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Exogenous Shocks and Endogenous  
Opportunities:  
The Economic-Security Tradeoff and  
Regionalism in East Asia

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## **Exogenous Shocks and Endogenous Opportunities: The Economics-Security Tradeoff and Regionalism in East Asia\***

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East Asia is becoming more regionalized. But it is doing so in fits and starts: two steps forward and one step back. Indeed, skeptics might suggest that even such a tentative description imputes unjustified clarity and speed to the process of regional cohesion. At present Asian governments share no overarching regional vision, nor have they demonstrated the political leadership and will needed to create robust institutions aimed at deepening and regularizing state-to-state interactions across the region. Yet even with its many missteps, Asia has, beyond question, become a far more regionalized neighborhood than it was one or two decades ago.

During the Cold War ideological divisions, bilateral alliances, and the legacies of colonialism kept the attention of most governments focused on nation-building and domestic matters. The result was a series of formidable barriers against widespread regional cooperation. True, Southeast Asian countries had forged ASEAN as early as 1967 but their counterpart countries in Northeast Asia were neither invited to join nor predisposed to forge any comparable body of their own. Additionally, cross-border production networks had begun to leaven previously tight national economic boundaries resulting in deeper regional economic integration (Katzenstein and Shiraishi, 1997; Pempel 1997; *inter alia*). But as John Ravenhill (2008: 43-44) has correctly pointed out, the very climate that allowed individual multinational corporations to operate across national borders throughout much of East Asia served to reduce, rather than accelerate, business pressures on governments to create new regional institutions. In short, East Asia saw a bottom-up, corporate-driven regionalization, but very little top-down, government-sponsored regional institutionalization (Pempel, 2005a)

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Global politics and national politics both continue to spur developments across East Asia and national governments, rather than regional institutions, continue to be the ultimate repositories of power and the primary building blocs in international affairs (Katzenstein, 2005: 105). Nevertheless, regionalism and regional institutions are becoming ever more frequently utilized tools in the arsenal of East Asian governments as they seek to mediate the extremes of globalization and to search for solutions to intra-regional problems that defy solution by any one government.

At the same time, even as regional ties become stronger and more institutionalized, there remains an uneasy relationship between East Asian ties in economics where they have been deepening and ties in the security realm where they are far less advanced. As I have argued elsewhere (Pempel, 2005a), the East Asian security condition suggests to most realists and neo-realists a region that, in the words of Aaron Friedberg (1993) is “ripe for rivalry” despite the fact that economic linkages suggest a region “ripe for cooperation.”

This paper assesses this deepening regionalism across East Asia, examining the mixed picture of regional ties in these two different functional areas—economics and security. It also analyzes the changing character of regional ties in both fields. It makes the argument that deeper regional links result from a combination of exogenous and endogenous forces. Forces from both directions provide opportunities as well as threats. But it has been largely extra-regional threats that have spurred the most recent moves particularly those toward economic regionalism, whereas regionalism in security matters has been in response largely to intra-regional threats. The paper concludes however by examining briefly how some security issues are being treated regionally, but with regional economic integration as a key “carrot” to change unwanted security behavior by the DPRK. It closes with a brief look at the East Asia Summit which potentially offers a regional forum that would fuse economic and security matters.

### **The Economics-Security Nexus and the National-Regional Nexus in East Asia**

There is considerable debate about the ways in which economics and security interact. Equally controversial is the link between state actors and regional development. On the questions surrounding economics and security, at one extreme, most realists and neo-realists view economic prowess as little more than one in a catalogue of national resources that need to be factored into a nation's overall strengths and vulnerabilities as they pursue relative gains within the international system. Economics to most such analysts pales next to such factors as geostrategic position, military capabilities of potential allies and challengers, and the like along with fears of potential actions by feared neighbors. Hence, the power of economic interdependence among various nation-states to catalyze alliances and global cooperation is seen as quite limited.

At another extreme, advocates of the power of cross-border economic interactions argue that as countries become increasingly interdependent and particularly as they create institutions around that interdependence, their motivations to engage in conflicts with one another are reduced. In effect economic interdependence builds trust among otherwise skeptical trading partners in addition to making military conflicts too costly.

Security problems within East Asia arise at the intersection of global and local uncertainties and competitions. East Asia was always at the nexus of Cold War tensions with the Korean and Viet-Nam wars being partial surrogates for the US-Soviet conflict. China's peasant-led revolution spurred imitation across much of the developing world and Indonesia was a key contributor to the Group of 77 and the non-aligned movement. Since the end of the Cold War, East Asia continues to draw global attention whether in the form of George W. Bush's declaration in his January 2002 State of the Union address that North Korea is a key component in a global "axis of evil," a Foreign Affairs analysis (Gershman, 2002) examining Southeast Asia as the "second front" in the "war on terror," the EU's commitment to helping secure East Asian sea lanes, or Russian president Putin's "pipeline diplomacy" aimed at both Northeast and Central Asia. Various extra-regional powers proclaim their critical interest in a variety of security developments across East Asia.

At the same time, within East Asia a host of forces fuels intra-regional security concerns. Northeast Asia, for example, sees the heaviest concentration of military and

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economic capabilities in the world. It is home to three of the five permanent members of the United Nations Security Council and these three also represent three of the five original nuclear weapons states (US, China, USSR/Russia). Southeast Asia is rife with pirates and separatist groups, many linked directly or ideologically to al Qaeda. Cross-Straits tensions have ebbed and flowed as the two governments on either side rattle their respective sabers in challenges to the unsteady status quo. The DPRK has recently tested a nuclear device and at least three other governments (ROK, Taiwan and Japan) have the technical capability to “go nuclear” on short notice. Within East Asia there are numerous unresolved territorial disputes and with the reunification of Germany and Viet-Nam, Northeast Asia also now contains the largest concentration of divided polities in the world (Kim, 2004).

