Policy Report: Governance of East Asian Regional Economic Architectures

S. RAJARATNAM SCHOOL
OF INTERNATIONAL STUDIES
A Graduate School of Nanyang Technological University

Edited by
Theresa Robles & Kaewkamol Pitakdumrongkit
November 2013

RSIS Policy Report: Governance of East Asian Regional Economic Architectures

Centre for Multilateralism Studies
S. Rajaratnam School of International Studies

Contents

Introduction

Kaewkamol Pitakdumrongkit
Research Fellow
Centre for Multilateralism Studies
S. Rajaratnam School of International Studies (RSIS)

The RSIS Centre for Multilateralism Studies held a workshop on "Governance of East Asian Regional Economic Architectures" on 10 September 2013. East Asian states are increasingly fostering economic cooperation in several areas such as trade, finance and investment. However, efforts to construct or improve regional economic governance are facing challenges—both from economic and political factors. This workshop aimed to: (i) identify economic and political challenges to East Asian economic governance, and (ii) suggest policy recommendations on the next steps to strengthen regional economic governance. Experts from around the region were invited to share their insights on how to address such challenges to enhance regional economic governance in the future. The commentaries in this policy report emerge from the presentations and discussions at the workshop and are divided into two groups.

The first group of commentaries discusses East Asian trade architecture and addresses the following issues. What are the prospects for the further development of bilateral, regional and intra-regional free trade agreements (FTAs) and the ASEAN Economic Community? What are the economic and political factors hindering the achievement of such arrangements' objectives? Moreover, as East Asia in recent years has witnessed a proliferation of FTAs which have complicated regional trade governance, what are the possible implications these developments can bring? For example, how do the different regional trade groupings (e.g. the Trans-Pacific Partnership [TPP] and the Regional Comprehensive Economic Partnership [RCEP]) complement or conflict with each other? How does international political competition play a role as these emerging groupings race to shape international trade rules? How could these overlapping mechanisms be managed to create a cohesive regional trade regime? The commentaries in this volume note that the dynamics between major regional projects, namely the TPP and the RCEP, can be made complementary if certain actions are taken. One of the commentaries contends that as different regional and global architectures have their own strengths and gaps, the former's strengths can fill in the latter's gaps and vice versa to enhance both regional and global trade governance.

The second group of commentaries explores regional monetary and financial architecture in the following ways. What are the prospects for the further development of regional mechanisms such as the Chiang Mai Initiative Multilateralisation (CMIM) and ASEAN+3 Macroeconomic Research Office (AMRO)? What are the economic and political challenges that prevent these regional efforts from achieving their goals? Considering East Asian monetary and financial architecture in a global context, how can regional projects be crafted to work together with the global mechanisms such as the International Monetary Fund (IMF)? The authors agree that the CMIM must be improved further. The future prospects of the CMIM hinge on how countries deal with issues such as the IMF de-linked portion and the AMRO's future. The creation of regional expert networks is needed to help lessen political economic tensions which could arise during the CMIM's development. One author notes that the CMIM could be used to enhance East Asia's influence in global institutions such as the IMF, and that as some East Asian states are increasingly promoting the use of their local currencies as an alternative to the U.S. dollar, the dominance of the U.S. currency will not go uncontested.

4 Policy Implications and Recommendations

- Profound and rapid change in the global political and economic landscape is driving the evolution of regional and global economic architectures. Shifting power configurations, changes in the flows and patterns of trade and finance and the limited ability of existing instruments and institutions to adapt to all these new developments have important implications for the governance of East Asian regional economic architectures.

- With regard to trade, the global trading regime has been called into question by the stalling of the Doha Round and the inability of World Trade Organization (WTO) rules and regulations to keep pace with the changing trading environment, including the expansion of global production networks and value chains. The proliferation of FTAs over the past two decades has complicated global and regional trade governance even further.

- Managing these overlapping agreements is crucial in creating a cohesive trading system. Different FTAs can be made complementary. For example, the RCEP can adopt the goals of the ASEAN Economic Community (AEC) such that commitments are aligned with existing external economic policies and domestic reform priorities. Agreements under both the RCEP and the TPP can be multilateralised over the long run. Accession criteria must be transparent and membership should be extended to new members who are willing to meet the standards and commitments covered by the RCEP and the TPP.

- Beyond FTAs, global and regional trade mechanisms and institutions should also be made complementary as each has its own strengths which can fill in each other's gaps. For example, ASEAN is more effective than the WTO on investment protection while the ASEAN relies on the WTO for dispute settlement and trade policy monitoring. Hence, constructing global and regional trade architecture should be viewed as a two-way process. Policymakers should find a way to build on the current global architecture to create effective regional institutions. Likewise, effective regional mechanisms can be used as building blocks towards a stronger multilateral trading system.

- On finance, recent developments in the CMIM and the AMRO are promising steps towards a stronger East Asian financial architecture. However, deepening regional financial cooperation is facing challenges such as leadership tensions, collective action problems, structural diversity and weak regional identity and norms.

