



Whither economic integration in East Asia?

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Countries in East Asia need to institutionalize their deepening economic interdependence. This institutionalization is however not to make East Asia a closed and protected region but to further promote globalization. There were meaningful initiatives for establishing regional trade and financial institutions in East Asia. However, they have not yet led to the creation of East Asian Free Trade Area and Asian Monetary Fund. One important hurdle in this regard was that China, Japan and Korea could not cooperate closely enough for the common goal of economic integration in East Asia. ASEAN was the center for the movement of regional integration, although the +3 countries were politically and economically the center of Asia. Establishing a core network among these +3 countries, separately from the ASEAN, is a precondition for the successful launch of Asia-wide regional trade and financial arrangements. In this process, Korea can play a key role as a gateway to the global market for East Asian countries as well as a gateway to Asian markets for outside countries such as the US and EU, taking maximum advantage of the two recently agreed FTAs with the US and the EU.

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1. Introduction

Countries in East Asia have achieved sustained economic growth through market-driven integration with the global markets. Greater economic openness and globalization in East Asia has created regional concentration of trade and FDI activities. Regionalization was therefore relatively recent in East Asia. The outbreak of 1997 Asian currency crisis was, however, a turning point in the movement toward regionalization.

Now, East Asian countries are rapidly catching up with the global trend of regionalization, intensifying the economic ties among themselves. Economic interdependence has been deepening, making closer regional cooperation essential. If economic integration means just an absence of any barriers for the free flow of goods, capital and people, countries in East Asia could have already attained quite a significant degree of market-driven integration but unlike the EU and other regions, they remained behind in official cooperation and institutional arrangements. As economic interdependence and the formal institutionalization are mutually reinforcing, policymakers in the region are becoming increasingly conscious of it. They feel the lack and the need for regional institutions to take common action and prevent economic crisis in an increasingly interdependent world. This is especially true in the era of G20. The shift of economic power from G7 to G20 certainly reflects the increasing role of emerging and Asian countries in global policymaking. Regionalization in East Asia will help to amplify the role of Asia.

Given that the East Asian region is becoming the motor of growth for the world economy, it is clear that the movement toward regionalization in East Asia will significantly influence the reshaping global economic and monetary order. This paper intends to shed a light on the possible future evolution of economic integration in East Asia. There are many studies addressing this issue from different national perspectives (See for example Chia 2007 for ASEAN perspective, Munakata 2002 for Japanese view, Bergten 2007 and Martin 2007 for US view), but only a few of them deal with the Korean perspective. Korea is becoming an economic hub in East Asia taking advantage of two recently agreed FTA with the US and the EU. This paper tries to add to the Korean view, focusing on the following three questions.

First, this paper asks about how much market driven regionalization was achieved in East Asia and what the final goal of regionalization in East Asia will be. This paper argues

that economic integration in Asia will encompass both regional and global integration and as a result, the intensifying regionalization in East Asia will contribute to globalization.

Second, this paper looks at the policy-driven regionalization in East Asia. There were constant calls for strengthening the existing ties among East Asian countries into institutionalized arrangements. These calls became especially visible after the outbreak of the currency crisis in Asia. As a result, the ASEAN+3 framework was established as a main vehicle for building the regional community. This framework is important, in the sense that unlike APEC, it includes the most important +3 countries in East Asia (i.e., China, Japan and Korea) and that it excludes countries outside the region. Nevertheless, this progress is not yet satisfactory. ASEAN+3 countries did not develop any FTA as a whole, although there were many bilateral FTAs among them. There was a multi-lateralization of CMI but there is still a long way to go for AMF. One important reason why official cooperation was lagging behind was that China, Japan and Korea, the three most important countries in East Asia, could not cooperate closely enough for the common goal of East Asian Community among themselves let alone among ASEAN+3, while ASEAN countries had neither the zeal nor the capacity to lead. What characterized the integration process in East Asia was that the ASEAN was the center for the movement of regional integration, although +3 were politically and economically the center of Asia. Forming the larger ASEAN+3 FTA Area is of course much harder, entailing an initiative from the +3 countries, but these +3 were not yet ready. Indeed, the cooperation among the +3 is essential just as in the case of monetary cooperation under the CMI. The +3 countries agreed to cooperate among themselves so that the extension of the +3 framework to ASEAN could be rather smooth. This paper thus suggests that there should be a separate core network among the +3 as a precondition for the successful launch of a regional arrangement.

Third, this paper explores the most desirable strategy for Korea amid the recent regionalization efforts of East Asian countries. This paper argues that Korea should take maximum advantage of the two recently agreed FTAs with the US and the EU in the process of building the +3 core framework and develop itself as a gateway to East Asian markets for outside countries such as the US and EU and to global market for East Asian countries.

The organization of this paper is as follows. In Section II, this paper examines the future possible shape of regionalization in East Asia, looking at the movement of goods,

capital and people. Section III assesses the current states of regional integration initiatives and achievements and asks about the possible challenges for further economic integration in East Asia. Section IV explores the Korean strategy.

II. Regionally integrated yet globally connected Asia: market-driven integration

In most East Asian countries, regionalization was a natural response to cope with globalization (Petri 2008, Moon 2009). This approach is in a sharp contrast with the European strategy of regionalization. In Europe, for example, regionalization once spread the fears of being the closed “fortress of Europe”. In East Asia, however, the final destination of regionalization is, as Kuroda, President of ADB, said, to make Asia “regionally integrated yet globally connected ” (Kuroda 2010). East Asian countries will not accept a regionalization that will thwart economic globalization.

1. Goods market integration in East Asia

East Asian countries have achieved remarkable growth over the past decades. This growth is largely attributed to the market driven expansion of trade. East Asian countries now account for over one-fourth of world trade.

Table 2 shows the trend of intra-regional trade in East Asia over the period 1990 to 2008. The intra-regional trade as a share of East Asia’s total trade has risen from 29.4% in 1990 to 40% in 2008. Now, intra-regional trade accounts for more than half of total trade in East Asia, while trade with the US or the EU accounts for about one third of total trade. It should be noted that the increase in intra-regional trade was due to the increase in the trade of parts and components, as East Asian firms shifted from exports to cross-border production. In fact, increasing intra-regional trade was supported by large intra-regional FDI in East Asia. This FDI was spearheaded by Japan as it was suffering from the continuing appreciation of the Japanese yen but was soon followed by advanced East Asian countries such as Korea and Taiwan.

