Characteristics of Trade Integration in East Asia and Their Implications for Institutional Economic Integration *

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I. Introduction

II. Propensity of Intra-regional Trade in East Asia

III. Characteristics of Trade Integration in East Asia
1. Trade integration through international production sharing
2. Increasing role of developing economies

IV. Implications for Further Economic Integration

V. Toward A New East Asian Regionalism
1. Institutionalization of regional cooperation
2. Cultivating Regional Identity through Asian Values

VI. Conclusion

Bibliography
Appendix Tables

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I. Introduction

East Asia (EA) emerged as a trading group due to market-led trade integration. Concentrated FDI flows, production sharing, increasing role of developing economies have been the mains factors for trade integration in EA. Due to this market-led integration, the macro-economic and financial interdependence among East Asian countries are becoming more pronounced. Thus, the economic and financial turbulence of one country could be easily transmitted to other economies. These are the reasons why East Asian countries want to set up an institutional integration scheme that can handle trade and investment as well as the harmonization of trade policies.

The needs for an institutional integration scheme in EA is also stimulated by the emergence of “new regionalism” and “shared experiences” that exalt the sense of the East Asian identity. That is, the expansion of the European Union and the evolution of NAFTA toward Free Trade Area for Americas (FTAA) has stimulated East Asian regionalism. The shared experience of the financial crisis in 1997 intensified the consciousness of mutual interdependence among East Asian countries, which manifested the need of East Asian regional integration schemes.

As a result, the “ASEN + 3” meeting was the first formal cooperation scheme. Other types of integration such as bilateral free trade agreements (FTA) have been considered. Nevertheless, EA has not yet fully pledged a region-wide economic integration whereby all member countries participate on an equal basis. As long as bilateral FTAs such as Japan-Singapore FTA, Korea-Singapore FTA, and even ASEAN-Japan and ASEAN-China FTA are concerned, they signify international cooperation, promoted not by regional interests but by national interests. In the case of the “ASEAN +3” meeting, it would imply an ASEAN-sponsored regionalism that means all member countries do not fully acquire regional identity. Furthermore, the “ASEAN +3” meeting, by itself, does not represent any kind of positive economic integration, which possesses common trade policies and the

removal of tariffs among member countries.

Thus, the question to be asked at this stage is how to further develop the existing cooperation scheme and to transform the existing market led integration into institutional one. In order to approach this question, this paper tries to verify the intra regional trade integration trend in EA and then, draw out the characteristics of the trade integration. The implications for further economic integration will be examined. Lastly, this paper intends to draw attention to regional identity as a centripetal force for East Asian regionalism, which aims to gather all member countries into fully-pledged regional integration.

II. Propensity of Intra Regional Trade in East Asia.

One of the most important characteristics of world trade since the end of the Cold War may be the regionalization of international trade that has been led by new regionalism in Europe, North America and EA[1]. Among these three trading groups, the regionalization trend in EA is the most remarkable. This is why this paper examines regional economic integration in EA in relation with intra regional trade integration. The aim of this chapter is to verify the regionalization trend of world trade

[1] In this paper, EA is defined as the region covering the countries of Northeast Asia (mainland China, Hong Kong, Taiwan, South Korea and Japan) and Southeast Asia (ASEAN member countries). For analytical purposes, these are divided into four groups: Japan, newly industrializing economies (NIEs: Hong Kong, Korea, Singapore and Taiwan), ASEAN (Indonesia, Malaysia, Philippines, and Thailand) and Mainland China(China hereafter). North Korea, Brunei, and new members of ASEAN in Indochina (Cambodia, Laos, Myanmar, and Vietnam) have been excluded because their trade relationships with other countries have been hard to gauge until now.

through two statistical methods “the regionalization coefficient” and “the index of propensity to intra-regional trade”

In general, the trade dependent ratio and the index of trade intensity are used to observe trade regionalization (Sohn, 2002). These two indices, however, are likely to change in accordance with the relative size of the market of the member countries. They may not accurately reflect the geographical bias of international trade. In order to find out the geographical bias of international trade, this paper examines the trade regionalization by means of the regionalization coefficient and the index of the propensity to intra-regional trade that reflect the relation between trade integration and economic growth.

In this paper, the regionalization coefficient in intra-regional trade (R_c) is defined as the share of country i’s exports to country j (in intra-regional trade, country i = country j) divided by country i’s gross domestic product (GDP). The index of the propensity to intra-regional trade (P_i) is defined as the relative share of i’s exports to j divided by i’s GDP (X_{ij} / GDP_i) when compared with the relative share of j’s imports in world imports (M_j / M_w).