Despite such classical military problems, however, East Asia, starting with Japan and then spreading across much of the rest of the region, focused far more political attention on internal economic development and collective interaction with the global economy than on security threats and potential military confrontations. For Japan, and subsequently many other countries in East Asia, economic security was seen as a critical component on the nation’s overall security and well-being; “security” was rarely defined solely in military or geostrategic terms. Following the defeat of the United States in Viet-Nam, in particular, most Asian governments opted for a focus on economic development rather than security confrontations. The phenomenal economic success of Japan, the NIEs, much of Southeast Asia and finally China is a familiar and powerful message about one potential course of interaction between economics and security.

In recent years, that region wide focus on economic development with less attention to security confrontation has continued. With a few notable exceptions such as the DPRK and Myanmar, there has been relatively widespread region wide agreement among political and business elites across most of East Asia that national economic development can be a positive sum game and should remain the principal focus of governmental policies. In the apt phrasing of Etel Solingen (2007: 760), East Asia’s rulers “pivoted their political survival on economic performance, export-led growth, and integration in the global political economy.” In the process, East Asia began to take shape

as a natural economic zone with ever expanding and integrated production linkages across many national borders.

The economics-security intersection in East Asia went forward in the absence of regional institutions. Basically East Asia until very recently was a region largely devoid of systematic state-level regional bodies. Instead, most activities in both areas were driven by either corporations (economics) or by national governments (security). Asian governments were active in global multinational institutions on both fronts but devoted little attention to the creation or maintenance of regional bodies. Toward the end of the Cold War however there were a few notable changes.

The end of the Cold War saw a diminished US and Russian penetration of the region (and a corresponding rise in the influence of China). Furthermore, America's strategic goals were subtly redefined in geo-economic terms as opposed to geo-strategic terms, largely as a function of the Clinton administration's concentrated focus on advancing the process of globalization and trade liberalization and the Clinton Administration's underlying conviction that economic growth and closer economic interdependence would go a long way toward reducing the chances of military conflicts throughout the world. This shift in American thinking fit well with East Asia's by then much longer focus on economic development as a central component of national security.

A major institutional consequence of this convergence between US and Asian attention to economics was the creation of the Asia-Pacific Economic Cooperation (APEC) forum. APEC was heavily promoted by two of America's strongest Asian allies, Japan and Australia who saw APEC as a way to lock the US into Asia, but also to institutionalize the already developing regional production networks and enhanced trade and investment across the region with an institution that reflected the pan-Pacific nature of most Asian trade markets.

APEC was inaugurated in 1989 in Canberra, Australia but it got its biggest boost in visibility and clout in 1993 when President Bill Clinton turned the annual meeting into a summit of national leaders in the APEC summit in Seattle. APEC has twenty-one "economies" as members (thus allowing both Taiwan and Hong Kong to join). It has been pan-Pacific in membership including several states geographically "outside" East

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Asia such as the US, Canada, Mexico, and Russia. APEC was committed to the pursuit of three goals: trade and investment liberalization, economic development, and economic assistance (though members frequently differed on how much priority to give to each.). APEC has, like most East Asian regional bodies operated on the principles of consensus; it has been minimally legalized, thinly staffed, and consequently constrained from exerting binding control to resolve disputes involving member states (Kahler 2000a).

In the security realm, ASEAN had been created primarily to provide an institutional mechanism for the smaller countries of Southeast Asia to present a united front against the larger powers whose predacious capabilities they most feared. ASEAN thus emerged in response to perceived “external threats.” A key principle in ASEAN’s organization was respect for sovereignty and the non-interference in internal affairs of individual members. Equally important was the commitment to the peaceful resolution of disputes in 1976 under ASEAN’s Treaty of Amity and Cooperation (TAC) which all members have signed. It was these principles that allowed ASEAN to play an important role in resolving the conflict surrounding Viet-Nam’s invasion of Cambodia (Acharya, 2001).

Institutional cooperation did not move further until the creation of the ASEAN plus Three (APT), a format that began in mid-1995 when ASEAN sought to reach north to weave China, Japan and South Korea into an Asian counterpart organization that would meet with the European Union. The result was ASEM (the Asia-Europe Meeting). But more specifically focused on security was ASEAN’s initiative in creating the ASEAN Regional Forum (ARF) in 1994.

ARF like APEC was designed to deal with intra-regional matters, in this case security, rather than being aimed at protection from extra-regional forces. As such it has focused on fostering confidence building measures (CMBs) including military-to-military exchanges. ARF symbolically ties Southeast Asia and Northeast Asia together but as Barry Buzan (2001: 156) makes clear, because of ASEAN’s central role, the ARF was much more effective in tying the northern powers, especially China and Japan to Southeast Asia, than it was in tying Southeast Asia to the security dynamics of Northeast

Asia. That latter area has continued to remain far more internally divided over its national and collective security problems.

In large measure therefore, regional developments in economics and security proceeded along two rather separate and largely nationally-autonomous tracks even after the end of the Cold War. Few regional institutions were created and those that were remained primarily arenas for discussion aimed at developing consensus on a series of ad hoc problems. Whatever regional cooperation emerged was the result largely of lots of discussion and the search for overlapping interests, though without question some political socialization almost certainly took place (Acharya: 2001).

Despite the apparently high focus on economic development and the fostering of cross-border economic linkages through corporate activity and the much lower level of regional attention to security problems, there was an undeniable link between economic development and security across the region. It is important, as former Singaporean President Lee Kwan Yew (2007) reminds us, to acknowledge that the overall economic success of East Asia was due in no small part to its improved security situation. The US defeat in Viet-Nam gave countries across the region the opportunity to explore paradigms of economic growth that were based neither on Chinese or Soviet communism nor on US laissez faire market stratagems. Governments were free instead to mix-and-match with heavy doses of state-led and export focused development that drew heavily on the blue print that had brought about Japanese success. The result of course was the phenomenal economic growth seen first in Japan, then in the Asian NICs and later in China and Southeast Asia. And while this growth was contingent on the improved security climate across the region, it was also a major contributing factor to the primacy given by most governments to economic growth as opposed to an obsession with military build-ups and territorial confrontations.