- Strategies to advance East Asian financial cooperation include (i) principled minimalism (through regionally coordinated minimal principles that could evolve with the global financial system), (ii) decomposition and linkage (promoting cooperation through expectations of future benefits or gains in non-financial areas) and (iii) informal intermediaries (through Track 2 diplomacy).

- Emerging economies in the region have struggled to gain more influence in global financial governance and have been relying on mini-lateral frameworks (e.g. BRICS and ASEAN+3) to promote cooperation to push shared interests and establish favoured rules and norms.

The RCEP and the TPP towards Open Regionalism

Shiro Armstrong
Research Fellow
International Development Economics
Crawford School of Public Policy
ANU College of Asia and the Pacific

The opening up of economies in East Asia and their economic development to date has been underpinned by a robust, open and non-discriminatory global trading system. That is no less important today in providing confidence to countries to continue to deepen economic integration, and keeping them from sliding into protectionism. It also provides the opportunity for new players to join regional and global production networks and supply chains. Yet that global trading system has been weakened with the stalling of the Doha Round in the WTO, the inability of the WTO to stay relevant to current cross-border commerce and the proliferation of preferential or "free trade" agreements that undermine the core principle of non-discrimination in the General Agreement on Tariffs and Trade (GATT) system.

FTAs are at best only part of the solution to further international trade liberalisation and have resulted in a noodle bowl of overlapping agreements in East Asia and the Asia Pacific. The TPP agreement and the RCEP mega-regional agreements have emerged in the vacuum at the global level, in an attempt to deal with the noodle bowl problem and, more hopefully, to define a way forward on new issues in the trading system.

The TPP and the RCEP may end up either providing ballast to the global trading system—and bringing some coherence to the many bilateral and overlapping FTAs in the region—or undermining it, by adding more bowls of noodles within the larger bowl.

The 12 Asia Pacific members negotiating the TPP are attempting to set rules for economic exchange that reflect commerce in the 21st century. These rules cover issues such as intellectual property and data flows, and aim for high standards in areas such as labour and environment. Among its negotiating members are Australia, Japan, Malaysia, Mexico, New Zealand, Singapore, the United States and Vietnam.

The RCEP consists of ASEAN members plus six of their FTA partners in China, Japan, South Korea, Australia, New Zealand and India. The RCEP starts from existing ASEAN+1 agreements and consolidating these agreements would seem to be a good starting point. Yet harmonising and consolidating the ASEAN+1 FTAs into the RCEP will be difficult and complicated, possibly more so than starting from scratch, if pursued simply as another FTA negotiation.

The worst-case scenario is for these agreements to become competing, exclusive blocs with very little overlap in membership. It is already clear that it will be difficult for China to join the TPP given the high hurdles for membership and the U.S. Congress will not easily facilitate U.S. membership in the RCEP.

These agreements need to be complementary and outward-looking. That means they should minimise discrimination towards non-members and be open to adding new members.

The two agreements are quite different in their approach and process, and potentially quite different in outcome. The TPP, which has completed 19 rounds of negotiations, is a single undertaking that is allowing carve outs and bilateral deals in some areas to achieve a high-standard agreement. The RCEP starts with more flexibility in its Guiding Principles with special and differential treatment for developing countries, while still aiming for a high-standard agreement. It is also at the early stages with the second round of negotiations in September.

Negotiations for the RCEP aim for completion by 2015 and the TPP is pushing for an ambitious conclusion as early as the end of 2013. Given the scale and importance of these two mega-regional agreements, they will need to be living agreements beyond their initial conclusions. Flexibility is a strength of the RCEP given that common objectives can be pursued through different paths and the interests of the less developed members will be met, but it could also be a weakness and limit greater liberalisation.

An Expert Roundtable has proposed moving each of the ASEAN+1 FTAs towards common AEC objectives which would be easier and more productive. This would make the RCEP a truly living agreement with initial commitments negotiated by 2015 and an end goal of binding targets for 2025. That would mean the process does not stop in 2015 when the negotiations finish, but that cooperation and implementation, with capacity building, towards hard targets starts in 2015.

The RCEP can adopt the four core goals of AEC, which are (i) a single market and production base, (ii) a highly competitive economic region, (iii) a region of equitable economic development and (iv) a region fully integrated into the global economy. The AEC target of 2015 will not be met by ASEAN but it is an on-going process which the six other members of the RCEP can join and contribute to.

A shift of this sort from a traditional FTA negotiating framework would mean there can be more of an alignment of external economic policies and domestic reform priorities that have already been committed to. There will be the external pressure as with other agreements, but with individual pathways, priorities and with inbuilt regional support.

Many aspects of the AEC, such as its connectivity agenda, will not be discriminatory and the benefits extend to non-members. Other areas can be multilateralised over time, consistent with past ASEAN practice, and a starting point would be for the economies with overlapping RCEP and TPP membership to extend their RCEP market access commitments to TPP members.