The index of propensity to intra-regional trade (P_i) represents the combined effect of geographic bias and overall openness to trade. This index is a useful indicator of cross-time comparisons for country i’s trade with country j, when trade has been changing due to the economic growth of country i. In considering the dynamic growth of East Asian countries during the last few decades, this index may be more useful in observing the regionalization trend that reflects economic growth rather than the index of trade intensity or the trade dependent ratio. This index, however, should not be used to compare different-sized countries or regions at a point in time. This is because the ratio of i’s trade to its GDP is necessarily dependent on the size of economy i, ceteris paribus.

Table 1 represents the intra-regional trade dependency of the three major trading blocs; the EU, NAFTA, and EA, by means of the regionalization coefficient.

Table 1. Regionalization coefficient in intra regional exports (R_c)

	1978	1988	1998	2002	2004
EA (10)	0.039	0.056	0.059	0.116	0.143
EU (15)	0.127	0.145	0.157	0.173	0.199
NAFTA (3)	0.028	0.033	0.053	0.053	0.050

Source: *Direction of Trade Statistics Yearbook*, and *International Financial Statistics Yearbook, 1980-2005*, IMF. *Taiwan Statistical Data Book,* Council for Economic Planning and Development, Taiwan 2005, and *Monthly Statistics of Exports and Imports, Taiwan Area,* Ministry of Finance, The Republic of China, Nov. 2005 (www.moea.gov.tw)

Notes: 1) $R_c = X_{ij} / GDP_i$ Where X_{ij}, Export from country (group) i to country j.

GDP_i, GDP of country (group) i.

2) GDP, calculated in US dollars with market exchange rates (period average) for countries quoting rates in national currency per US dollar. *International Financial Statistics Yearbook, 1980-2005*, IMF.

3) EA(10): China, Japan, 4 NIEs (Hong Kong, Korea, Singapore, Taiwan) and Four ASEAN members (Indonesia, Malaysia, Philippines, and Thailand).

NAFTA(3): USA, Canada, Mexico. EU: 15 members of European Union.

Table 2. Index of the propensity to intra-regional trade (P_i)

	1978	1988	1998	2002	2004
EA (10)	0.30	0.31	0.31	0.54	0.65
EU (15)	0.29	0.34	0.42	0.49	0.56
NAFTA (3)	0.14	0.15	0.23	0.22	0.24

Source: Same as Table 1.

Notes: $P_i = \dfrac{X_{ij}}{GDP_i} \Big/ \dfrac{M_i}{M_w}$, Where X_{ij}; Exports from country (group) i to

country j.

M_j; Total imports of country (group) j, M_w; World total imports.

As shown in Table 1, the regionalization coefficient of intra-regional exports has continuously been increasing for virtually all regions except for EA in 1998. That is, the coefficient of EA increased remarkably from 0.039 in 1978 to 0.056 in 1988 and to 0.143 in 2004 after stagnating in 1998 when the financial crisis has occurred. The coefficient of the EU increased from 0.127 in 1978 to 0.145 in 1988 and to 0.199 in 2004. The regionalization coefficient of NAFTA also increased continuously from 0.028 in 1978 to 0.033 in 1998 and to 0.050 in 2004. The rise of the regionalization coefficient is mainly attributed to the proportion of the GDP that is traded intra-regionally. That is, it is attributed to the tendency to trade more of one's GDP with one's own region, rather than outside the region. In general, the regionalization of world trade was accentuated during the last two decades for all of the three major trading groups, except for NAFTA, since 2002. This trend seems to result from the new regionalism in Europe and North America in the 1990s and in EA after the financial crisis in 1997.

Table 2 shows the index of the propensity to intra-regional trade in the three major trading groups. There has been an increasing propensity toward intra-regional trade over the last two decades for the three continents. The index has grown from 0.31 in 1988, to 0.54 in 2002, and 0.65 in 2004 for EA. For the EU, the index increased continuously from 0.34 in 1988 to 0.42 in 1998 and to 0.56 in 2004. The index in North America has also increased from 0.15 to 0.24 between 1988 and 2004 respectively. This increase of the index for the three major regions represents an increase of geographic bias in world trade. This trend seems to be related with the strengthening of economic regionalism in Europe, North America and even EA since the financial crisis. As a result, the world trading system should

be reshaped along with the tri-polarization of world trade which was brought about by the strengthening of regionalism.

In short, trade regionalization in the major trading groups has become stronger during the last two decades according to economic (GDP) growth. This increase in geographical bias of world trade since the 1990s seems be influenced mainly by the enforcement of regional trade arrangements(RTAs), in which a series of preferential trade policies had been introduced. In the case of EA, however, where there weren't any regional arrangements in the past, this increase can be explained by other factors. Furthermore, it is noteworthy to indicate that the increase of regionalization in EA is much higher than in the EU and NAFTA. The reason for this rapid regionalization can be explained by regional factors in addition to the new regionalism of the 1990s. The next chapter will address these regional factors that have led intra-regional trade integration in EA.

