on to earn national wealth to be distributed to the latter. With this structure in place, Japan could not be responsive to its neighbors' requests for reducing trade barriers to Japan's sensitive items. At the same time, the dual structure has become unsustainable as low costs of protecting the weak became prohibitive in a low growth environment.

Incidentally, the Asian financial crisis had a large impact on the thinking of the Japanese policy makers. They recognized the interdependence between Japan and the rest of Asia. Japan's deeper integration in Asia would revitalize its economy, provide more demand, help Asia recover, and let Japan capitalize on Asia's growth potential, creating a virtuous cycle. For Japan to integrate itself in Asia, Japan would have to go through structural reform. This thinking paved the way to use FTAs as a new vehicle of reform (Munakata, 2001). As the Japanese policy makers expect political resistance to the liberalization of sensitive sectors, they have carefully chosen the country to negotiate an FTA with, so that the perceived benefits were large enough to overcome the political resistance involved in each deal. As a result, for example, in the process of negotiations with Mexico, the elimination or reduction of sensitive items were put on the table. While FTA negotiations with Mexico suffered a temporary setback, these positive developments were unthinkable just a few years ago.

At the same time, the Japanese economic system have not yet sufficiently adapted to this new competitive reality. In fact, they cannot change overnight. For a long time, Japan did not have adequate external markets in corporate resources. The lack of corporate executive markets has led to the shortage of general managers and professionals needed for corporate restructuring. The lack of well-functioning labor markets has led to the mismatch between skills needed in new sectors and skills of those unemployed, adding to the public anxiety about rising unemployment. The Japanese political system with uneven voting power in favor of rural areas has also tended to reinforce the status quo. While there are

signs that indicate fundamental changes in the expectations and orientations of businesses, the general public, and the government, the inertia in the economic, social and political structures has made Japan's transformation all the more difficult.

The new regional developments that Japan's nascent policy shift has helped set off, are, in turn, putting more pressure on Japan to complete its policy shift. Whether Japan will be able to play a more constructive role in the process of Asian regionalism eventually depends on whether and how fast Japan will come up with a political consensus to dismantle its dual structure.

The rise of China changed the regional landscape in two ways. First, China's new role as a link in the production network contributed to the growth of intra-regional trade. Second, China became an active player in promoting the regionalism. The first element firmly positioned China as an indispensable member of regional economic frameworks in East Asia and reinforced the second element.

China's advantage is that it is, for now, free from messy democratic processes and can make bold moves once there is a consensus among political elites. It seems to be focused on a political agenda of reassuring ASEAN and enjoying the diplomatic good will that the FTA with ASEAN has brought about.

This approach, however, is not without risks. China is still struggling to implement WTO rules in its vast territories where local officials have varying levels of willingness and capacity to enforce rules and regulations. If China fails to faithfully implement FTAs, it will lose credibility with the business sector. Furthermore, Beijing's focus seems to be shifting from pursuing faster economic growth and technological progress to rectifying domestic gaps and achieving more equitable development. This shift in domestic policy focus could affect the pace of implementing existing agreements and of taking new initiatives that would accelerate the process of the regional and global integration of its economy. Therefore, the

question is when China starts to align its external policies with its domestic capabilities and priorities.

With all these uncertainties, the regionalization and regionalism in Asia are mutually reinforcing and transforming the external as well as domestic policy priorities of major powers that are willing to engage in this process. How far they are willing to adapt their policies to the demand of the regionalism will have a large impact on their influence on the process of regionalism.

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