## **Deeper Regionalism in the Economic Sphere: Responding to Exogenous Shocks**



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During the Cold War and for about a decade after it ended (at least in Europe), integration into the global economy remained of much higher priority to most East Asian governments than intra-regional economic integration. Virtually all national economies of the region depended heavily for their success on regular and sustained access to the US and global markets. Any closed regional economic fusion would have been self-destructive. Nevertheless, in January, 1992, the then six members of ASEAN signed the ASEAN Free Trade Agreement (AFTA). Yet, AFTA was designed not to create a closed customs union, but rather to reduce tariff and non-tariff barriers among the signing members as a way to enhance the global competitiveness of ASEAN firms and to create a sub-region that would provide a more commonly appealing market for external investment. AFTA relied on a Common Effective Preferential Tariff (CEPT) whose aim was explicitly identified as increasing the "*region's competitive advantage as a production base geared for the world market*" (ASEAN web site).

Nevertheless, the collective goal of integrating local economies with the broader global marketplace led to considerable cross-border investment that created the production networks. These provided a way for Asian multinationals to integrate more efficiently into the global economy. Japanese corporations and the Japanese government were initially the key drivers in this process of developing regional production networks. Typically Japanese official aid to Asia constituted 70 percent of the country's national total. Not at all coincidentally, the benefits of that aid were often as lucrative for Japanese companies as they were for the recipient Asian governments, preparing as it did, the groundwork for more long lasting Japanese corporate penetration of neighboring Asian markets.

As the U.S. reduced its Asian presence following the defeat in Vietnam and Richard Nixon's articulation of the Guam Doctrine, Japanese government monies loomed even larger as a source of region-wide economic development. Thus, by 1989, Japan accounted for 69 percent of total aid to Thailand, 62 percent of Indonesia's; 57 percent of Malaysia's, 48 percent of the Philippines', and 39 percent of China's (Kato, 1999: 4). Asia's economies began to soar, stimulated in large part by Japanese capital. As a consequence, so did Japan's regional prestige, both as a result of its aid and investment, but also as a consequence of

Japan's successful "developmental state" and the "alternative model of capitalism" Japan presented to developing Asia.

Individual companies, taking advantage of the increasingly valuable Japanese currency began heavy investments in various Asian countries with cheaper land and labor, spreading their production processes across several different countries. Into the early 1980s roughly one-quarter of Japan's investment capital went to Asia and absolute amounts continued to rise from about \$1.4 billion in 1982 to \$7.7 billion in 1989 (Okurashô, 1987: 451-53, 1991: 458-60). Between 50 and 60 percent of this investment was given over to manufacturing ventures. For many Japanese companies Southeast Asia provided a "way out" of the pressures created by rising domestic costs and monetary realignments; moving production overseas obviated the need to accept slower growth or corporate overhauls (Shiraishi, 1995: 171). Numerous Japanese firms, particularly in the consumer electronics and automobile industries, began an expanded, intra-industry division of labor throughout the Asian region and the regionalization of previously national production networks. (Doner, 1993; Hatch and Yamamura, 1996).

Just as Japanese aid had done from a governmental perspective, so Japan's expanded investment from private sources constituted a massive increase in the incoming monies for many Asian countries. Thus, in 1989, Japanese firms were investing four times more money in Taiwan as they had in 1985; five times more in Malaysia; five times more in South Korea; six times more in Singapore; fifteen times more in Hong Kong and twenty-five times more in Thailand. (Curtis, 1992 as cited in Fallows, 1994: 264). Most of the countries into which Japanese production facilities were moving realized exponential rates of economic expansion, driven in part by this surge of Japanese capital. The regionalization and internationalization of Japanese manufacturing was most clearly demonstrated in the fact that by 1995, Japanese-owned companies were manufacturing more overseas (¥41.2 trillion) than they exported from the home islands (¥39.6 trillion) (Far Eastern Economic Review, July 4, 1996, 45; Kubota, 1994). And the benefits for the countries in which Japanese investments flowed were also phenomenal as witnessed by the rapid growth rates and economic development that created the "Asian miracle."

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Meanwhile additional investments and production catalysts were flowing across the region along ethnic and family lines that led to enhanced business ties across “Greater China” (Katzenstein and Shiraishi, 1997; Pempel, 2005a). These have expanded with the dramatic economic success of China itself. For the most part, though often painted in zero-sum terms, China’s rise has expanded economic opportunities rather than economic competition for Japan, South Korea, Hong Kong and Taiwan (Perkins, 2007: 47)

At the same time, however, because of ASEAN’s industrialization and the rise of China, the original ASEAN 5 members have lost their previous advantage in factor endowment—particularly in unskilled labor. Thus, by 2003 ASEAN was attracting only 16 percent of the foreign direct investment coming into Asia, compared with China’s 66 percent—the exact reverse of their two positions in 1990 (Jones and Smith, 2007: 165). Even as the overall pattern of cross-border production networks continued, the specific locations of incoming direct investment shifted substantially.

The cumulative effect overall has been a big increase in cross-border investment and production which in turn has generated enhanced intra-Asian trade thus deepening East Asia’s regionalization. Between 1986 and 1992, for example, the intra-regional share of exports from Asian countries increased from 31 percent to 43 percent while dependence on the U.S. market fell from 34 percent to 24 percent (Kato, 1999: 6; IMF, 1995; Pempel, 1995: 54, 66). By 2006, intra-Asian trade had risen to 56 percent of total Asian trade, a figure higher than that even for the EU and Asian reliance on the US market had sunk even further.

But the pattern was long dominated by open-regionalization and East Asia continues to rely heavily on extra-regional product and capital markets. Thus, even though intra-regional trade is around 56 percent East Asia as a whole still depends heavily on extra-regional demand for exports as well as on external sources for approximately half of inward capital and foreign direct investment (Stanley Foundation, 2007: 7)

This combination of largely market and corporate driven ties, plus minimal formal governmentally-created institutions changed with the Asian economic crisis of 1997-98. This phenomenal exogenous shock made it clear that the previous patterns of economic development were potentially quite vulnerable to forces completely outside the region.

Consequently, during and following the crisis, a burst of collective enthusiasm arose across Asia for deeper and more formalized institutional arrangements—well short of those found in the EU, but vastly more comprehensive than what had been seen before the crisis. The drivers of this new regionalism were particularly the countries of ASEAN, and, following its accession to the WTO, by China. Japan, though it demonstrated considerable interest in cooperation on trade and investment, showed less interest in taking a leadership role in the forging of new Asian institutions aimed at more comprehensive cooperation and continued to approach Asian regionalism with an eye toward its security ties to the US. Furthermore, the new institutions were focused far less on creating a single regional bloc for *trade* and more on generating new mechanisms for *financial* cooperation.