The rise of China as a dominant economic force in the region is another important factor in explaining increasing intra-regional trade. China now accounts for one third of intra-

regional exports. China has been receiving large FDI from the rest of the world, and much of these investments were aimed at export-oriented production. As a consequence of its trade and investment policies, China exported finished and semi-finished products while importing raw materials, semi-finished components, and capital goods.

(INSERT) Figure 1: Intra-Regional Trade Share, 1990-2008 (%)

Trade is however inter-regional as well as intra-regional. In fact, East Asian countries started its industrialization relying largely on the US and world markets and therefore their economies had been intimately integrated with the global economy, in particular with the US economy. Thus, although intra-regional market has grown steadily and become dominant, the US and global markets still remain very important. The US and European market is especially important for Asia's finished manufactured products. As ADB (2007) pointed out, the G3 countries including the US and the EU absorb 61.3% of the emerging Asia's total exports as the destination place of final demand for Asian manufactured goods, while the emerging East Asian economies themselves absorb only 21.2% of Asian exports. In a similar context, China's influence proves to be still limited, if only the final import demand is considered. For instance, the US final import demand for the world economy is three times larger than China's import demand (Lee 2009). Furthermore, the US and the EU are the largest investors to East Asia, which means that the Asian trade structure reflects global as well as regional production sharing.

(INSERT) Figure 2: Share of exports from emerging Asia

(INSERT) Table 1: Final Import Demand in China and US, 2009

2. Capital Market integration

Compared to commodity markets, financial markets in East Asia are far more globally integrated. Especially after the 1997 Asian currency crisis, East Asian countries

accelerated financial globalization, deregulation of domestic financial systems, opening of financial services markets, and relaxation of capital and exchange rate controls. As a result, the East Asian financial markets have become increasingly integrated with global financial markets and particularly with the US and European markets.

Table 2 shows the intra-regional portfolio inflows in East Asia. Although the intra-regional portfolio inflows appear to be not very large, intra-regional portfolio investment in East Asia is not far behind other regions, once one controls for the standard gravity models (Kim, Lee and Shin (2005) and Eichengreen et al. (2006)). For example, Eichengreen et al. (2006) argues that if the low level of economic development could be controlled, the difference between the volume of intra-European and intra-East Asian flows is not large. In fact, financial and trade integrations are mutually reinforcing so that more intra-regional trade and FDI flows generate more intra-regional capital flows.

(INSERT) Figure 3 : Intra-Regional Share of Portfolio Inflows 2001-8 (%)

More importantly, the increasing financial globalization in East Asia led to the financial regionalization through the deepened linkages between Asian and global financial markets. For instance, East Asian countries have been increasing their capital investments in safe US treasury bonds, while the US financial firms reinvested these funds thus mobilized in rather risky Asian assets (García-Herrero et al. 2009). The result was a rising degree of convergence of interest rates and stock market returns among East Asian countries as well as between East Asian and global markets. The speed, scale, and extent of the contagion of the financial crisis further confirm the growing financial market linkages among Asian countries. Jeon et al. (2006) and Moon (2009a) and confirm this observation. For instance, Moon (2009) shows that there is a trend of interest rate convergence among East Asian countries

3. Labor market integration;

Capanelli et al.(2009) measures intraregional flows of people on the basis of tourist data from the World Tourism Organization. According to him, the EU has two-way flow share in

the low 60% range, while Asian groups have shares in the mid 50% range. Thus labor mobility measured by the movement of tourists is more global in East Asia than other regions. But he also remarks that NAFTA and EU's two-way shares have been falling while Asian shares have been rising, which means that there is more regionalization in East Asia, whereas more globalization is observed in the EU and NAFTA.

(INSERT) Figure 4 Intra-regional share of tourism

4. *Business cycle synchronization*

Along with the trend of increasing regionalization, especially after the 1997 Asian currency crisis, there seemed to be some observations that the East Asian economies tended to be coupled more within themselves, and decoupled from the world economy. However, as Moon (2009) shows in Table 5, the business cycles of East Asian economies are closely connected with the global economies as well as Asian economies. This result suggests again that Asia is “regionally integrated yet globally connected”

(INSERT) Table 2: Business cycle synchronization

III. Regional institution building: policy-driven integration

The fact that East Asian countries pursued regionalization cum globalization might explain the relatively belated reaction in their official and policy-driven regional integration. Following the Asian crisis, however, East Asian economies have embarked on various initiatives for establishing regional trade and monetary arrangements. There are two initiatives under way: EAFTA and AMF.

1. *East Asia Free Trade Area (EAFTA)*

As East Asia is regionally integrated yet globally connected, an FTA approach is

envisaged to be more appropriate in the short run. Moving to customs union as in the case of Europe is neither plausible nor necessarily efficient. First of all, East Asian countries will not like to delegate their powers to some common institutions because of their natural preference for national sovereignty. Furthermore, although a customs union is possible, it is not clear that it will necessarily increase welfare if common tariff policy is used for setting a protective goal than for increasing openness in East Asia. East Asian countries are so diverse in their development stages and therefore possible attempts of some underdeveloped Asian countries to protect their national industries cannot be ignored. All of these mean that although an FTA has some unavoidable costs related to the rules of origin and trade deflection, customs union is not the alternative answer.

There have been continuing calls for establishing FTA in East Asia, ever since the prime Minister of Malaysia Mahatir proposed the formation of East Asian Economic Caucus (EAEC) in 1990. This proposal could not be realized, however, because the US was opposed to any ideas of Asia-only regionalism and instead supported the APEC framework that would include itself as a member country. The eruption of 1997 Asian currency crisis was a turning point. The first official step toward forming an East Asian Free Trade Area started with the convening of ASEAN+3 Summit in 2000 and the development of the ASEAN+3 framework as a main vehicle for building an economic community in East Asia. The ASEAN+3 summit decided to create the East Asian Vision Group to explore “East Asian Community”. The East Asian Vision Group (EAVG) submitted a report to the leaders of ASEAN+3 in 2001 and recommended the formation of an East Asia Free Trade Area.