III. Characteristics of Trade Integration in East Asia

1. Trade integration through international production sharing

As we have verified the propensity of intra regional trade in the previous chapter, EA has revealed a net trend for trade regionalization which has been more rapid than that of the EU and NAFTA, in spite of lack of region-wide trade arrangements. Thus, trade integration in EA has been characterized by market-led integration. Then, what are the main causes of this market-led integration?

First, foreign direct investment (FDI) flows from industrialized economies into developing countries; first from Japan and then by the NIEs. They have largely contributed to trade integration during the last few decades. The Share of EA to the total Japanese FDI outflows between 1951-2001 represents about 18 percent, it has risen from 10.3 percent in 1986 to 12.2 percent in 1992, and to 22.0 percent in 1996 (OECD, 1999, 2002).

More than half of the total FDIs of the Asia NIEs were invested in EA in the mid 1990s(Sohn, 2002). The East Asian countries share of the total FDI inflows in China between 1995-2001, represented about 70 percent (Appendix Table 3). These concentrated investments have contributed to international production networking that has resulted in the increase of intra-regional trade[2](Sohn 2002, pp 167-170).

Furthermore, the process of investment in EA has been driven by the logic of the “flying geese” pattern of relocating production sites to cheaper areas abroad, as domestic costs have risen (M. Pangestu and Sudarsham Gootu, 2004, p.42). So, firms moved their production sites from Japan to the NIEs, ASEAN and then China(Appendix Table 1), and also from the NIEs to ASEAN and China. According to this flying geese pattern of relocation, the vertical division of labor and vertical intra-industry trade, along the value chain, has been developed in this region. Thus, intra-regional trade in intermediate goods (parts, components and other inputs) has grown rapidly[3](Appendix Table 2). As shown in Table 3, the share of parts and components to the total intra-regional trade of manufactured goods has increased in recent years in almost all East Asian countries. In particular, the share of China, Korea, Philippines and Indonesia has been remarkable. This is why FDI has played an integral role in the intra regional trade of intermediate goods, which has resulted in production sharing among East Asian countries.

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[2] According to recent empirical studies of the relations between FDI and intra-regional trade in EA, there is a series of interactive processes between FDI, production sharing, and intra-industry trade integration: F. Ng and A. Yeats(1999), F. Kyoji et al.,(2002).

[3] In fact, the share of imported intermediate goods from Asia to the total input supply in manufacturing industry of Japan has remarkably increased over the last decade (1990-2000) (Appendix Table 1).
For China, about 60% of imports from Asia NIEs, and about 40% of its imports from Japan were input products in 2002(G. Gaulier, 2005 P.17). For Korea, about two thirds of trade deficits vis-à-vis Japan and about 80% of trade surplus vis-à-vis China were represented by the trade of parts and components in 2004 (Kyung jong, Kim, 2005, p.18).

Table 3. The share of parts and components to the total intra-regional trade of manufactured goods in E.A. (%)

	China	Japan	Korea	Indonesia	Malaysia	Philippines	Singapore	Thailand	East Asia
1999	0.18	0.21	0.16	0.17	0.30	0.37	0.29	0.31	0.23
2001	0.20	0.21	0.19	0.22	0.31	0.42	0.29	0.32	0.24
2003	0.21	0.22	0.22	0.22	0.30	0.43*	0.27	0.31	0.24

Source: WTO/UNCTAD, PCTAS,(Kang, 2005. P. 21 and 51)

Note : ① The share of parts and components to the total trade of manufactured goods among East Asian countries.

② Parts and components in this table refer to 141 categories of commodities classified by 4-5 digits in the SITC Section 7 and 8. If we include other categories of intermediate goods in other section of SITC classification (ex. SITC 4, 5 and 6), this share will significantly increase.

③ *, for 2002

The increase in intra regional trade regarding intermediate goods, which was induced by the relocation of production through FDI within EA, has resulted in intra-regional input-output relations among East Asian countries as shown in Table 4.

In order to examine industrial-interdependence between trading partners caused by the intra-regional trade of intermediate products within EA, this paper refers to the linked international input-output tables for China, Japan and Korea.[4] Table 4 represents the international backward-linkage effect among three countries; China, Japan, and Korea. That is, the table represents the induced production coefficient of each country (on line), which is caused by the additional production

[4] This paper refers to the Asian international input-output table, established by the Institute of Developing Economies (IDE) JETRO. The IDE is under going establishment the I/O table for 2000. So, this paper refers to the tables of 1985, 1990 and 1995. IDE has established international I/O table covering China, Japan, Korea, major ASEAN members, Taiwan and the US. This paper refers only to China, Japan and Korea as representative countries in the “flying geese” model and to ten key industries, which are influenced easily by international production sharing (Hong bae, Lee, 2004, p.145).

of final goods in the host countries (on column). According to this table, the induced production coefficient between home and host countries had increased between 1985-1995, except for the effect of Korea's production, which was induced by Japanese domestic production. In particular, production in Korea and later in Japan, which was induced by the additional production in China, has remarkably increased in all industries. The effects in Japan and later in China, which were induced by the additional production of final products in Korea, have increased continuously.[5] This means that an expansion of final demand in a host country induces additional imports of intermediate goods from home country. Intra-regional trade in intermediate goods and the intra regional production chain that resulted in FDI flows, can explain this kind of increased international input-output relations within EA. This is why EA is transforming into a production community where its countries share a series of production chains within the region.