When the economic tsunami of 1997-98 struck, most governments in Northeast Asia had been active shapers of their domestic economies even though they had done little to develop regional economic institutions. The rapidity and devastation of the economic wave that swept across Northeast and Southeast Asia brought home the heightened vulnerability of many Asian economies to unfettered global markets and highly mobile and exceptionally volatile capital flows—what Winters (1999) aptly characterized as plugging into a global economy without adequate governmental surge protectors. Furthermore, existing regional bodies demonstrated neither the willingness nor the ability to stem the spreading crisis. Finally, the crisis revealed how, with the end of the Cold War, the world had become far more unipolar and the US showed vastly less predisposition than it had previously to tolerate East Asian models of development when these conflicted with broader US economic or security concerns. The external environment had become far less conducive to doing business the old way.

The countries of East Asia responded with a combination of increased governmental actions aimed at taking greater control of their (and the region's) foreign economic policies. These represent what I have called (2005b) governmental “push-backs” against the forces of unbridled marketization and globalization that many Asian elites concluded had been responsible for the crisis. Formal institutions and overt governmental actions to shape them became much more characteristic of the region. No longer are Asian regional ties the exclusive byproducts of bottom-up market connections.

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Instead, since the crisis, more and more Asian governments, including those in Northeast Asia, have more actively embraced an enhanced and integrative regional architecture. Among the most powerful of these efforts have been measures to bolster regional cooperation in finance and trade (though not to create a closed trade bloc). A key goal has been mobilizing the region's underlying financial strengths in a collective region wide effort to ward off any possible repeat of the devastating impact of the global forces that devastated East Asia in 1997-98.

The only two regional economic institutions in existence at the time of the crisis, APEC and ASEAN, had proven completely feckless in warding off the crisis as well as in coping with its after effects (though in fairness neither had been set up with such a mandate). APEC further lost viability particularly in the eyes of American policymakers as a consequence of the failure of APEC's Early Voluntary Sector Liberalization (EVSL) process which it had been hoped would open Japanese agricultural markets (Krauss 2004; Tay 2006: 4). Finally, contributing to APEC's marginalization on economic matters across Asia was George W. Bush's singular focus on the region as a military front in what Richard Higgott (2004) has called American efforts to "securitize" economic globalization. At Bush's behest, APEC was pressed to compromise its original economic focus in favor of taking a collective stand in support of the so-called "Global War on Terror."

With a few noteworthy exceptions, ASEAN Plus Three (APT) became the predominant process that structured most of the subsequent regional architecture. The APT format began in mid-1995 when ASEAN joined with China, Japan and South Korea offering an Asian counterpart to meet with the European Union in what became ASEM (Asia-Europe Meeting). But starting in 1997, the ASEAN governments pressed to heighten the independent role of APT, expanding it from a series of meetings among senior officials to becoming a meeting of finance and economic ministers and eventually to forming a more institutionalized set of links with their major northern neighbors that culminated in an annual meeting of heads of state. This thirteen nation summit has since been the major engine fostering cooperation on a variety of regional problems, particularly in finance. As Kim (2004: 35) has argued, APT is regional but not anti-

global; it represents a collective Asian “search for new and better ways of managing the forces of globalization to the region’s advantage by combining the resources of Northeast Asia and Southeast Asia.” And of particular note for Northeast Asia the “plus three” countries, Japan, ROK and PRC, typically have met together on trilateral cooperation on the sidelines of the formal 13 country meetings since first agreeing to do so in October 2003. Since it began, APT has effectively provided a convenient regional forum within which various combinations of countries could work out particular bilateral problems or enter into other cooperative arrangements.

ASEAN was able to take the lead in the APT in part due to national rivalries in Northeast Asia. But the APT was also part of what Evelyn Goh (2007-2008: 121) has labeled “omni enmeshment” namely a Southeast Asian effort to entice its Northeast Asian neighbors into a series of formal institutions and governmental processes. And as Jones and Smith (2007: 152-53) have rightly pointed out in contrast to the predictions of realism, “a shared sense of weakness rather than strength facilitated ASEAN’s capacity to transform the regional order” leading to a discourse that was “conducted according to the nonlegalistic, consensus-oriented ASEAN way that represented a distinctive alternative to European styles of diplomacy...”

When the crisis began, many in Asia were frustrated by the slowness with which the US and the IMF sought to help. In response to the non-action from outside the region, Japan sought to provide the first assistance. In September 1997, during the early stages of the Asian crisis, the government proposed a \$100 billion "Asian Monetary Fund" designed to provide liquidity to the troubled economies. Though only vaguely formulated, Japan would have provided one-half of the funds with the remainder of Asia providing the other half. The idea was almost immediately rejected (Amyx, 2004: 201-207). Other Asian countries (most notably China) were neither anxious to see Japan gain enhanced regional influence nor anxious to part with their own riches to aid impoverished neighbors. Even more importantly, US Treasury Secretary Rubin and his deputy Larry Summers were lividly hostile to the plan, characterizing it as a potential institutional competitor with the IMF but also as undercutting American interests and influence in Asia (New York Times February 17, 1999: A8). Only with the Kuala Lumpur meetings of APEC in 1998 did a scaled down version of Japan's

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proposal gain acceptance, and then it was integrated with US, World Bank, and ADB measures.

In the aftermath of the crisis, however, the governments of Asia took a number of steps to create new institutions that would deepen their regional ties, complementing although not bypassing existing global multilateral fora. One of the first new moves was the Chiang Mai Initiative of May 6, 2000 begun under the auspices of the ASEAN + 3 (APT). CMI expanded existing ASEAN currency swap arrangements (ASA) and added a network of bilateral swap arrangements (BSA) among the ASEAN countries, China, Japan and the ROK. These were to provide emergency liquidity in the event of any future crisis (Amyx, 2008; Grimes 2006; Pempel, 2005b).