Similarly, although it will be harder, TPP members can extend preferences to RCEP members over time, and both agreements can be multilateralised over the longer term.

Finally, both agreements have open accession as a core principle. For that to be operational, both agreements should have transparent accession criteria and be open to new members willing to meet standards and commitments. The TPP should be ambitious and practical in this and one idea is to welcome any new regional members willing to subscribe to a corresponding level of commitments made by a founding TPP member, one whose level of economic development or economic structure it most closely resembles at the time of accession.

The TPP and the RCEP are game-changers in regional economic governance and architecture. The key question is whether they will ultimately be forces for furthering economic integration of regional economies into the regional and global economy, or whether they further fragment trade and investment.

Integrating the Old and the New Trade Architectures: WTO and ASEAN

Michael Ewing-Chow
Associate Professor
Head, Trade and Investment Law and Policy
Co-Director, ASEAN ITL Research Project
Centre of International Law
National University of Singapore

When I.M. Pei unveiled his proposed addition to the Louvre in the form of a glass pyramid, many Parisians voiced their discontent arguing that such a modern edifice would not integrate well with the classical architecture of the Louvre. History has lain to rest most of those fears and today, many acknowledge that the modern structure not only integrates well with the old but potentially enhances it. With careful design and planning, I.M. Pei showed that the old and the new could enhance each other beyond just the sum of their parts.

Can we be as optimistic about the complementarity between the long-established global trade architecture represented by the multilateral WTO and the newer regional initiative within ASEAN to develop the AEC?

Unfortunately, such institutional architecture cannot be easily seen, envisaged or modelled unlike physical structures. Economists such as Jagdish Bhagwati argued that such regional trade agreements (RTAs) potentially undermine the multilateral system because they create trade diversion and a "spaghetti bowl" of complex obligations that require high transactional costs to navigate. This is true. RTAs in theory do create these problems though with the current impasse in the WTO trade negotiations, they probably represent the best alternative to add any further liberalisation to the existing trade architecture.

I do not propose to examine each and every element of the WTO and compare them with their ASEAN institutional counterparts to determine if ASEAN offers more. Instead, I will look at the larger systemic issue of governance and suggest where gaps in the edifice of the WTO may be filled by ASEAN and vice versa. In order to do so, I propose to start with the concept of Legalisation in the context world politics.

In 2000, the journal *International Organization* published a special issue that proposed a new way to look at international institutions. Prominent political scientists Abbott, Keohane, Moravcsik, Slaughter and Snidal suggested that the legalisation of international institutions should be studied because both "legal and political considerations combine to influence behaviour". They argued that Legalisation had three dimensions—Obligations, Precision and Delegation. Obligation refers to the binding nature of a norm, Precision refers to how clearly the norm is stated and Delegation refers to "the extent to which states and other actors delegate authority to designated third parties—including courts, arbitrators, and administrative organisations—to implement agreements". Today, Legalisation is accepted as a useful principle in the design of international institutions so as to clarify norms and encourage bargains to be kept. This would be a useful starting point to compare the efficacy of the WTO and ASEAN in the same way that an architectural blueprint could be analysed based on the initial client's briefs or requirements.

If we look at the structure of the WTO, clearly specified obligatory norms are in place regarding trade in goods and trade in services in the form of GATT and the General Agreement on Trade in Services (GATS). The WTO also has a very effective dispute settlement system through the Dispute Settlement Understanding (DSU) as well as a WTO Secretariat that is highly competent and experienced. The Secretariat is critical for the implementation of the regular Trade Policy Review (TPR) process in which WTO members regularly agree to receive monitoring teams and transparently explain their trade policies to other WTO members. The WTO, however, has very limited disciplines on investment protection (mainly in the Trade Related Investment Measures prohibiting local content requirements and Mode 3 of the GATS relating to commercial presence of service suppliers). While this gap was proposed to be covered by negotiations in the Doha Round, many developing countries opposed this fearing a hidden agenda by the developed, capital exporting countries. Today, investment obligations are off the negotiating table at the WTO.

This gap is somewhat problematic. Globalisation has resulted in the rise of Global Value Chains (GVCs) where Multinational Companies (MNCs), like the famous case of the Apple iPhone, produce component parts in many different countries and assemble them in another while doing research and development in yet another. The WTO disciplines only protect the movement of goods between these countries but do little to ensure that the investments needed to produce the components are protected from arbitrary or unfair discrimination by host governments. This hole in the existing WTO architecture limits the spread of GVCs and creates vulnerabilities in existing chains where the weakest link may be hosted in a country with limited Rule of Law.

In the ASEAN region, the AEC plugs this gap. Soon after the ASEAN Charter was ratified in 2008, ASEAN members entered into the ASEAN Comprehensive Investment Agreement between themselves and followed that up with International Investment Agreements (IIAs) with Australia-New Zealand, China and South Korea. Future IIAs with Japan and India are also in the pipeline. These IIAs coupled with ASEAN's RTAs with those regional countries attempt to facilitate and strengthen the GVCs in Asia. Some ASEAN members (not all) are also involved in TPP negotiations and the nascent RCEP discussions. Regardless, at least on Investment Protection, ASEAN has been more effective than the WTO in Precise Obligation Creation, perhaps because all ASEAN members being developing countries were in accord about the need to carve out policy space and were therefore less distrustful of the agenda.