[5] The effect of production in Korea, induced by Japanese domestic production, decreased between 1985 and 1995. This may explained by the replacement of Japanese overseas production base from Korea to China and ASEAN, along with the rise of labor cost since the mid 1980's. Therefore, it cannot be seen necessarily as a negative aspect to intra-regional industrial linkage within EA as a whole.

Table 4, International Input-Output Relations between China, Japan and Korea

(Backward linkage effect in production)

Industry		1985			1990			1995		
		China	Japan	Korea	China	Japan	Korea	China	Japan	Korea
China	Foods stuffs	2.1385	0.0128	0.0003	2.2481	0.0095	0.0002	2.2624	0.0097	0.0181
	Textiles	2.4459	0.0417	0.0023	2.4600	0.0301	0.0013	2.3331	0.0214	0.1071
	Chemicals	2.1065	0.0385	0.0015	2.4312	0.0267	0.0012	2.2628	0.0156	0.0367
	Ceramics	2.1248	0.0109	0.0005	2.5628	0.0090	0.0004	2.5697	0.0106	0.0328
	Manuf. of metal	2.1609	0.0077	0.0010	2.7734	0.0094	0.0006	2.6135	0.0179	0.0732
	General Machinery	2.2186	0.0042	0.0009	2.6627	0.0050	0.0007	2.5309	0.0111	0.0276
	Electric Machinery	2.2469	0.0050	0.0012	2.5710	0.0058	0.0011	2.4240	0.0136	0.0250
	Transport equip.	2.3770	0.0055	0.0010	2.4954	0.0054	0.0007	2.4147	0.0082	0.0249
	Precision Machinery	2.0499	0.0042	0.0012	2.4273	0.0051	0.0009	2.2635	0.0100	0.0221
	Other manufacturing	2.1870	0.0086	0.0017	2.3398	0.0102	0.0010	2.3975	0.0115	0.0261
Japan	Foods stuffs	0.0085	2.1607	0.0251	0.0087	2.1071	0.0279	0.0154	2.0481	0.0231
	Textiles	0.0229	2.2333	0.1465	0.0252	2.1005	0.1100	0.0521	2.0489	0.0733
	Chemicals	0.0349	1.8225	0.0879	0.0320	1.8169	0.0998	0.0413	1.8068	0.0888
	Ceramics	0.0374	2.1091	0.0610	0.0182	2.0211	0.0497	0.0314	1.9935	0.0563
	Manuf. of metal	0.1008	2.4983	0.2282	0.0376	2.2666	0.1179	0.0543	2.1999	0.0968
	General Machinery	0.1012	2.2603	0.2661	0.0494	2.1638	0.2084	0.0983	2.1689	0.1473
	Electric Machinery	0.1474	2.3232	0.3521	0.0812	2.2295	0.3212	0.1623	2.1616	0.2298
	Transport equip.	0.0808	2.6325	0.2873	0.0980	2.6916	0.1961	0.1202	2.6317	0.1697
	Precision Machinery	0.1086	2.1205	0.3617	0.0715	2.0327	0.2689	0.1417	2.0107	0.1374
	Other manufacturing	0.0607	2.1143	0.1269	0.0312	2.1736	0.1238	0.0544	2.1578	0.1044
Korea	Foods stuffs	0.0000	0.0071	2.1044	0.0009	0.0061	2.1334	0.0057	0.0043	2.0134
	Textiles	0.0001	0.0189	2.1781	0.0072	0.0150	2.1765	0.0456	0.0131	1.8773
	Chemicals	0.0001	0.0042	1.5797	0.0036	0.0049	1.7324	0.0254	0.0063	1.6094
	Ceramics	0.0001	0.0053	1.9628	0.0021	0.0052	1.8830	0.0129	0.0033	1.9342
	Manuf. of metal	0.0003	0.0081	2.2961	0.0038	0.0143	2.2342	0.0165	0.0139	2.1430
	General Machinery	0.0003	0.0037	2.0116	0.0041	0.0059	1.9977	0.0215	0.0065	1.9725
	Electric Machinery	0.0004	0.0062	1.8173	0.0100	0.0092	1.8839	0.0335	0.0170	1.7284
	Transport equip.	0.0002	0.0035	2.0003	0.0048	0.0053	2.1398	0.0225	0.0056	2.0627
	Precision Machinery	0.0003	0.0041	1.7998	0.0044	0.0071	1.9184	0.0202	0.0104	1.8078
	Other manufacturing	0.0001	0.0036	2.0330	0.0036	0.0075	2.0483	0.0294	0.0080	1.9417

2. The increasing role of developing economies in trade integration.

1) The increasing role of the NIEs

Second, the emergence of newly industrialized economies (NIEs) such as Hong Kong, Korea, Singapore and Taiwan as main trading partners along with their rapid economic development during the last few decades have contributed to intra-regional trade integration. In fact, the NIEs have assumed the lead role in intra-regional trade integration, replacing Japan since the beginning of the 1990s, as shown in Table 5 .