When the CMI originally went into effect, considerable stress was placed on the limited amounts of money involved, along with the underlying requirement that most swaps be congruent with IMF regulations. Yet, by early 2005, some sixteen bilateral swap agreements had been organized under CMI totaling \$39 billion. Then, at the 8<sup>th</sup> meeting of Finance Ministers of the APT in Kuala Lumpur on May 5, 2005 the APT agreed to double the amounts in existing swap arrangements, raising the total to \$80 billion. Subsequently on May 5, 2007, the Finance Ministers Meeting went much further when they agreed "in principle" to multilateralize the CMI through a reserve pool and a single contractual agreement for the drawing of funds. Such an arrangement would change what is currently a series of bilateral swaps into a more comprehensive reserve pool with a single contractual agreement that would centralize and multilateralize the entire arrangement.

Nonetheless, CMI is not designed to serve as an alternative to the IMF; rather it represents a regional arrangement that, among other things, is working to strengthen capacity building, transparency, and early warning in the less developed Asian economies. All the same, the swap arrangements simultaneously demonstrate a growing capacity for Asia to move collectively toward creating what elsewhere I have called a regional "firebreak" (Pempel, 2005b) against future monetary crises and a partial alternative to the region's previously unbridled dependence on the IMF and its policy prescriptions. Of at least equal if not greater importance for the future, the CMI has created an arena within

which further regional monetary and financial cooperation can be nurtured. And as Asian finance becomes more integrated, the result will be an even stronger case for enhanced Asian voting rights within the IMF (Rapkin and Strand 2003).

The more advanced economies in Asia have also moved to develop an enriched Asian Bond Fund through the regional central banks, while CMI has pushed an Asian Bond Market Initiative (ABMI). In combination these will provide an additional mechanism of regional financial collaboration likely to reduce Asian dependence on the US dollar for financial reserves, currency baskets, and international transactions. The first ABF involved a group of 11 Asian central banks and an initial size of \$1 billion (US). The APT Finance Ministers' Meeting subsequently opted to develop a local-currency bond market, including a regional clearing and settlement system, a bond rating agency, a trading system and so forth (Pempel 2005b, 2006b; Grimes 2006).

Driving these bond market endeavors is an effort to mobilize regional savings for intra-Asian investment thereby reducing the region's dependency on the US dollar. A bond market denominated in local currencies will also allow Asian borrowers to avoid the "double mismatch" problem that arose in 1997-98, i.e. borrowing short in foreign currency (mostly dollars) and lending long in domestic currencies. If effective it also promises to free many Asian borrowers from their longstanding dependence on bank borrowing for domestic capital needs.

Governments have also been moving actively and collectively on a series of common, though not regionalized, economic fronts. For example, most Asian governments, and in particular the three largest economies of Northeast Asia have also been aggressive in the accumulation of war chests of foreign reserves in response to the crisis and the collective sense of economic vulnerability felt across the region. East Asia's collective financial power has ballooned globally (and vis a vis the United States in particular) by this rapid increase in foreign reserve holdings. In 1998 total East Asian holdings totaled \$742 billion. By the end of 2007, the reserves of the four largest economies in Northeast Asia alone had ballooned to over \$3 trillion, roughly two-thirds of the world total and up from about \$1 trillion in 2001. The People's Bank of China and the Hong Kong Monetary Authority lead the way with \$1.53 trillion as of June 2006, with



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Japan a close second at nearly \$973 billion; Taiwan (not a member of APT) held an additional \$273 billion while the ROK had \$262 billion.

(<http://www.imf.org/external/np/sta/ir/jpn/eng/curjpn.htm>);).

In addition, most of the governments in the region have, since about 2001-2002, become active promoters of bilateral and multilateral Free Trade Agreements (FTAs) or Economic Partnership Agreements (EPAs) (Amyx, 2004, 2005; Grimes, 2007; Pempel 2005b, 2008). Such arrangements were virtually non-existent in Asia at the time of the crisis but they have quickly become a favored state instrument aimed at enhancing political control over trade and improving intra-regional trade ties. These now weave ever denser networks of trade throughout Northeast Asia, even though most of them reach beyond the immediate region, continuing open regionalism, and they also remain explicit components of each country's national trade enhancement strategy.

Closer contact and increased regionalism and regionalization have yet to shrink the central role played by individual national governments: "state governments, not regional institutional actors, remain the arbiters of East Asia's regional financial and trade orders." (Higgott 2007: 384). And to date, state actors have been somewhat slow and selective in turning to the newly created regional institutions as their first mechanism for problem-solving. For example, CMI was not used when the interaction of high oil prices and domestic fuel subsidies worsened the budgetary outlook and caused a currency crash in Indonesia in the summer of 2006, nor was it used when the Thai baht crashed in December 2007 due to the bungled imposition and removal of capital controls. CMI retains considerable potential but it can help to stabilize exchange rates only to the extent that governments use it. So far they have shown no inclination to do so (Eichengreen: 2007: 96). Moreover the bond markets are in their infancy and have yet to establish for themselves any major role in local capital markets. And finally, important as the FTAs have been in linking various East Asian economies to one another, they are also frequently arranged between Asian and non-Asian governments rather than being exclusively intra-Asia (e.g. the Japan-Mexico EPA, the Korea-Chile FTA and the proposed Korea-US FTA and Taiwan's FTAs with Guatemala, Nicaragua and Panama).

National competition rather than multilateral cooperation also continues in the different postures taken by Japan and China regarding FTAs with ASEAN. One of China's most important successes in combining its economic power with its regional strategy came with its proposal at the 2000 ASEAN Summit for an ASEAN-China FTA. Psychologically, the proposal helped bolster the impression that China's rise might generate a win-win economic cooperation with Southeast Asia in what would potentially be a market of some 1.7 billion people. Importantly, Chinese negotiators offered an "early harvest" of lower tariffs for agricultural goods from Southeast Asia coming into China. Prime Minister Koizumi was caught somewhat flat-footed by China's proposal. He in turn was able only to propose joint discussion of a comprehensive economic partnership that did not come into play until 2007, and one that excluded any serious liberalization of the Japanese agricultural markets. Since agricultural exports are so critical to the growth strategies of most countries in Southeast Asia, particularly its newer members, the Chinese move was particularly deft politically. ASEAN trade with China jumped almost 60 percent in 2005 over 2004 due largely to the "early harvest" (Weatherbee 2006: 275). In addition, China's move also underscored the extent to which democratic political systems could constrain countries such as Japan, the United States, and Korea, because though much richer, they were handicapped from making similar gestures due to the power of their domestic farm lobbies.