While the feasibility of East Asian FTA was still being studied, a proliferation of bilateral and plurilateral FTAs took place in East Asia. By the end of May 2010, there were 45 FTAs in effect, and another 84 in various stages of preparations in East Asia (Kawai and Wignaraja 2010)¹. East Asian countries traditionally relied on multilateralism and WTO for trade liberalization and were latecomers in the move towards regional trade arrangements. Very recently, however, they are rapidly catching up with the global trend. In particular, Northeast Asia has seen an unprecedented increase in FTA activity. Two facts are noteworthy.

First, the FTAs East Asian countries concluded so far are both for intra-regional and

¹ For more details, see the ADB FTA Database at Asian regional integration center (ARIC) at www.aric.adb.org

extra regional countries. Table 6 summarizes the status of FTAs of Korea, Japan, and China.

(INSERT) Table 3: Status of FTAs of Korea, Japan and China (As of June, 2010)

For instance, Korea had a FTA agreement with ASEAN but more importantly it successfully negotiated FTAs with countries outside the region, such as the US, EU and India, ever since it had its first FTA with Chile in 2004. Through such agreements, Korea sought to establish itself as a trade hub for world economy. But at the same time it wanted to be the region's trade hub, taking advantage of the country's geo-political position in Northeast Asia. For Japan, the first FTA was with Singapore in 2002 and since then its government concluded economic partnership agreements (EPA) with ASEAN and its member countries. Although Japan's FTA strategy is more regionally oriented, Japan also had a few FTAs with external countries such as Mexico, Chile and Switzerland. China had a regional approach too, because it signed FTAs more with its neighboring economies than with outside countries. Furthermore, the FTAs of China were less comprehensive compared to those of Korea and Japan because their FTAs focused on primarily liberalizing trade in goods and services.

Second, there is no region-wide multi-lateral FTA in Asia yet but the proliferation of the bilateral FTAs (called spaghetti bowl FTAs) is leading to the creation of a region-wide FTA through networking. Currently two proposals regarding an East Asian FTA are competing. The first one is, as pointed out, the proposal to establish an East Asia Free Trade Area (EAFTA) only with ASEAN+3 as possible member countries. This proposal is supported by China. In contrast, the second one, which has been supported by Japan, is to create an Economic Partnership Agreement for East Asia (EPAEA) with 16 Asian member countries including Australia, India and New Zealand. No matter which platform will prevail, a practical approach to East Asian FTA will be to base it on the network of existing bilateral FTAs and thus EAFTA is likely to emerge as a de facto region wide FTA arrangement.

It is obvious that closer cooperation among the +3 is the catalyst for economic integration in the region. Indeed, because the +3 countries had already an FTA with ASEAN, the future creation of a region-wide FTA will critically depend on the decision of the +3 to form an FTA among themselves. That is, if these +3 are linked with each other through the FTA, all countries in East Asia will be linked, which will be translated into East Asian FTA.

There are currently two approaches in action. One is bilateral, linking Korea-Japan FTA with Korea-China FTA as a first step and to move to Japan-China FTA. The other is multilateral, leading to China-Japan-Korea FTA (CJK FTA). In either case, however, the obstacle is the historic animosity and possible military rivalry between Japan and China.

(INSERT) Figure 5: Two Possible Scenarios for EAFTA

2. *Asian Monetary Fund (AMF)*

Compared to trade and investment arrangements, regional arrangements in the area of money and finance were more advanced. The first idea came out of the need to support Asian countries in crisis and to this end the Japanese Ministry of Finance proposed to create an AMF in September 1997. But this notion faced strong opposition from the US government on the grounds that the AMF was a duplication of IMF and would only exacerbate the moral hazard behavior of borrowing countries.

However, debates over the need of emergency funds to prevent the currency crisis subsisted. In 2001, leaders of ASEAN+3 met together at Chiang Mai, Thailand and they agreed to create a set of bilateral swap arrangements. Under this initiative named as Chiang Mai Initiative (CMI), countries in East Asia could borrow short term liquidity in the event of a crisis or contagion. The CMI was undeniably an important step in establishing a regional monetary cooperation. However, the CMI was far from being such a regional arrangement, due to its limited capacity to conduct an effective surveillance and monitoring of Asian economies and its linkage to the IMF programs. In addition, the activation of the CMI was extremely cumbersome due to its nature of bilateral swap. For instance, there were 17 bilateral swap agreements (BSAs) among 8 Asian countries. There were continuous efforts to multi-lateralize the CMI and expand the size of the CMI. In May 2008, there was an agreement made to increase the total size of the CMI to US\$80 billion and to fix the proportion of contribution coming from ASEAN countries and the +3 countries to be 20:80. Then the leaders of ASEAN+3 agreed on all the main components of the CMI multi-lateralization (CMIM) at the ASEAN+3 Finance Ministers' Meeting (AFMM+3) in May 2009 in Bali, Indonesia. The CMIM came into effect in March 2010. As a result, the existing

multiple BSAs were replaced by a single contractual self-managed reserve pool agreement and the total size of the swap pool was again extended to US\$120 billion. Member contributions and borrowing limits were decided in such a way that Japan and the China (including both mainland China and Hong Kong) would contribute 32% each, Korea 16% and ASEAN 20%. Furthermore in May 2010, ASEAN+3 agreed to establish an ASEAN+3 Macroeconomic Research Office (AMRO) in Singapore by May 2011, initially with a small number of professional staff who work with the ASEAN Secretariat to conduct an effective surveillance and monitoring of member states' economies. In a sense, the CMIM is heading towards AMF, with further institutionalized structure combined with independent surveillance unit.

(INSERT) Table 4: Structure of CMIM

Kawai (2009) points out the three new features of CMIM compared to the previous CMI. First, the CMIM was designed as a liquidity support arrangement of the US dollar only, thereby excluding the local currency swaps that were in place in the CMI bilateral swaps. Second, the CMIM included all ASEAN+3 members, while the CMI did not include Brunei and low-income ASEAN members (such as Cambodia, Laos, Myanmar and Viet Nam). Also, Hong Kong joined the CMIM without becoming a formal member of the ASEAN+3 finance ministers' meeting. This means that the CMIM is now a fully legitimate institution representing all ASEAN+3 countries, opening up the possibility for other Asian countries to join it. Third, the amount that Indonesia was allowed to borrow became smaller (with US\$11.9 billion) than that eligible amount under the CMI (US\$18 billion). This may require some additional liquidity support system such as the bilateral swap between Japan and Indonesia.