Table 5. Intra-regional export dependent ratio (R_{ij}).

		1978	1988	1998	2002	2004
China	Japan	17.64	16.88	14.11	14.56	12.39
	NIEs	28.53	41.40	30.66	26.48	26.64
	ASEAN	3.29	2.78	2.77	4.03	4.12
Japan	China	3.13	3.58	5.26	9.05	13.07
	NIEs	15.39	18.80	20.22	21.07	24.98
	ASEAN	6.49	4.91	8.27	8.82	9.11
NIEs	China	0.2	8.1	15.0	18.96	24.64
	Japan	12.9	12.4	6.9	7.44	6.96
	NIEs	8.4	10.7	13.4	14.29	13.81
	ASEAN	8.0	6.3	9.9	9.87	9.10
ASEAN	China	0.8	2.2	3.1	4.91	2.47
	Japan	29.4	24.6	13.1	14.24	13.34
	NIEs	16.1	21.0	23.7	23.82	25.45
	ASEAN	3.2	3.6	6.5	7.47	3.36

Source: *Direction of Trade*, IMF, and *Monthly Statistics of Exports and Imports*, Taiwan Area, Ministry of Finance, The Republic of China, every year.

Note: Export dependent ratio (R_{ij})= x_{ij}/x_{i*}. Where, x_{ij}: Exports from country i to country j. x_{i*}: Total exports of country i.

ASEAN: Indonesia, Malaysia, Philippines, and Thailand.

That is, the share of intra-NIEs exports, in the total exports of the NIEs, has increased from 8.4 percent in 1978 to 13.81 percent in 2004, while the share of the Japanese market in the NIEs' total export has decreased from 12.9 percent to 6.96 percent. In the case of ASEAN, the share of the Japanese market in the total export of ASEAN has decreased from 29.4 percent to 13.34 percent, while that of the NIEs' market has increased from 16.1 percent to 25.45 percent between 1978 and 2004 respectively. The share of the NIEs in Japanese exports has also expanded from 15.39 percent to 24.98 percent during the same period. Although the share of the NIEs in China's exports decreased slightly from 28.53 percent to 26.64 percent between 1978 and 2004 respectively, the NIEs are the most important trade partner of China as ever.

These evolving patterns of intra-regional trade flows indicate that the NIEs, as a group, have become a more important market for East Asian countries' exports, while the absorbing role of the Japanese market, which was the most important market in the past, has declined during the last two decades.

We can highlight from these changing intra-regional trade flows that the trade integration in EA, during the last decade, has been mainly led by the NIEs. In addition, the NIEs have assumed the leading role in intra-regional trade integration, replacing Japan, which was the main contributor to regional trade in the past. This change in intra-regional trade, from Japan to the NIEs, would become significant for institutional economic integration in EA and this will be discussed later in this paper.

2) The emergence of China and ethnic Chinese networks

Third, the emergence of China as a great economic power can be regarded also as a main contributor to East Asian trade integration in recent years. Since 1980, the Chinese economy has grown at an average rate of 9 percent per year until recently, and its foreign trade has expanded to about 15 percent per year. Its share in the world trade rose from less than 1 percent in

the 1980s to more than 6 percent in 2004. China's share in intra-regional trade in EA doubled from 10 percent to 22 percent between 1990 and 2004 respectively. Thus, China has become a major trading partner for East Asian countries. From 2003, China became the second main export market of Japan behind the US. China is the first export market for Korea.

As a result, East Asian countries' trading patterns have largely been influenced by China's trading policies. Since the mid-eighties, China's selective trade policies have determined not only the commodity and geographic pattern of China's trade, but also the intra-regional trade linkage in EA (G. Gaulier et al. 2005, pp.12-19). That is, in China, duty exemptions have been granted to selected categories of imports in order to promote export-oriented industries and to stimulate the inflow of capital. Intermediate products, which are imported to be used in the production of exports (export processing activities), have been the most important category, which has benefited from selective tariff exemptions. The effective protection by selective trade liberalization has thus favored strong production links between China and East Asian trading partners, through trading in intermediate goods.