Beyond the issue of Investment Protection, ASEAN has not been any more successful than the WTO in creating new Obligations on Agriculture and Services. While ASEAN has agreements covering trade in goods and services, concrete WTO Plus obligations have not been easily agreed upon. Yet, the biggest gap in ASEAN has been in the Delegation dimension. ASEAN members have agreed and ratified the Enhanced Dispute Settlement Mechanism for economic disputes which is modelled on the WTO DSU, albeit with even tighter timelines. However, the ASEAN Way based on building consensus and avoiding confrontation has resulted in a reluctance to refer matters for resolution to dispute mechanisms within ASEAN. Instead, when trade disputes between Malaysia and Singapore and between Thailand and the Philippines arose, these ASEAN members referred the disputes to the WTO.

Discussions with officials involved in those disputes suggested that they trusted the institutional set up of the WTO more as the ASEAN Secretariat had limited experience and a very small staff of lawyers to manage such cases. The meagre resources of about US$15.8 million per annum provided to the ASEAN Secretariat have limited the in-house capacity of the institution. At the same time ASEAN members are wary of empowering the ASEAN Secretariat to monitor the AEC implementation. The AEC Scorecard is largely self-reported, limited to ratification and legislation (as opposed to implementation and enforcement) and not transparently discussed. This is puzzling since all ASEAN members are now WTO members and have agreed to subject themselves to the WTO TPR process where WTO Secretariat staff monitor and report on trade policies and the implementation of WTO obligations in a transparent manner.

So how well does the new ASEAN architecture sit with the older WTO one? It does it fairly well in the dimension of Precise Obligation Creation relating to trade and investment policy through the IIAs it has negotiated. In other areas, it has not been significantly more successful than the WTO in negotiating more liberalisation in Agriculture or Services. On the institutional level, ASEAN leans on the WTO structure for dispute settlement and monitoring of trade policy. The common explanation for this is that ASEAN was never conceived as a supranational organisation and the idea of delegating such matters to a strong institution is against the ASEAN Way.

Yet, all ASEAN members have already done this in relation to the WTO. Over-reliance on the WTO is unsustainable in the long term as WTO Plus issues (and obligations) will arise with closer ASEAN economic integration. This is already the case with the monitoring of WTO Plus obligations for the AEC—the WTO does not focus on it and the ASEAN Scorecard is insufficient. Instead, we need to find a way to build on the current global architecture, model the new infrastructure on the familiar (subject to relevant contextual modifications) so as to build effective regional institutions. Conversely, the global architecture can use the regional agreements as building blocks towards multilateral liberalisation by using them as new foundations or baselines. Only then will both the new and the old components and integrate effectively.

Asian RTAs and Singapore's Perspectives

Linda Low
Senior Research Fellow
Asia Competitiveness Institute
Lee Kuan Yew School of Public Policy
National University of Singapore

Three key points are highlighted in this commentary. One is the rise in the number of members of regional groupings as enlargement is counterbalanced with the improvement in the quality of the role of ASEAN and the incremental achievements of the ASEAN Free Trade Area, from the realisation of the AEC by 2015 to the latest ASEAN-led RCEP. All these together with the U.S.-led TPP, a Pacific mini-WTO, suggest the emergence of different groups aligned with different leadership.

Developments in the ten ASEAN member states reflect the changing regional and global environment, including the good, the bad and the ugly of globalisation. It is one of the most successful regional groups among developing nations, if not across Asia. Capacity-cum-capability building in ASEAN projects shows a two-track ASEAN of older and experienced members (ASEAN-6) on one hand and Cambodia, Laos, Myanmar and Vietnam on the other.

Nested within the RCEP is a potential East Asia FTA for China, Japan and South Korea. If ASEAN seems marginalised or redundant as a buffer, the RCEP offers catch-all inclusivity. Duplication and overlapping of FTAs and RTAs are not a major concern for politicians. At the same time, it is grist for the mill for economists and econometricians churning up trade models to predict before-and-after outcomes.

In the literature of economic and trade integration, the perception of a common threat is usually the glue that drives the process. Mindful of the next wave of globalisation or deglobalisation with outsourcing and offshoring reaching their limits, job creation is the universal goal driving trade integration.

Politics in East Asia, however defined, stand side-by-side with the primacy of economics. It may be easier to forget than to forgive history to pave the way for potential future ventures. It takes leadership, better still, congruent leadership of all parties to move from the past, as well as the politicians' ability to get support from their respective electorates. At the end, domestic politics prevails.