Finally it is important to note that even though economic interdependence may lead to collective prosperity and presumably toward lowered security tensions, it can also have the opposite effect of increasing tensions. Thus, economic success opens the door to military modernization and expanded defense expenditures, as we see with China, among others, today. And as the recent problems with Japanese imports of poisoned frozen gyoza or American imports of Chinese toys with lead paint have shown, economic interdependence can also leave markets open to new bilateral problems. Hence, even the most positive economic interdependence, in the absence of other moves to reduce national tensions, does not automatically forge regional peace or neighborhood harmony.

In short, Asian regionalism, though it has become more institutionalized and more Asia-centric in many of its new financial and economic institutions, has not been a major

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force in opposition to continued ties to global institutions such as the World Bank, the IMF or the WTO, even though many of them were created in response to perceived failures by these global institutions. Nor has it replaced many of the bilateral security and economic arrangements that continue to keep the US very deeply enmeshed in the region.

### **Security: New Institutions in the Face of Endogenous Threats**

Not surprisingly, the end of the Cold War saw a flurry of predictions that the longstanding tensions in Asia would surface, making the region a hotbed of rivalries (e.g. Friedberg 1993, 2002; Buzan and Segal, 1994). Certain recent events are compatible with these predictions. Thus, the increased economic might and military spending by China has touched off concerns among many of its neighbors as well as others outside the immediate area that military and territorial expansion and a challenge to the regional status-quo will quickly be forthcoming (e.g. Mearsheimer, 2001; Shambaugh, 2006). In August 2004, the United States began a rebasing strategy, aimed at giving greater flexibility and mobility to its Asia-based forces, including the capability to move “out of area,” presumably to the Middle East and Central and South Asia. Japan has moved away from its once “defensive defense” posture, taking on a more active and territorially-broader military role (Pempel, 2007; Pyle, 2007; Samuels, 2007; Soeya, 2005 *inter alia*). Cross-Straits relations became particularly tense following the election of an independence-minded DPP government in 2000 and China’s retaliatory passage of a law threatening military actions to prevent Taiwanese separation in March 2005; the combination fueled intense security fears across much of the region. Elsewhere, territorial squabbles periodically exacerbate certain already fractious bilateral relationships: Japan and the ROK over Dokdo/Takeshima, Japan and Russia over the Kuriles, China and Japan over explorations in what each claims as its EEZ and of course the unresolved Cross-Straits problem. More alarming than any of these at present however is the perilous deterioration in regional security that centers around the DPRK and its missile and nuclear programs.

All the same it would be a mistake to overemphasize the security problems in East Asia. For example, as Muthiah Alagapa (2003: 1-33) and others (e.g. Goh, 2007-08: 113; Kang, 2003) have shown although Asia is still fraught with a bevy of serious internal and international challenges, their number has gone down and most of the region's disputes and conflicts, while far from disappearing, have at least been stabilized. A number have actually been resolved and a series of confidence building measures have been taking place across the region. China and Russia have solved their various border disputes and demilitarized their 2,640 mile shared border; commercial interactions between the two (including increased military sales) have increased steadily (Weitz: 2007: 53). Furthermore, "although historical animosities and distrust among China, South Korea, and Japan, not to mention Russia, persist, in recent years, the conversations among the respective governments have tended to focus more on free trade areas and increasing cooperation at all levels." (Armstrong: 2006: 257-58) Overall, a common Northeast Asian attention to economic growth appears for the moment to have been given official precedence over irredentist territorial claims and military freelancing. Episodic problems continue to recur, but for the most part governments across the region have resisted exploiting them beyond the rhetorical level.

This relatively improved security climate can be appreciated by certain military statistics. As Solingen (2007: 757) points out: "Existing disputes have been restrained as never before in recent history, and major powers have normalized diplomatic relations despite continued tensions....Military modernization has not undermined macroeconomic and regional stability. Military expenditures relative to GNP have declined from 2.6% (1985) to 1.8% (2001), lower than world averages of 5.4% (1985) and 2.5% (2001), with parallel declines—in most states—in military expenditures relative to central government expenditures."

Nevertheless, what is clear is that, regardless of how one weighs the balance between danger and tranquility East Asia by the early 2000s had made few moves toward the creation of a regional security regime, let alone a common security community. During the Cold War, the governments of East Asia faced no commonly agreed-upon 'enemy' or external threat; instead they divided along bipolar lines aimed at one another.

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Even with the end of the Cold War, most bilateral alliances have remained intact and certainly there has been no emergence of any extra-regional threat (Certainly there has been no Asian “balancing” against the now single superpower, the US). In stark contrast to Western Europe facing the Soviet Union and its allies for the first forty-five years after World War II, or many Arab countries in the Middle East confronting Israel, East Asia faces no commonly perceived external threat. Rather, as Michael Yahuda (2004: 229) points out, “the defenses of most East Asian countries are directed against one another.” Moreover, many countries such as the Philippines, Indonesia, Thailand, and even China, continue to worry primarily about internal, territorially-rooted separatist movements driven by ethnic or religious differences and potentially underwritten from abroad. Regional approaches to security have thus been far less appealing across East Asia than they have been in trade and finance.

The main threats to East Asian security remain largely endogenous to the region itself. Yet on one of the most nettlesome security problems in Northeast Asia, namely the denuclearization of the Korean peninsula and the missile programs of the DPRK, there has been significant recent improvement, primarily as the consequence of fitful but effective regional cooperation combined with efforts to use regional economic inducement as a way to resolve a serious security problem.