China has been used as an export-processing base by the firms of East Asian economies (Japan and the NIEs), which export intermediate goods to their affiliates in China. Thus, in 2002, almost 60 percent of China's import from Asian NIEs and 40 percent of its imports from Japan were aimed at supplying inputs for processing industries. Processed exports also account for a large share of Chinese exports to East Asian countries, up to 60 percent in 2002(G. Gaulier et al. 2005, pp.17-19). In this way, China is playing an integrating role in the intra regional trade of intermediate goods, which has resulted in production sharing among East Asian countries.

On the other hand, the ethnic Chinese network has also widened the effects of intra-regional trade and investment in EA. With the opening up of China's economy, overseas Chinese have

established business relations with Mainland China based on language and historical bonds. This linkage has contributed to the development of intra-regional investment and trade in EA. As shown in appendix Table 3, the Chinese NIEs represented about 70 percent of the total FDI inflow into China between 1979-1994, and about 56 percent between 1996-2001. This is the reason why the NIEs (Hong Kong, Taiwan, and Singapore) now play a major role in connecting intra-regional trade in EA.

IV. Implications for Further Economic Integration

All of these factors can be regarded as being catalyst for further regional integration in EA. Then, what are the implications of these factors for further economic integration ?

International production networking through FDI will facilitate functional integration between home and host countries. The increasing role of developing economies will be helpful in eliminating the imbalance of trade gains between most advanced country and less developed countries within the same region and so, it will be an important precondition for tariff-removing institutional integration. The ethnic Chinese network is related to the formation of the Greater Chinese Economic Zone, which assumes a facilitating role of East Asian trade integration. Thanks to these factors, the existing hindrances to region-wide integration in EA, such as differences in economic systems and at the development level, are likely to be reduced. Among these factors, the expectant economic effect related with this linking role of developing economies and production sharing will be of great significance for further economic integration.

In the static aspect, the increase in market led integration (*de facto* integration), based on production network and production sharing, can be a supporting base for institutional integration (*de jure* integration). If institutional integration, such as the East-Asian Free Trade Area (EAFTA), is formed in EA, its trade creation is likely to be great while trade diversion

is small. This is because the major trading partners already work together, thanks to the existing production network. The diversification of production processes stimulated by production sharing among East Asian countries could result in the regional division of labor. This development may be linked more closely due to institutional integration arrangement. In this sense, market-led integration, which is mainly led by production sharing in EA, can be regarded as a favorable precondition for institutional integration. Thus, institutional integration in EA should be formulated in the form of production community in which intra-regional production sharing could be extended through the free movement of intermediate goods to all East Asian countries, along with their respective industrial development levels.

On the other hand, EA, as a group, has emerged as a trading bloc since the 1970s through the intensification of intra-regional trade, the main connector of which was Japan, the most advanced country in the region. Thus, the East Asian trading group can be represented as asymmetrical integration in the form of "hub and spokes", in which trade gains were distributed in favor of the hub country. Developing economies -- the NIEs and China, -- however, are generating ongoing trade integration. As a result, the intra-regional trade pattern is shifting progressively, from vertical to horizontal, and from inter-industry to intra-industry trade. This change may lead, to some extent, to an equalization of trade gains between advanced countries and developing countries.

The increasing role of developing economies in intra-regional trade represents an expansion of the trade spectrum between Japan and developing countries in the manufacturing sector. Thus, East Asian countries can further diversify their production process along with the production sharing. These factors could enlarge still more opportunity for the intra-regional division of labor in the manufacturing sector among East Asian countries. Thereby EA will be able to reduce industrial readjustment costs in the face of tariff removing institutional trade arrangements.

In short, the increasing connecting role of the developing economies, as well as the market led trade integration in EA, could be regarded as a favorable pre-condition for region-wide institutional integration in the near future.

V. Toward A New East Asian Regionalism

1. Region-wide institutional integration.

Then, what should be taken into consideration for further regional integration in EA when evaluating these characteristics of intra-regional trade?

EA has demonstrated the need for an institutional approach in regional cooperation in order to further develop existing market-led integration on the one hand, and to counter a growing sense of new East Asian regionalism on the other hand. Thus, East Asian countries have held summit meetings under the auspices of the ASEAN-plus-three since 1997. The economic ministers of the respective countries have begun to meet annually. The central banks of these countries established a currency-swap agreement with each other in 2000.

For bilateral arrangements in EA, the Japan-Singapore Economic Partnership Agreement has been implemented. ASEAN-China concluded a framework agreement for FTA in 2002. ASEAN- Japan signed a framework for comprehensive economic partnership in 2003, and Korea is considering a similar negotiation with ASEAN. Other types of bilateral FTAs between individual countries are being officially considered.