Although the CMIM could be developed into an AMF, it is most likely that the CMIM would not be self-sufficient to protect Asian countries. The amount of swap is still insufficient and therefore should be supplemented further by both intra and extra-regional institutions. In fact, the outbreak of the global financial crisis in 2008 revealed again the weakness of the CMIM as a regional lender of last resort. Kawai (2009) proposes to transform the CMIM into an AMF. This will require the improvement of ERPD so that

lending conditionality, independent of IMF programs, can be formulated in the event of CMIM activation. Once these conditions are met, a *de facto* AMF will have emerged, capable of conducting effective surveillance and handling regional financial crises. No matter what happens for the CMIM, however, it is clear that the appropriate coordination of global, regional and national institutions is essential to prevent the crisis.

There are two possible ways to supplement the regional lender of last resort. The first one is to rely on global financial support. Indeed, in the case of global crisis, Korea and Singapore relied on US swap. Unwilling to go to the IMF or CMI (which is tightly linked with IMF), the Korean authority entered into a US\$30 billion currency swap arrangement with the US Fed in October 2008. The second option is to conclude a separate swap with Japan and China. For instance, Korea had a swap agreement with the Bank of Japan for US 30 billion dollars. Korea had also a yuan-based currency swap with China for the same amount (180 billion yuan equivalent to US 30 billion dollars).

3. Challenges for East Asian economic integration: ASEAN+3 or 3+ASEAN?

Despite the quasi-consensus on the ASEAN+3 as the basic framework for any regional institutional arrangements and community buildings in East Asia since the 1997 Asian currency crisis, there has been a continuing debate over the appropriate membership of the region-wide arrangement. One reason was the opposition of the US government, which has very strong economic and political stakes in the region. Indeed, the previous US administrations were opposed to any Asia-only regionalism, which prevented the realization of East Asian Economic Caucus (EAEC) and Asian Monetary Fund. Given the nature of open regionalism in East Asia, however, there is little reason why the US should continue to be so. A regional framework would not be harmful to the US either, especially if it could successfully engage China in regional cooperation. (Martin 2007). For these reasons there seems to be some changes in the attitude of the US.

The most serious challenge is coming from the Asian side regarding the issue of leadership competition. Currently ASEAN has been and is still the central core of Asian regionalism, gravitating neighboring countries around it. Inviting the leaders of China, Japan, and Korea to their informal Leaders' Meeting in December 1997 for instance, the ASEAN

leaders helped to establish ASEAN+3 framework as a main vehicle for building the regional community. This framework is important, in the sense that unlike APEC it is a Asia-only regional framework including the most important +3 countries. ASEAN is playing a leading role in this framework. Although there is a summit meeting for the +3, it is held on the sidelines of the ASEAN+3 and it is nothing but an “annual informal breakfast” (Rathus 2010). The ASEAN member countries will make best efforts to maintain this so-called ASEAN centrality. Nevertheless, there is a limit for ASEAN in taking a leadership position in to develop a true East Asian institution or community.

First of all, ASEAN does not have one voice or entity. Given that it is also a group of 10 very different countries economically and politically, there could be no strong leadership. The ASEAN is rather a forum and so far, although there were so many ritualized statements on regional integration issued by ASEAN, the action for realizing it was slow and delayed.

Second and more importantly, ASEAN is an economic dwarf compared to the +3 countries in Northeast Asia. The ASEAN accounts for only 10% of the region’s GDP and 20% of the quota for the CMIM, while the +3 represents 90% of the region’s GDP and 80% of the CMIM quota. Most of the ASEAN members except for Singapore are also receiving official development assistances from the +3 countries.

It is needless to say that successful regionalization in East Asia necessitates closer cooperation between the +3 countries, China, Japan and Korea. Rivalry and competition between China and Japan was one reason for slower cooperation among +3. Obviously, China and Japan have different interests and hence different strategies for economic integration in East Asia. As far as China is concerned, economic integration with the ASEAN members, South Asian and central Asian countries might be more important both economically and geo-politically than financial cooperation or free trade with either Japan or South Korea. While China is a super military power in the world, it is still a developing economy with a huge gap to narrow in terms of technological and industrial sophistication compared to that of Japan. These differences in the economic and military status of the two countries suggest that, even if they manage to reconcile their troubled memories of the past, they may find it difficult to work together as equal partners for regional integration in East Asia. In fact, the ASEAN centrality itself was the reaction to the coordination failure among the +3.

Fortunately, in December 2008, Japan held the first trilateral summit meeting between China, Japan and Korea, separately from the ASEAN+3 process, to acquire its own identity. Then on its third trilateral summit meeting held in Jeju, Korea, the leaders of the +3 agreed to establish a Secretariat for the efficient promotion and management of trilateral cooperative projects in Korea. This will be the first crucial step towards the institutionalization of the partnership among the +3, which few believed possible. And once this secretariat is in operation, the ASEAN secretariat and CJK Secretariat are likely to compete and cooperate to further regional integration in East Asia.

Anyway, the establishment of the CJK Secretariat will contribute to building up a sub-regionalism for Northeast Asia in parallel to ASEAN for Southeast Asia but more importantly it will serve as a stepping stone for East Asian regionalism given the economic and political importance of the +3 countries in ASEAN+3.

IV. Thinking Global and Acting Regional: A Strategy for Korea

Given the limited role and importance of ASEAN for representing ASEAN+3, it is expected that the future process of regional integration in Asia will be shaped by two core sub-regional networks, ASEAN and +3 and two countries, Singapore and Korea.

As a mediator between China and Japan, Korea is already playing a key role for facilitating regional integration as well as a sub-regional hub. Geographically Korea is in best position as a regional hub in Northeast Asia. Korea sits at the heart of Northeast Asia, and will emerge as the most dynamic regional economy in the 21st century. Already 3 Northeast Asian economies (Korea, China, Japan) account for nearly 20% of world GDP. Its location is between the two big neighboring countries. In fact, within a three hour flight radius of Seoul are 43 cities, each with a population of more than 1 million people.