The second point is on the wider construct of the political economy of trade and liberalisation and its effects on FTAs. A subtle shift from bilateral FTAs to embracing RTAs is as fashionable as pragmatic. However, the assumption that ASEAN speaks and acts as one in the RCEP needs both imagination and diplomatic agility. When push comes to shove, a communiqué which does not necessarily paper over issues but acknowledges the need to move on can still be worked out. RTAs are good building blocks, as existing studies on foreign direct investment (FDI) and MNCs recognise that regionness or regionality matters.

Both FDI and MNCs are not located in Singapore per se; instead, they tap its comparative advantage as headquarters and training or R&D hub for ASEAN or the wider Asia region. Singapore is skilfully adaptive and is able to tap FTAs and RTAs as a platform for block-building opportunities.

The choice of partners in trade and investment liberalisation is relevant to the political economy of building blocks. Starting FTAs with the members of the Organisation for Economic Co-operation and Development gives Singapore leverage when it comes to quality. In any project, Singapore is mindful of full implementation, even with details of customs procedures. All in all, building blocks aligned with multilateral WTO rules facilitate, not clash, with North-South or South-South realpolitik.

The third point drills down to Singapore's foreign economic policy. It encapsulates ever-changing geoeconomics and geopolitics amidst the rising middle power of Indonesia in ASEAN, subdued and more domestic-oriented growth in China and the U.S.-led TPP. A simple question to consider is whether the city-state's hinterland is ASEAN, East Asia or the wider Asia stretching to the Indian subcontinent. Should Singapore's focus be international in the post-global financial crisis (GFC) era? Ideally, straddling both with able statesmanship is realistic and acceptable. Singapore, like Japan, has always been globally-oriented with regard to FDI, MNCs, economic competitiveness, ease of doing business, etc. Both are constituent Asian states, shifting strategically as the wind of political economy blows and this enables both to work reasonably well with the region and the rest of the world. Their FTAs are standard-bearers with in-built idiosyncratic features.

There are, however, inevitable times when Singapore or ASEAN is caught between and betwixt as in the disputes in the South China Sea. The same applies in an enlarged TPP with alignment in politics and security, compared to the original P4 (the Trans-Pacific Strategic Economic Partnership Agreement) which had Brunei, Chile, New Zealand and Singapore as the founding members.

The issue here is not whether China is outside of the TPP by design or by choice. It is more important to think about how the TPP-minus-China works with the RCEP-plus-China. Again, ASEAN's intermediary role is critical if the major players are agreeable to less of a stark U.S.-led TPP and more of a Pacific mini-WTO. With the elephant in the room, the answers are self-evident. Tied to U.S. economic recovery and the promise of energy sufficiency and surplus, notwithstanding domestic U.S. politics, small Singapore and behemoth United States have the same goal of shaping standards and best practices in international trade rules and managing overlapping mechanisms to create cohesive a regional trade regime.

Given all these evolving pieces of a jigsaw puzzle, recovery from GFC has varied. All countries face the unrelenting issue of job loss, one that is not cyclical but fundamentally structural. The United States is not adding jobs fast enough even with on-shoring. The same approach is not sustainable—the manufacturing sector's return to higher quality of production and capital and labour productivity requires retraining, reskilling and even a new industrial mind-set.

Having subscribed to an export-led and investment-led growth model for too long, it is not easy either for China to switch over to a consumption-led domestic base, even with a rising middle-income class. Armed with FTAs and RTAs, this is how Singapore can prise more leeway for its growth than others. Singapore adheres to a subtly implicit strategy of economics before politics. The country can take a bold step if it can push ASEAN leadership for the RCEP to work harmoniously with the TPP.

In conclusion, RTAs—both in quantity (in terms of number and membership) and quality of block-building FTAs—underscore regionness or regionality, even as geoeconomics and geopolitics are set in the global context. Singapore certainly can carve a role for itself in both the RCEP (with support from ASEAN) and the TPP (with a more accommodating United States). The RCEP-TPP dynamics need not be a zero-sum game.

Solving East Asia's Architectural Problems: Conceptual Models of Policy Instruments

Injoo Sohn
Associate Professor
Department of Politics and Public Administration
University of Hong Kong

Despite a growing consensus on the desirability of an East Asian financial architecture, East Asia faces politically and economically daunting tasks. They include power struggles, sovereignty, collective action problems, structural diversity and weak regional identity and norms. This commentary lays out several logically possible solutions to such generic problems. They are: (i) principled minimalism, (ii) decomposition (and linkage) and (iii) informal intermediaries.