As is well known, the DPRK, claiming the need for security from a putatively hostile US, was accused of starting a nuclear program and threatening to leave the NPT. This crisis spanned an eighteen month period during 1993-1994 and nearly triggered a US military strike. Eventually, bilateral negotiations between the US and the DPRK led to the 1994 Agreed Framework under which the DPRK program was halted. The DPRK remained within the NPT, IAEA inspectors oversaw potential DPRK nuclear facilities, and in exchange the North was promised energy aid, most notably a light water reactor. A mini-regional body, the Korean Peninsula Energy Development Organization (KEDO) was established by the US, Japan and the ROK to deal with the energy portion of the agreement (the EU later joined as a member of the KEDO executive board). Until 2002, despite much delay in delivering on promised aid, as well as many DPRK threats to the surrounding area (not least of was a missile test over Japan in 1998), the Agreed

Framework held and a measure of tense stability took root. Indeed, Japanese Prime Minister Koizumi even went to Pyongyang in September, 2002 in an effort to normalize Japanese-DPRK relations.

This changed in October, 2002. The US confronted the DPRK with the claim that it had evidence of DPRK violations of the Agreed Framework, most specifically in starting an HEU program (separate from the plutonium program at Yongbyon that had been shut down). The US charges were interpreted by the DPRK as part of a broader and threatening change in US policy, namely the US claim by Bush in January 2002 that the DPRK was part of an ‘axis of evil,’ one leg of which, Iraq, was subsequently invaded in March, 2003 along with the overt US shift under George W. Bush to a foreign policy explicitly embracing the right to wage preemptive war. In response (or as critics would contend, as part of a longstanding plan to develop a nuclear capability), the DPRK left the APT, ended IAEA inspections, and began a rushed program of both missile and nuclear testing (Pritchard, 2007). In combination these recent events left Northeast Asia quite tension-filled. Eventually, the DPRK announced the successful test of a nuclear device in October, 2006, following a series of missile launches the preceding July.

In an important break with prior bilateral US-DPRK negotiations, the most recent crisis catalyzed a new multilateral process, the Six Party Talks involving the two Koreas, the US, Japan, China and Russia. China has chaired the talks. The decision to address the problem through the Six Party Talks was a signal victory for multilateralism over bilateralism (as well as for negotiation over confrontation), even if the participating parties did not include all “East Asian” states. For roughly two years, the talks saw little real negotiation; instead they served largely as an arena for speech making and posturing, particularly by the US and the DPRK. The US (in response to pressures from both Japan and China) finally changed its posture in Fall 2005 and demonstrated an explicit willingness to reverse its prior stance of an obdurate demand that the DPRK surrender all nuclear weapons capabilities as a precondition to actual negotiation; instead the US began engaging the North in a substantive give-and-take. It was then that the multilateral process that had begun in August 2003 finally gained traction. The result was the Joint

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Statement of the Fourth Round of the Six Party Talks, signed by all parties in Beijing on September 19, 2005.

This Joint Statement provided a major breakthrough in the long-stalled process and offered the fundamental outlines for the eventual resolution of the complex mix of security and economic issues. Six points were critical: 1) the verifiable and peaceful denuclearization of the Korean Peninsula; 2) a return by the DPRK to the NPT and the IAEA inspection regime; 3) guarantees by the United States not to attack the DPRK, a respect for its sovereignty, and the commitment to negotiate a permanent peace regime on the peninsula; and 4) promotion by all six parties of economic cooperation on a bilateral and multilateral basis (full statement and details at <http://www.state.gov/r/pa/prs/ps/2007/february/80479.htm>.)

Many problems remained unresolved, most notably the absence of any step-by-step timetable for achieving the goals laid out. Moreover, many of the joint statement's specifics were open to competing interpretations. The devil, of course, lay in the details. Initial optimism proved ephemeral. The talks broke down soon after the signing. Almost simultaneously with the issuance of the Joint Statement, the DPRK demanded a light water reactor (promised by the US as part of the Agreed Framework of 1994) as the first step in the process while the United States Treasury froze \$24 million in DPRK banking assets in Banca Delta Asia (BDA) claiming that the account was being used for money laundering. Mutual recriminations flooded the airwaves. The DPRK walked out of the talks, refusing to return until the American 'economic sanctions' had been lifted. Unsuccessful efforts were made to resolve issues and to restart the talks at the NEACD meeting in Tokyo in April, 2006 and later at the ARF meeting that summer. Then in early July, 2006 the DPRK tested a series of missiles that led to a strong U.N. Security Council resolution of condemnation. On October 9, the DPRK carried out an actual nuclear test and in less than a week, the United Nations Security Council unanimously passed an even stronger resolution (#1718) condemning the DPRK's actions. The DPRK promised a second test soon after. By mid-Fall, 2006, the complicated and overlapping alignments among the Six Parties that had characterized the preceding three years of negotiations had shifted into a five versus one line up, with the US, China, Japan, the ROK and Russia all

supporting the resolution and agreeing to impose varying degrees of sanctions against DPRK trade, travel and transportation. (In addition to the formal sanctions on trade in a host of technological and luxury goods, my confidential interviews with participants indicate that China apparently suspended certain military assistance to the DPRK, not visible in typical trade statistics, as a way to telegraph its discontent with the North's behavior.)

Bilateral talks within the Six Party Process had always been a key component of their movement forward. But an important breakthrough took place when the US agreed to meet with DPRK negotiators *outside* the Beijing framework, specifically in Berlin in January, 2007. These talks along with the return to the DPRK of the monies frozen at BDA allowed talks to resume on February 8, 2007 and a major statement was issued on February 13. It was largely the September, 2005 agreement that formed the core of the deal. In essence, the DPRK agreed to shut-down its Yongbyon nuclear facilities, to welcome back IAEA inspectors, and to dismantle its nuclear program and to refrain from any actions that would transfer its nuclear technologies to third parties. In return the US agreed to begin the process of removing the DPRK from its list of state sponsors of terrorism and to move toward normalization of diplomatic relations. As of early February 2008, nine of the eleven steps in the dismantling and disablement of the Yongbyon facilities had been completed, but a distinctive slowdown in the process was clear, in part triggered by the DPRK's claim that there had been delays in the fuel deliveries that had been promised. In essence, the arrangement involved a mixture of security and economic incentives from and to the parties involved.