(INSERT) Figure 6: The Location of Korea

It means that Korea could be developed as a global gateway to Northeast Asia just like Singapore to Southeast Asia. There are many advantages including its' developed IT and transport infrastructure, Christian religion, and its share of universal values such as

democracy and human rights. But more importantly, Korea is the most open economy among the +3. All of these factors contributed to strengthening its ties with two global superpowers, the US and EU.

1. Global cooperation as a starting point

Taking advantage of its favorable factors, the Korean government tried to develop Korea as a FTA hub in the region and in the world, and thereby to establish peace in the Korean peninsula. The FTA was considered essential not only to expand its export markets but also to attract foreign direct investment and to create jobs. Ever since Korean government concluded its first FTA with Chile in October 2002, it has been actively engaged in FTA negotiations with over 50 countries. As a result,

- The FTAs with Chile, Singapore, EFTA and ASEAN entered into force.
- KOREA-US FTA was signed in April 2007 and currently awaits approval for ratification.
- KOREA-EU FTA was initialed on Nov 2009, with the plan of putting the agreement into effect in 2010.
- The FTA with India entered into force from January 1, 2010.
- Korea is also considering to negotiate FTA with Japan and China.

The most important landmark in the trade policy of Korea was the Korea-US FTA negotiations. The Korea-U.S. FTA, launched on February 3, 2006, was concluded on April 2, 2007 after ten official rounds of negotiations. Korea and the U.S. signed the KORUS FTA on June 30, 2007 in Washington D.C. The KOREA-US FTA is a comprehensive FTA that covers all trade-related sectors including goods, trade remedies, investment, services, competition, intellectual property rights, government procurement, labor and environment. The FTA, which was concluded after considerable reparatory efforts and an entire year of arduous negotiations, was a learning experience and confidence building process.

With its gain of confidence though the Korea US FTA, the Korean government proceeded to Korea-EU FTA. The Korea-EU FTA negotiations were launched on May 6, 2007 in Seoul

and there were 8 official rounds of talks. The talks on tariff concessions for Korean manufactured goods and agricultural products, automobile safety and environmental standards, and services got bogged down and the original target date for the conclusion of the pact was postponed from 2007 to indefinite. However, the conclusion of Korea-US FTA in June 2007 heightened the concern that EU companies would face disadvantages vis-à-vis US competitor in Korean markets and this became an impetus for Korea and EU negotiators and the FTA was finally initialed on October 15, 2009.

The recent Korea-EU FTA agreement will create a huge opportunity for Korea to take a full advantage of the newly emerging multi-polar system and to develop its economy as a hub for world economy as well as for Asia. Korea is the only country in East Asia that had been capable of concluding FTAs with the US and the EU, and given its size, it is not too big and not too small to fear them. For example, Japanese industries are too competitive and too large for the EU to open its market. China is also too big to be allowed to enter into the EU market. Obviously in the short run, there will be an important benefit from the rise in trade and FDI flows between Korea and the US and between Korea and the EU, once these FTA enter into force. The Korean market itself is important enough because Korea is world's 11th largest economy. But, given that Korea is very likely to pursue its FTA even with Japan and China, Korea is expected to play a key role in helping global companies to advance in ever growing Asian markets, particularly in the Chinese market. In fact, Korea will be a gateway for European and American companies to penetrate into Japanese and Chinese markets with no tariff. In the same way, Japanese and Chinese companies will have a strong interest to advance into European and American markets through Korea. To take advantage of this strategic position of the Korean economy as a gateway, both Asian and Western companies are expected to bring a huge FDI investment into Korea. Unlike Singapore, Korea has a good manufacturing base, which means that the rules of origin related to its FTA would strengthen Korea's merit as an FDI destination. In short, Korea is a gateway to Asian markets for global companies, while a gateway to global markets for Asian companies.

Korea's strategic importance as a gateway is not fixed and is rather expanding because Korea has concluded its FTA also with India and ASEAN countries. But it is the most important to accomplish the FTAs with its two big neighboring countries, China and Japan. Once these agreements are made, the cooperation will go far beyond the trade and

investment area and the CJK Secretariat will play a key role in expanding the trilateral cooperation and its institutionalization.

2. CJK FTA and monetary cooperation

Korea and Japan held six rounds of FTA negotiations from December 2003 to November 2004. The negotiations were stalled due to different positions on agriculture, industrial cooperation, non-tariff measures, government procurement, etc. On April 21 2008, President Lee Myung Bak agreed to hold ‘working-level consultations for the resumption of the Korea-Japan FTA negotiations’ during his first Korea-Japan summit meeting held in Tokyo. Japan is the world’s second largest economy well known for its high technology sector and ample investment resources. The agreement might further increase Korea’s trade deficit with Japan and inflict damages on the Korean manufacturing industry such as material and components industries. However, if the role of Korea as gateway for trade and investment is taken into account, the long term benefit will far outweigh this cost, creating a new incentive for the negotiation.

Concerning Korea-China FTA, both countries agreed to begin a Joint Feasibility Study, taking advantage of the bilateral Trade Ministerial Meeting, held on the sidelines of the APEC Ministerial Meeting, The two sides held 5 rounds of joint study meetings until 2008. An FTA with China will help Korean and global companies investing in Korea to significantly increase their access to Chinese markets because Chinese markets are the least open markets with relatively high tariff structure. Of course, negative economic impacts on the Korean agricultural sector due to the geographical adjacency between the two countries remain the most sensitive issue for Korea. However, given a strong Chinese interest in this FTA, it is very likely that this obstacle will be overcome to allow more concessions for Korea.

Also, together with these bilateral negotiations, a multi-lateral attempt to form the CJK FTA is under way and in this context +3 countries agreed to conduct a joint research on the possibility of forging a trilateral FTAs on October 2009.

The CJK cooperation will not be limited only to trade and FTA area but will be enlarged to monetary areas and other fields. As pointed out, the CMIM will not be sufficient

to prevent the crisis, although it is transformed into an AMF. Bilateral swaps between the central banks of the +3 countries are needed. Furthermore, as the recent currency war between China, Japan, the US and EU shows, there is a need for closer exchange rate coordination among the +3 countries. A creation of a basket currency incorporating Japanese yen, Chinese yuan and Korean won might be considered as well.