First, the sovereignty-sensitive (realist) minimalist approach to regional institutions addresses philosophical differences regarding the issue of regional super-regulation vis-à-vis strong national regulations coordinated on a regional basis. It is hard to build a single set of rules and norms that would be appropriate and effective for different Asian countries. Even if a single regional standard were to be created, national enforcement and compliance would vary with national priorities and/or enforcement capacity. Rather than developing a single set of regulatory standards, Asian countries may prefer to adopt the least controversial principles possible, with which all member countries must comply, while allowing countries to go beyond those principles and concomitant regulations if they wish. A country that is focused more on financial stability than on financial innovation, for instance, would not only be required to meet regionally coordinated minimum principles and standards for the Asian bond market, but would also be allowed to apply stricter regulations to the financial activities of both national and foreign institutions. While emphasising principled minimalism, the proposed solution stresses that such regulation should be coordinated regionally to reflect the demands of regional financial integration. Coordination should cover agreement on guiding principles and a procedure by which the principles could change over time, and provide a channel for peer monitoring, implementation and mutual adjustment to address common regulatory challenges. Regionally coordinated minimal principles, ones that are not fixed in time but could evolve with the global financial system, would be more durable and relevant in today's rapidly changing financial world.

Secondly, the logic of decomposition and linkage can be incorporated into the aforementioned realist approach. The game theory and institutional microeconomic literatures suggest that reciprocity or tit-for-tat strategies in an iterated situation can be useful in promoting cooperation by establishing a link between an actor's present behaviour and expected future benefits. Some game theorists suggest that issue decomposition over time can create favourable conditions for cooperation by lengthening the shadow of the future. The basic logic of decomposition is that the temptation to defect will be reduced if a deal is sliced up into increments. For instance, cooperation on tariff reduction might be difficult if tariffs were to be reduced in one jump. If they could be reduced incrementally, however, then cooperation would be more likely. Decomposition logic is manifested in the "early-harvest schemes" adopted in FTAs in Asia. Likewise, if an Asian deal on exchange rates or monetary policy coordination can be implemented incrementally, then the temptation to veto or defect may decrease. The proposal by Masahiro Kawai to implement exchange rate policy coordination in East Asia in three stages also appears to reflect decomposition logic. The three consecutive phases are: (i) informal coordination, which would involve using a basket of G3-plus currencies (the U.S. dollar, the euro, the yen and emerging East Asian currencies) as a loose reference, (ii) formal coordination, which would feature a G3-plus currency basket system with well-defined rules for intra-regional exchange rate stability, and (iii) tight and systemic coordination through the developed Asian Currency Unit-based system. Such an incremental and multi-phase approach would provide favourable conditions for exchange rate policy coordination by lengthening the shadow of the future. Another approach to increase the iterative nature of the situation is cross-issue linkage. The linkage approach presupposes that inter-state relations are rarely confined to one single-play issue of significance. When states face a single-play situation on one issue, the temptation to defect can be deterred by threats of future retaliation on other iterated issues. A state concerned about one-time losses if another state devalues its currency may thus link devaluation to an iterated environment or trade game. For example, given China's greater emphasis on non-traditional over traditional security cooperation as a promising avenue for initial regional architecture building, one may consider linking China's monetary cooperation with other non-traditional security issues, such as terrorism, illegal immigration and drug trafficking. Such issue linkages are likely to incentivise Beijing to restrain its otherwise more assertive behaviour in regional monetary cooperation, as the Chinese leadership may perceive the potential benefits achievable through repeated cooperative games in non-traditional security areas. By establishing a direct connection between present behaviour on a financial issue and future benefits related to a non-financial issue, cross-issue linkage can lengthen the shadow of the future and thereby increase the likelihood of regional financial cooperation.

Thirdly, informal Track 2 diplomacy could be instrumental in resolving the problems of competition for power and weak regional norms and identity. Unofficial (or semi-official) interactions outside the formal government structure can serve as channels for defusing potentially volatile issues and as persuasion processes. Issues that are too controversial for formal Track 1 meetings can be discussed in informal Track 2 talks involving professionals and (formal) government officials. This approach allows discussion, persuasion and negotiation concerning controversial yet innovative ideas, which might otherwise be discarded at the Track 1 level. Track 2 diplomacy can also depersonalise policy initiatives that would otherwise be seen as more controversial due to the identity of the proposers, which can sometimes be more important than the content of the proposal itself. The same information can be interpreted differently depending on the source: information from friends is more persuasive than that from foes or strangers. Based on this view, China would feel less comfortable with a proposal made by its regional rival, Japan, than if the same proposal were made by Thailand at an official governmental meeting. If an informal and unofficial Track 2 consensus process can have the effect of depersonalising proposals, then the destabilising effects of controversial issues may decrease. This could, in turn, create a social environment conducive to persuasion and socialisation, resulting in the internalisation of new ideas and norms. In addition, informal Track 2 meetings could help in the cultivation of ties of common interest, consensual knowledge and personal friendship among policy elites in the region. Such transnational elite networks would create and consolidate the sense of regional solidarity (or identity) needed to deepen monetary and financial cooperation.

The CMIM: Much Ado About Nothing?

Yong Wook Lee
Associate Professor
Department of Political Science and International Relations
Korea University

Despite sceptics, the ASEAN+3 (China, Japan and South Korea) countries have managed to make steady, non-trivial progress in institutionalising their financial cooperation over the last 15 years. Two notable developments stand out. One is the CMIM. The other is the Asian Bond Market Initiative (ABMI).