These moves, both multilateral and bilateral, to enhance regional cooperation through inter-governmental agreement, can be seen as a step toward an institutional approach as well as an expression of the growing new regionalism in EA. EA, however, has not yet fully pledged a region-wide economic integration scheme, in which all member countries can participate on an equal basis. The bilateral FTAs represent only the national interests of the contracting parties. The multiplication of

bilateral FTAs among East Asian countries may cause a “spaghetti bowl effect”, which would make the nations pay more than in a region-wide FTA in maintaining free trade order. In the case of the “ASEAN +3” meeting, although it covers most East Asian countries, it neither represents positive economic integration, which is endowed with common trade policies, nor negative integration, which pursues the removal of tariffs among member countries. Therefore, it is necessary to form a region-wide institutional integration scheme, which is endowed with intra-regional free trade rules, and it should cover all member states[6].

The question to be asked at this stage is how to develop the existing cooperation schemes and how to transform the existing market-led integration into region-wide institutional integration.

2. Cultivating regional identity through Asian Values

In order to realize the multilateral dimension of region-wide institutional integration within EA, the countries need to introduce a collective regional identity that enables them to integrate with each other. This is because such integration has to embrace all East Asian countries, which are endowed with different socio-cultural and economic backgrounds and forge a single economic community.

A sense of identity among countries in a certain region is an important component in promoting regional integration. Without

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[6] Concerning East Asian region-wide cooperation, the ASEAN+3 process saw the strongest development after the financial crisis. For example, the East Asian Vision Group(EAVG) was established in 1988 in order to develop regional cooperation. ASEAN+3 leaders produced a Joint Statement on East Asian cooperation in 1999. They established the East Asian Study Group in 2001 to assess the recommendations of the EAVG such as “East Asia FTA” and “East Asia Investment Area”. In 2003, they expressed their intention to establish an East Asia FTA(EAFTA).

There has been some progress in financial cooperation since the Chiang Mai Initiative in 2000. In 2003, ASEAN+3 finance ministers agreed to strengthen East Asian financial cooperation. As a result, 16 bilateral swap arrangements (BSAs) worth a total of 36.5 billion dollars were closed by the end of 2003. They agreed to intensify their efforts to develop regional bond markets and also to set up the ASEAN+3 Finance Cooperation Fund in order to support ongoing economic review and policy dialogue (Hadi Soesastro, 2003).

regional identity, there would be no way to demarcate the region , whether it be in establishing regional institution or in establishing regionalism. In order to build region-wide integration in EA, there must be a consensus regarding the concept of East Asian identity. This concept[7] , however, can not be defined in economic literature, but it can be found in terms of common cultural denominators, especially those derived from Confucian ethics (Park, 2005, pp.185-189, Sohn 2006).

As one of the “three ways” together with Taoism and Buddhism, Confucianism grew into the traditional thought of the East Asian region (Northeast Asian region). Concerning the socio-political system of East Asian traditional societies, Confucianism was the dominant system of thought for the elite political leaders. On the other hand, Buddhism taught non-political doctrine and Taoism is based on the ideas of escaping from reality. As a result, such doctrines did not influence directly changes in the social system. As far as politics and economic affairs are concerned, Confucianism has been a very powerful socio-cultural force in East Asian countries since the middle ages.[8]

Confucian ethics are manifest in the importance of thrift, hard work, self-cultivation, respect for education and morality, social civility and the well being of people. These factors are the key variables in explaining the economic performance of East Asian economies during the last several decades (Ju, Sung Whan 2000, Wang, Russell and Tan, 2000). This is the reason why we suggest that East Asian countries must re-examine Confucian values as an ethos for economic development and as an origin of Asian values.

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[7] In EA, the concept of East Asian identity began to gain political attention beginning in the 1990s with the proposal of Asian values by Asian political leaders, Lee Kuan Yeu in Singapore and M.Mahatir in Malaysia (Lee Geun, 2000, p.72).

[8] East Asian countries, which have been influenced by Confucianism- China, Japan, Korea, Hong Kong, Singapore and Taiwan- represent actually more than 90% of the GDP of the region and more than 70% of the population of EA. They have been economically successful since the 1960s. These countries assume a leading role in establishing a regional economic order. Other countries in Southeast Asia are approaching Northeast countries’ economic thought through the Japanese FDI inflow and bilateral FTAs with China, Japan, and Korea. In this respect, we can say that the traditional thought of these countries represents the main idea of Asian values.

A series of regional integration movements in recent years, such as “ASEAN+3” meetings, have given rise to the formation of an East Asian identity and an awareness of shared values. It is important to find the basis of this regional identity and to cultivate the contents of Asian values. It is possible to examine this issue by investigating Confucian thought, which has spread over the industrial countries in the region.

VI. Conclusion

According to a statistical analysis on the regionalization coefficient of the three major trading blocs--The EU, NAFTA and East Asia --, the trend of trade regionalization has become stronger from the 1970s, along with economic growth.