VI. Conclusion

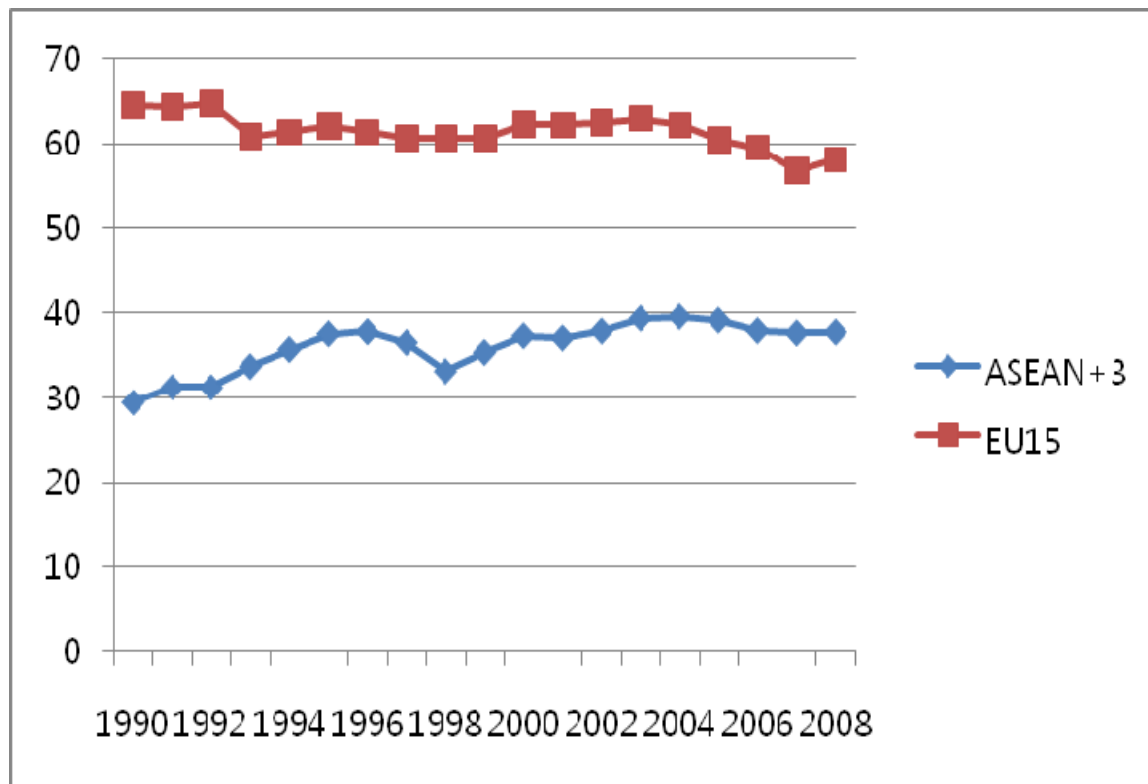
Countries in East Asia need to institutionalize their deepening economic interdependence. This institutionalization is however not to make East Asia a closed protected region but to further promote globalization. For instance, aspiring to be a global economic hub, Korea is trying to strengthen its regional ties with its neighboring economies, in particular with China and Japan. Although some important progress was made in the areas of trade and finance for regional institution building, there still remains a long way to go for EAFTA and AMF. One important hurdle in this regard is that China, Japan and Korea, the three most important countries in East Asia, could not cooperate closely enough for the common goal of “East Asian Community.” As a result, ASEAN was the center for the movement of regional integration, although the +3 countries were politically and economically the center of Asia. Therefore, a separate core network among the +3, along with ASEAN, is a precondition for the successful launch of Asia-wide regional arrangement. In this process of building the +3 core framework, Korea can play a key role and develop itself into a gateway to Asian markets for outside countries such as the US and EU and a gateway to the global market for East Asian countries, taking maximum advantage of the two recently agreed FTAs with the US and the EU.

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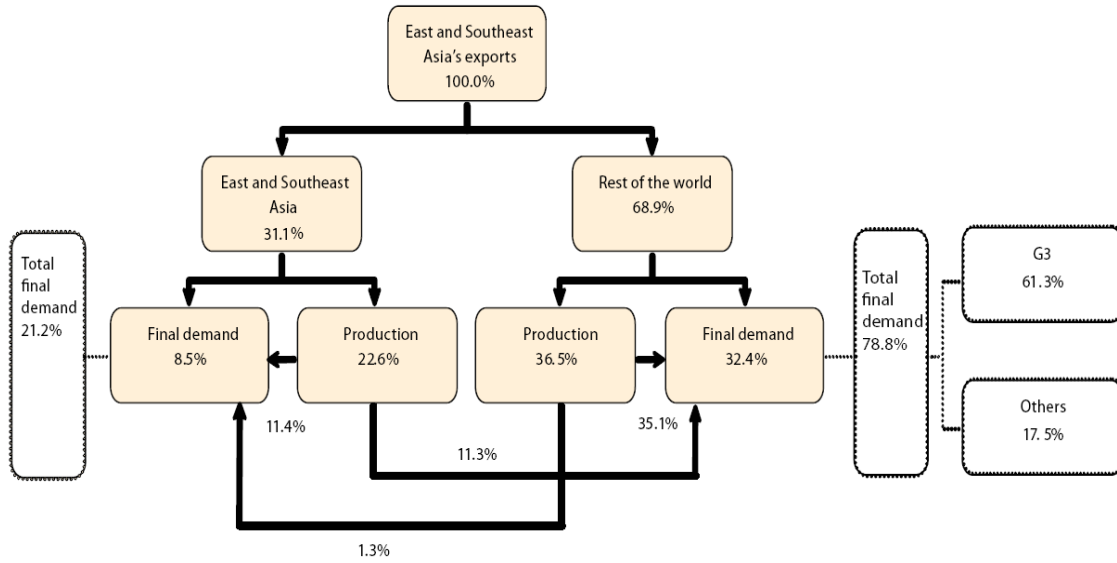
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Figure 1: Intra-Regional Trade Share, 1990-2008 (%)