The CMI came into existence in May 2000 and was successfully multilateralised on 24 March 2010. It was envisioned to be a regional framework to contain and manage financial crises in East Asia. With the multilateralisation came an agreement on the total funding size of US$120 billion (US$240 billion since 2012), voting rules on major issues such as new membership, financial extension and agenda-setting. These institutional developments encouraged the proponents of East Asian financial cooperation to view that a full-fledged Asian Monetary Fund (AMF), a regional self-help mechanism, would be just around the corner. The emergent CMIM counts as a historic agreement, as it is the first time that sovereign states in East Asia allowed majoritarian decision-making rules to govern any aspect of their inter-state relations. It constitutes a sharp departure in a formal sense from the so-called ASEAN way, the norm of unanimity prevalent among ASEAN countries and between ASEAN countries and their three East Asian neighbours.

The ABMI was proposed by Japan in 2002. It has been subsequently institutionalised to facilitate development of local (or regional) financial markets for regional financial stability since then. The institutional purpose of the ABMI is not only to address the so-called "double mismatch" problems (currency and maturity mismatches), but also to increase financial autonomy of East Asia by tapping regional high savings for full use in the region. The ASEAN+3 has produced noteworthy institutional outcomes over the last nine years: (i) creation of the Credit Guarantee and Investment Facility (CGIF) in 2010, (ii) initiation of the ASEAN+3 Bond Market Forum (ABMF) in 2010, and (iii) fleshing out concrete plans to establish the Regional Settlement Intermediary (RSI). Furthermore, ASEAN+3 has been investing its time and resources in establishing regional bond market standards to harmonise national bond market operations.

All these institutional developments do not, however, shelve sceptics' negative view. Given the limits of the space, I will focus on the CMIM, which is by all means the symbol of the successful East Asian cooperation from the perspective of its advocates. In the eyes of sceptics, regional efforts for the CMIM are not real in any meaningful sense, or only gestures of regional cooperation without substantive institutional teeth. Here are three indicators these sceptics use to debunk the myth of the CMIM.

First, CMIM's funding size is way too small. US$240 billion may not look like a small number, but it is dwarfed by the ASEAN+3 members' US$6.1 trillion in foreign reserves. Each member also has its own quota. This means that the CMIM is something that can't be counted on when it is needed. The CMIM has never been used. Moreover, sceptics point to the South Korean case. The fragile nature of East Asian cooperation is evident from the way South Korea handled its economic emergency in 2008. South Korea did not rely on the CMIM. Instead, South Koreans went off to the U.S. Treasury Department when they were in dire need of foreign reserves. Why the United States? Would it not have been much easier to turn to Japan or China, co-leaders of the CMIM, even for bilateral swap arrangements? Yes, South Korea concluded the bilateral swap arrangements later on with China and Japan. But it does not help to account for its first choice.

Second, the CMIM is not a genuinely regional institution, precisely because of its IMF linkage. True, the de-linked portion is expected to increase from the original 10 per cent to 40 per cent in 2014. But as long as the CMIM has to rely on the IMF for approving financial assistance, it is not truly regional as there will always be U.S. involvement under IMF cover. Regional autonomy through the CMIM is only illusory.

Last but not least, the CMIM has not yet clarified its lending policies or lending conditionality. Yes, the CMIM would go against the IMF style "one-size-fits-all" policy. Other than that, nothing has been suggested as to how the CMIM would work out the details of its lending conditionality with recipients if it is ever used. Without the specifications of lending conditionality (or how the CMIM would design it with recipients), the CMIM may remain only in paper.

Regardless of how one evaluates these critiques, they are the ones that the CMIM should address for furthering its institutional consolidation. In other words, if ASEAN+3 is ambitious enough to turn the CMIM into a full-fledged AMF, it has to be successful in increasing the total funding size so as to effectively meet the challenges of financial contagion, in eliminating the IMF linkage and in concretising lending conditionality.

The increase in total funding size can be relatively easy, given the enormous foreign reserves ASEAN+3 collectively holds. Then, real challenges lie in the latter two issues, delinking the CMIM from the IMF and institutionalising lending conditionality. Both issues involve politics and political will. While the delinking requires recasting ASEAN+3's relations with the United States, institutionalising lending conditionality calls in sovereignty sensitivities within ASEAN+3. Also both issues depend on the future of the ASEAN+3 Macroeconomic Research Office (AMRO), as the surveillance unit is the site of providing reasons/ justification for an independent AMF equipped with its own tools of lending policy.

