

# Introduction

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The economic integration of East Asia is a remarkably uneven phenomenon.

Production of goods is highly integrated. Many products labeled ‘Made in China’ would be more accurately identified as ‘Made in East Asia’, as over 40 per cent of the content of manufactured exports from China typically consists of components or other inputs imported from the region. This system of production is replicated in other nations of the region – the nation that finally assembles a product may well contribute less than one-half of the actual value of the final product. Indeed, manufacturing in East Asia today can often more accurately be viewed as a regional, rather than national, endeavour.

This production integration is supported by a high degree of formal trade integration achieved by way of a noodle bowl of regional and bilateral trade agreements. It is also supported by a high degree of direct investment integration, with nations in the region investing in production facilities in other nations. This investment integration in support of production activities is in turn supported by a network of multilateral and bilateral investment treaties. Regional portfolio investment, however, is less well developed.

In stark contrast, financial integration in the region is underdeveloped. Most East Asian nations are more closely integrated financially with nations outside the region, typically in Europe or North America, than they are with other nations in the region. This would make sense if the region were capital poor and the principal sources of capital were external. Yet the region enjoys the largest foreign exchange reserves, and the highest personal savings rates, in the world. So this lack of financial integration is a product of historical factors and underdeveloped financial sectors – particularly underdeveloped equity and capital markets – not supply-side factors.

This volume explores these fascinating inconsistencies in regional integration. It is a volume in three parts. Part I explores the changing regional

institutional order and the dynamics of the rapidly evolving regional cooperation. Part II explores the functional and formal integration in trade and investment within the region. Part III analyses the anomalous case of financial integration and explores ways forward this integration may take.

Part I commences with a chapter by Richard Hu that provides an overview of the state of regional institution building and an analysis of the influences in this regard of China and the United States. This is followed by Chin Leng Lim's contribution, exploring who is afraid of East Asian regionalism and why. This chapter puts the increasing integration of this region in a broader context and explores which countries beyond the region might oppose these developments and why they might do so.

In the final chapter in Part I, Roda and Miron Mushkat use the case of transboundary pollution in Hong Kong to analyse the institutional fragility of the region particularly when it comes to balancing the tension between economic and ecological imperatives.

Part II – trade integration – begins with chapters by Junji Nakagawa and Henry Gao which explore the regional free trade agreement (FTA) strategies of Japan and China respectively. Nakagawa concludes that competitive dynamics best explain Japan's policy shift, in the past decade, towards preferential trade arrangements and away from its traditionally staunch support of multilateral initiatives. Gao on the other hand concludes that the principal drivers of China's use of preferential trade arrangements have been geo-political factors rather than economic ones.

Bryan Mercurio then takes a sceptical look at the dramatic expansion in intra-regional trade in the past three decades and concludes that while this growth occurred at the same time as the growth in regional trade agreements, there is no causal link between the two; that is, trade grew despite, rather than because of, the proliferation of formal trade agreements. Mercurio then goes on to explore the changes in regional trade agreements which would serve to promote intra-regional trade.

The next chapter in this part is by Lisa Toohey. She analyses ASEAN trade dispute resolution and explores the cultural, political and other factors which explain why ASEAN's members have consistently avoided resolving trade disputes by using the region's own dispute resolution protocols and instead, when it is unavoidable, taken their trade disputes to the Dispute Settlement Understanding of the World Trade Organization (WTO).

In the final chapter of Part II, Trinh Yen examines the role of investment treaties in regional investment integration and analyses preferable ways forward towards a more coherent and consistent regional investment regulatory structure.

Part III deals with financial integration. It commences with an analysis

by Douglas Arner and Cyn-Young Park of the implications for Asia of the recent global financial regulatory reforms and of the regional and sub-regional mechanisms and institutions that would serve to advance the region's financial growth and integration. It then proceeds with Injoo Sohn's analysis of the political dynamics of East Asia's financial regionalism. The following chapter by Paul Lejot analyses the multilateralized Chiang Mai Initiative (CMIM), the series of bilateral credit arrangements among regional central banks designed to enhance the financial autonomy and stability of the region in times of crisis. Lejot explores the incompleteness of the initiative at its current stage of evolution.

From this basis, Ross Buckley explores one direction in which the CMIM might lead, if developed extensively, which is to an Asian Monetary Fund. Buckley explores what a regional monetary fund has to offer and concludes that while such a fund has an important role in enhancing regional financial autonomy and stability, it may have even more to offer the region, and the world, by developing an Asian Consensus on development and becoming an authoritative voice to enunciate and promote those policies that have worked in Asia to the benefit of the region's further development and that of other developing nations in other parts of the world.

In the final chapter of Part III Nhu Vu explores one of the potential future paths open for regional financial integration: the establishment of an Asian currency unit and, in particular, the potential role of the Asian Development Bank in its creation.

The work concludes with a chapter by the editors in which we summarize some of the themes of the volume and examine the future prospects of regional institution building.

This volume grew out of two workshops held in the region in the second half of 2009. In October, the University of New South Wales and the Asian Institute of International Financial Law of the University of Hong Kong jointly hosted a workshop in Hong Kong on regional economic integration. The following month the University of New South Wales hosted a workshop on the same subject in Hanoi, Vietnam. Most of the chapters in this volume were presented and discussed at these workshops. Discussions have continued since then among authors working in similar areas with a view to producing a cohesive volume.

This book seeks to do more than describe what is, although we trust it does this competently. More importantly, it seeks to explore alternative pathways down which the region could progress, for the region today truly does stand at a cross-roads. In the past regional institution building and cooperation have been stymied by China's distrust of regional institutions, the long-standing tensions between China and Japan as they have

competed for influence, and the strong preference of the United States to continue to exert its influence in the region through its series of bilateral relationships – a preference that has resulted in US opposition to most regional initiatives.

In the past decade this landscape has changed. China has come to understand and appreciate the need for, and potential of, regional institutions and has grown comfortable with being a member of such institutions. China and Japan, while certainly still competing for influence, have seemingly come to some rapprochement, an understanding that influence shared might be influence enhanced. And, finally, for most of the first decade of the new century the United States was obsessed with terrorism and the Middle East. By the time the Obama administration came to power and started to give Asia a focus appropriate to the region's economic importance, the region generally, and China in particular, had grown remarkably in confidence and economic power, and the United States has found a return to its old approaches simply untenable.

So East Asia's economic destiny lies today in its own hands more than it has for the past century. It will be Asians who decide on paths of regional cooperation or competition. And it will be the region that decides whether it is sufficiently committed and serious to lift its financial integration to the levels of its integration in production and trade.

The past two decades in East Asia have witnessed economic growth without peer in human history (except perhaps for the two decades of Japan's growth in the 1950s and 1960s, which is in many ways the starting point for the East Asian growth story). The potential for the next two decades is no less exciting. It has been our pleasure to assemble this volume which explores the directions the region might most usefully take in the future.