Source: Direction of Trade, IMF and Eurostat

Figure 2: Share of exports from emerging Asia



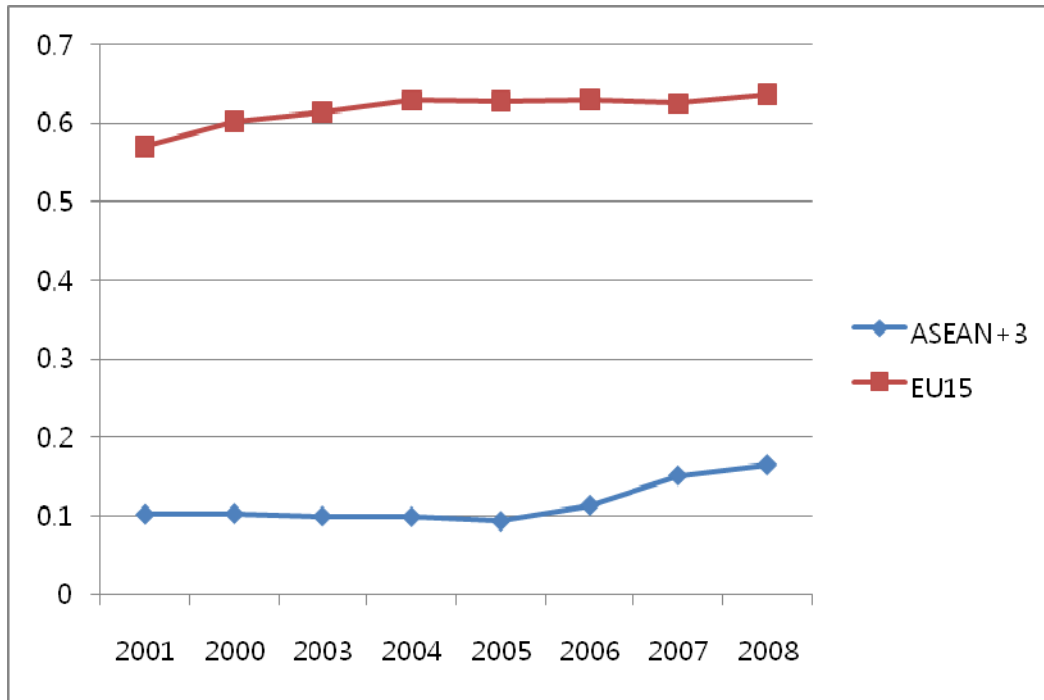
Source: ADB(2007)

Table 1: Final Import Demand in China and US 2009

		China	US
World	Imports (billion US \$)	955	2,171
	Share of final import demand (%)	68.1%	92.7%
	Final import demand (billion US \$)	650	1,869
Korea	Imports from Korea (billion US \$)	82	46
	Share of final import demand (%)	68.2%	92.8%
	Final import demand (billion US \$)	56	43

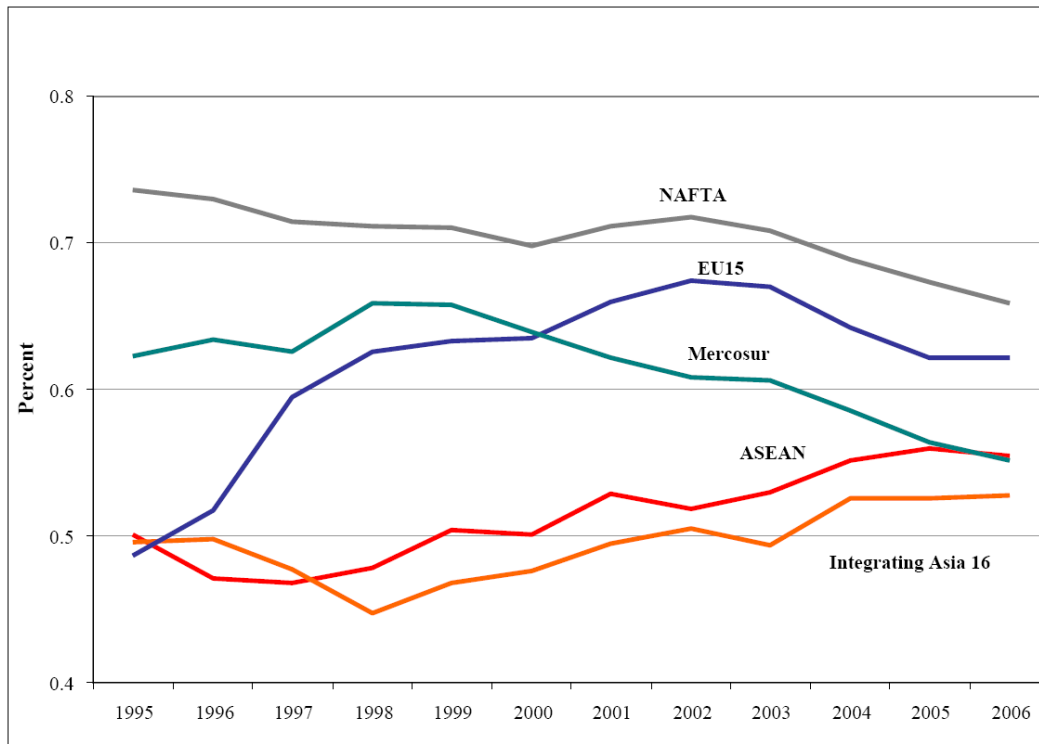
Source: Lee, C. Y(2009)

Figure 3 : Intra-Regional Share of Portfolio Inflows 2001-8 (%)



Source: IMF

Figure 4: Intra-Regional Share of Tourism



Source: Capannelli et al.(2008)