The increasing geographical bias of international trade, especially since the mid 1990s, has been influenced mainly by the enforcement of regional trading arrangements (RTAs), in which a series of preferential trade policies had been introduced. In the case of EA, however, where no region–wide arrangements took place in the past, other factors have led intra-regional trade integration. Concentrated FDI flows, increasing intra-regional trade of intermediate goods and production sharing have been the main factors in the development of trade integration. The connecting roles of the NIEs and the rapid economic growth of China have been important contributors to trade integration in this region. In this sense, East Asian trade integration is being characterized as market-led integration. These characteristics have some favorable implications for further economic integration as follows.

First, the market-led integration, which mainly led by production sharing in EA can be regarded as a favorable condition for institutional economic integration. If institutional integration such as the East-Asian Free Trade Area (EAFTA) is formed, its trade creation is likely to be great while trade diversion is small. Because the major trading

partners already work together. And the diversification of production processes caused by production sharing can result in the regional division of labor. This development will be linked more closely by institutional integration arrangement. In this sense, the market-led integration can be regarded as a building step for institutional integration.

Second, the increasing role of developing economies in intra-regional trade means an expansion of the trade spectrum between Japan and developing countries. Thus, East Asian countries can further diversify their production processes that create more opportunity for the intra-regional division of labor.

In this sense, the increasing role of developing economies as well as the market-led trade integration based on production sharing could be regarded as favorable pre-condition for region-wide institutional integration in the future.

In order to establish the multilateral dimension of region-wide institutional integration within EA, the countries need to introduce a collective regional identity that enables them to integrate with each other. This is because such integration has to embrace all East Asian countries, which are endowed with different socio-cultural and economic backgrounds. The concept of an East Asian identity can be found in terms of common cultural denominators, especially those derived from Confucian ethics, which has spread over the industrial countries in the region. It is important to cultivate the contents of Asian values by investigating Confucian values in regionalism building in EA.

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Appendix Tables

Appendix Table 1. Japan's FDI flows in East Asia, by sub-region.

(Millions of US dollars, percentage)

	NIEs 4		ASEAN 4		China		EA, Total	
	Sum, B	B/A	Sum, C	C/A	Sum, D	D/A	Sum, A	%
1951-69	120	25.3	353	74.6	0	0.0	473	100.0
1970-79	3,070	38.2	4,946	61.6	14	0.2	8,030	100.0
1980-84	3,765	40.7	5,307	57.4	173	1.9	9,245	100.0
1985-89	12,993	58.5	6,927	31.2	2,286	10.3	22,206	100.0
1990-94	12,764	36.7	15,808	45.4	6,254	18.0	34,826	100.0
1997-01(1)	12,068	37.2	14,848	45.7	5,550	17.1	32,466	100.0

Source: The ministry of Finance, Japan, *Annual Report of the International Finance,* for 1951-89, and OECD, *International Direct Investment Statistics Yearbook*, for 1990-94. JETRO, *Investment White Paper,* for 1997-2001.

Note: (1), Up to the first half of 2001.

Amounts; notification base, cumulative value in each period. Japanese investment in China in 1995 was exceptionally great with unknown reason so the table expressed the recent five years' amounts during 1997-01 in omitting the amount of 1995-96.

Appendix Table 2. The Share of imported intermediate goods to Japanese domestic production, in manufacturing industry.

	Tex-tiles	Lea-ther	Machinery					Manufac. industry Total
			General	Indus-trial	House-hold	Other	Precision	
1990	7.4	8.4	2.0	1.7	3.0	2.4	6.9	3.0
(Asia)	5.1	2.9	0.6	0.6	1.1	0.6	2.1	0.9
2000	90.4	17.6	8.0	11.1	32.7	13.2	60.2	7.6
(Asia)	85.4	9.5	4.3	6.3	17.9	7.1	31.3	3.7

Source: Keiko, Ito (2003), "FDI and trade pattern in East Asia; influences to Japanese manufacturing industry", Working paper 2003-03, ICSEAD, Japan, pp.12-13.

Appendix Table 3. FDI inflows in China by origin

(Cumulative stock, 1979-1994 and 1995-2001, millions of US dollars).

Country	1979-1994		1995-2001	
	Amounts*	Percentage	Amounts*	Percentage
Hong Kong	58,109	60.76	129,677	42.96
Taiwan	8,447	8.83	20,780	6.88
U.S.A.	7,732	8.08	26,920	8.92
Japan	7,326	7.66	24,933	8.26
ASEAN(5) (Singapore)	3,527	3.68	22,508 (17,077)	7.46 (5.66)
Korea	na	na	11,498	3.81
Others	10,496	10.97	65,527	21.70
Total	95,637	100.00	301,843	100,00

Source: *Statistical Yearbook of China*, 1979-2002.

Note: ASEAN (5) refers to Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

Amounts*, based on foreign capital actually used by country.