It remains, of course, to be seen whether the Six Party Talks will in fact eventually resolve the existing problems without armed conflict. But in the interim it is vital to recognize the fact that a regional multilateral process is working, however fitfully, within the East Asian security arena. So far it has at least damped down tensions that might otherwise have flared up into actual military strikes. And a key component of the February 13 agreement is the creation of a series of five working groups, several of which are aimed at addressing a series of bilateral issues, and one of which optimistically looks forward to the establishment of a joint Northeast Asia peace and security mechanism to



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replace the Six Party Talks, once the immediate issues are resolved. Clearly a “Concert of Powers” is now operating on this issue and might well continue to do so in the future.

A central objective of any security and peace mechanism for Northeast Asia and one that is largely shared by the other five participants in the Six Party Talks is to integrate the DPRK into the regional economy. Such regional economic integration would create cross cutting pressures on the DPRK leadership concerning its current military strategy and its emphasis on forward deployment of conventional forces. Some of this is already going forward. As Khanna (2008: 271) has suggested both the ROK and China are already engaged in the “capitalist colonization of the nuclear-armed but destitute North Korea, which lies between them.” China has bought up the DPRK’s mines and railways while the ROK has opened joint production and export zones in the North. Increasingly, economic activities between both China and the ROK on the one hand and the DPRK on the other are moving from direct grants to commercial interactions. For the talks to lead to the denuclearization of the Korean peninsula, massive aid from Japan and the ROK, plus closer economic ties with China and energy links to Russia, are a certainty.

As was noted in the section above on economics, it is naïve to assume that greater economic interactions alone will eliminate or greatly reduce conflicts in national interest. But the long term success of East Asia as a region lies in its decades- long concentration on rapid economic transformation and improved living standards for its citizens. To hold out such a vision of growth and regional economic integration for the DPRK’s leaders is likely to be a powerful motivation toward changed behavior and closer links to the immediate neighborhood.

Perhaps, the most long term promise of moving tough security issues off the saber rattling stage and into the negotiating arena lies with the fifth working group set up under the Six Party Talks. That group is charged with establishing a joint instrumentality for long term peace and security in Northeast Asian. It would build upon any successes achieved by the Six Party Talks and their regularized top-level meetings to begin to address other security problems, both tradition and non-traditional security issues, that plague the region..

One other regional security forum deserves mention, namely the Shanghai Cooperation Organization (SCO), even though it is geographically outside “East Asia.” But with Russia and China as two of its six members it is worth at least noting briefly. SCO began in 1996 (with the Shanghai Five) and was officially launched with its current six members on June 15, 2001. SCO has internal military security as its primary focus. The military forces of the six members have held joint exercises annually while there has also been agreement on economic cooperation, particularly within the energy field. (SCO website at <http://www.sectsco.org/html/00026.html>)

The SCO is primarily concerned, like the Six Party Talks with security problems endogenous to the members (specifically identified as terrorism, separatism and extremism). Its charter states explicitly that it “is not an alliance directed against other states and regions and it adheres to the principle of openness.” Nevertheless, it also has the consequence of making it more difficult for the US or NATO countries, now engaged militarily in neighboring Afghanistan, to think quite so easily about further actions in Central Asia. It also provides a potential response to US advances in the deployment of its missile defense systems.

In both the Six Party Talks and the SCO, we see significant moves toward regional security multilateralism. This regionalism is not directed at creating a security community to withstand or offset some external threat, but rather to provide a “community” approach to endogenous security threats—North Korea in the case of the Six Party Talks and separatism and terrorism for SCO. Importantly, both fora provide umbrellas under which member states can seek to deal with outstanding issues either on a multilateral or bilateral basis. But also valuable as students of such organizations have long pointed out, they also provide power mechanisms for socialization of members into common patterns of conduct and collaborative norms, the end result of which potentially is greater understanding of competing motivations and eventually, reduced conflict (Acharya, 2001; Wendt, 1999, *inter alia*)

### **In Conclusion: Toward Regional Integration of Economics and Security**

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One final regional forum should be noted, and it provides a partial transition toward concluding remarks. The forum, namely the East Asia Summit, was begun in 2005. Initially proposed by the East Asia Vision Group (EAVG) which had been set up under the aegis of APT, the EAS met for the first time in December 2005. Its primary goal was to move toward the creation of an “East Asian Community” that would cooperate on a host of issues, including, but not restricted to, economic cooperation and development. EAS was initially opposed by many in Washington as either irrelevant without the US or as an explicit threat to US interests. In parallel, some APT countries, most notably Japan, but also including Indonesia and Singapore were troubled about the growing and possibly disproportionate influence of the PRC in the Asian region as a result of the APT. Hence, EAS was kept separate from APT and its membership was broadened from the thirteen members of APT to include India, New Zealand and Australia. The first EAS meeting was long on rhetoric and short on tangible outcomes.

At its second meeting in Manila in January, 2007, the Summit laid out an ambitious framework for regional cooperation on a number of issues, including energy, environment, economics, education and a host of non-traditional security challenges such as pandemic diseases. It also lent its support to efforts at a more traditional security issue, namely denuclearization of the Korean peninsula. This sweeping orientation was continued in the third EAS meeting in Singapore in November, 2007.

It remains unclear whether or not EAS will prove to be a viable and influential regional body, and if so, within what problem areas. However, its structure replicates at least in part the more closed regional character of APT (though expanded to include the extra three countries rather than including the US as does ARF and APEC). Additionally, it is a body that clearly focuses on the comprehensive security and economic issues being faced by the countries of East Asia. So far its actions have been largely advisory and admonitory, but working groups are now studying a host of regional problems and potentially this forum could prove to offer a serious regional mechanism for the overt fusing of a broad range of economic and security issues faced by its members.

Regardless of the rhetorical promises of these various fora in East Asia, regional institutions have still not replaced either bilateral or global interactions for most states...

Instead they provide one more forum within which government can pursue national interest. However, as a consequence of regular participation in regional institutions a process of socialization can, and often does, take place creating greater overlap in goals and identities and processes of conflict resolution. And to date that process has clearly begun in East Asia.

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