Table 2: Business Cycle Synchronization

	1990-1997			1998-2008		
	US	EU	EA	US	EU	EA
CHN	-0.02	-0.01	0.22	0.42	0.48	0.47
JAP	-0.26	0.5	0.53	0.82	0.84	0.72
KOR	-0.19	0.45	0.44	0.71	0.71	0.69
IDN	0.05	0.1	0.2	0.15	0.16	0.19
MAL	-0.02	0.24	0.45	0.66	0.57	0.79
PHIL	-0.34	0.21	0.29	0.22	0.25	0.29
SGP	-0.01	0.08	0.26	0.48	0.42	0.54
THAI	-0.2	-0.38	0.05	0.62	0.64	0.67
TWN	0.15	0.28	0.1	0.63	0.64	0.69
US	-	0.09	-0.23	-	0.71	0.83
EU	0.09	-	0.34	0.71	-	0.77

Source: Moon (2009)

Table 3: Status of FTAs of Korea, Japan and China (As of June, 2010)

		Within the region	Outside of Region
Korea	Concluded	Singapore (2006.3.2) ASEAN (2007.6.1 for Goods, 2009.5.1 for Services and 2009.6.2 for investment)	Chile (2004.4.1) EFTA (2006.9.1) US (2007.6.30) EU (2009.7.1) India Peru
	Under negotiation	Japan China	Canada Mexico GCC Australia New Zealand
Japan	Concluded	Malaysia (2006.7.13) Singapore (2006.11.30) Thailand (2007.11.1) Indonesia (2008.7.1) Brunei (2008.7.31) ASEAN (2008.12.1) Philippines (2008.12.11) Vietnam (2008.12.25)	Mexico (2005.4.1) Chile (2007.9.3) Switzerland (2009.2.19)
	Under negotiation	Korea	GCC India Australia Peru
China	Concluded	ASEAN(2003.7.1 for Goods and 2007.7.1 Services) Hong Kong (2004.1.1) Macau (2004.1.1) Singapore (2009.1.1)	Chile (2006.10.1) Pakistan (2007.7.1) New Zealand (2008.10.1)
	Under negotiation	Korea	Australia GCC Iceland Norway South Africa

Source: Moon and Oh (2010)

Figure 5: Two Possible Scenarios for EAFTA

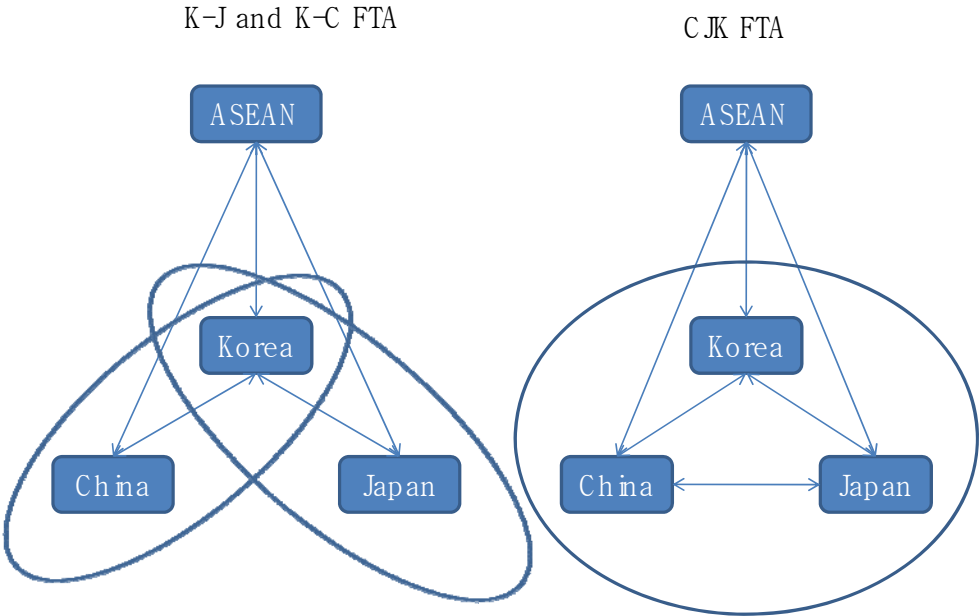


Table 2. CMIM Financial Contributions, Borrowing Agreements, and Voting Power

	Financial Contributions		Borrowing Agreements			Voting power			
	\$Billion	Share (%)	Multiplier	Maximum Swap Amount (\$Billion)	IMF De-linked Portion (\$Billion)	No. of Basic Votes	No. of Votes Based on Contributions	Total No. of Votes	Share (%)
Members									
Plus Three Countries	96.00	(80.00)	0.69*	57.6	13.20	4.8	96.0	100.8	(71.59)
PRC and HKG	38.40	(32.00)	0.72*	19.2	5.52	1.6	38.4	40.0	(28.41)
PRC	34.20	(28.50)	0.50	17.1	3.42	1.6	34.2	35.8	(25.43)
<i>Hong Kong, China</i>	4.20	(3.50)	2.50*	2.1	2.10	0.0	4.2	4.2	(2.98)
Japan	38.40	(32.00)	0.50	19.2	3.84	1.6	38.4	40.0	(28.41)
Republic of Korea	19.20	(16.00)	1.00	19.2	3.84	1.6	19.2	20.8	(14.77)
ASEAN	24.00	(20.00)	2.63	63.1	12.62	16.0	24.0	40.0	(28.41)
Brunei Darussalam	0.03	(0.03)	5.00	0.2	0.03	1.6	0.0	1.6	(1.16)
Cambodia	0.12	(0.10)	5.00	0.6	0.12	1.6	0.1	1.7	(1.22)
Indonesia	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Lao PDR	0.03	(0.03)	5.00	0.2	0.03	1.6	0.0	1.6	(1.16)
Malaysia	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Myanmar	0.06	(0.05)	5.00	0.3	0.06	1.6	0.1	1.7	(1.18)
Philippines	3.68	(3.07)	2.50	9.2	1.84	1.6	3.7	5.3	(3.75)
Singapore	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Thailand	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Viet Nam	1.00	(0.83)	5.00	5.0	1.00	1.6	1.0	2.6	(1.85)
ASEAN+3	120.00	(100.00)	1.16*	120.7	25.82	20.8	120.0	140.8	(100.00)

Note: *Hong Kong, China's borrowing is limited to the IMF de-linked portion because Hong Kong, China is not a member of the IMF.

Source: The Joint Media Statement of the 12th ASEAN+3 Finance Ministers' Meeting, 3 May 2009, Bali, Indonesia.

Figure 6: The Location of Korea