How can ASEAN+3 go beyond what it has achieved so far? Injoo Sohn suggests three mechanisms for this in his article "Toward Normative Fragmentation: An East Asian Financial Architecture in the Post Global Crisis World" (published in the *Review of International Political Economy* in 2012). I elaborate on his argument. The three mechanisms Sohn identifies are "principled minimalism and host regulation," "decomposition and issue linkage" and finally "informal intermediaries." Principled minimalism and host regulation is a strategy of making agreements for easier issues first, thus creating patterns of cooperation for the future. This strategy also implies that each member state is responsible for implementing the agreed-upon rules and regulations. Sohn argues that the European Union's supranational imposition may be a non-starter in East Asian context, given the asymmetry of power, sovereignty sensitivities and diversity of political and economic systems in the region. Decomposition and issue linkage suggests that a more difficult issue such as the making of an AMF should be pursued gradually, going through several stages of institutional building processes. And issue linkage or side payments are encouraged to manage the distributional conflicts of member states in institutionalising, say, an AMF. Informal intermediaries feature Track 1.5 or Track 2 diplomacy, weaving expert networks for vision development and sharing.

Although the three mechanisms are presented separately for analytical purpose, they work closely together in practice. They are interrelated, shaping the boundary of each other. But on a closer look at the interactions of each mechanism, one can find a way to apply them sequentially, which suggests the different degrees of emphasis on the staged cooperation. Basically, principled minimalism and host regulation are about and emanate from policy goals. Decomposition and issue linkage are negotiation strategies. The main function of informal intermediaries is to develop and set agendas for vision-making and discussion. Analytically as well as practically, then, the sequential order is from vision-making through policy goals to negotiation and bargaining.

As such, a greater emphasis should be placed on the development of informal intermediaries particularly when ASEAN+3 is facing such structural challenges as the asymmetry of power, sovereignty sensitivities and diversity of political and economic systems in the region. The creation and effective functioning of a regional epistemic community is called for. No less important is the composition of such an epistemic community. It has to include private experts, academics as well as former high ranking financial officials who can speak directly to their governments and who have built networks of East Asian financial cooperation for the last 15 years. As evident in the European case, a regional integration project is a "stop and go" project. It thrives on the strong presence of promoters and visionaries and dies out without them. Geopolitical and economic exigencies would have the limits of making a region hang together to the extent that they are always subject to change.

China's Global Financial Ambition: Linking Mini-lateral Frameworks

Takashi Terada
Professor
Department of Political Science
Doshisha University

As the second-largest economy in the world, China's keener interest in IMF reform and efforts to reduce its reliance on the U.S. dollar would lead to the possible formation of a new currency and financial order. China's major motivation behind its challenge of the existing financial and currency rules is less reliance on the U.S. dollar and this stemmed from its efforts to achieve a national goal: to support the 1.2 billion population and maintain 8 per cent annual economic growth. After the global financial crisis, China viewed the current global financial architecture, based on the U.S. dollar as the key currency, as "a thing of the past", as declared by then President Hu Jintao in January 2011. This indicated a view that the architecture was not favourable to the national goal. If the on-going reform in the IMF, with a view to increase voting rights of emerging economies through reallocation of quotas and the number of board members, were implemented, China would be the third-largest contributor in the IMF, slightly after Japan. The United States, however, would maintain more than 15 per cent of the voting rights even after the reform (17.41 per cent), meaning that the United States would remain as the only veto power in the IMF. The U.S. Congress is still opposed to the approval of the reform plan and a majority of the board members are also critical of China's market intervention to control the exchange rate between the renminbi and the U.S. dollar to give an advantage to its exporters. Mutual discontent between China and the status quo powers of the IMF such as the United States would continue to exist, as far as China maintains the government intervention practice in the foreign exchange market.

While demanding the United States to maintain the value of the U.S. dollar and calling for the IMF to reflect the views and preferences of emerging economies in the decision-making process, China has also endeavoured to reduce its heavy reliance on the U.S. dollar. For instance, since establishing a currency swap agreement with South Korea in December 2008, China has expanded its currency swap networks with its major trading partners including Australia and the United Kingdom, key U.S. allies. From the Chinese perspective, these swap arrangements not only provide short-term liquidity, but also possibly promote the use of renminbi in overseas markets and in bilateral trade and investment. China has permitted foreign central banks that have currency swaps with China and overseas banks involved in cross-border trade settlements in renminbi to invest in the Chinese interbank bond markets. Also, as China's previous bilateral swap arrangements are composed of local currencies, including renminbi, the currency swap arrangements are expected to increase the bilateral trade in local currencies, bypassing the U.S. dollar. China also agreed with Japan, another U.S. ally, to implement the direct trading system between renminbi and yen in June 2012, making it possible for companies not to settle their transactions with U.S. dollars and avoid paying double the foreign exchange charges. Less reliance on the U.S. dollar can thus be viewed as a key shared concern among many economies and a robust evidence of the declining U.S. economic power, and China has taken advantage of it to build a coalition with like-minded states, to which Indonesia was recently added as both nations signed a RMB100 billion currency swap agreement in October 2013.

One of the approaches China and other emerging economies have utilised to increase their influence on global economic governance is to use mini-lateral frameworks in which a smaller number of like-minded states come together to promote cooperation to realise common interests or establish their favourite rules and norms. China has at least two mini-lateral forums in this aim: the BRICS and East Asian regionalism.

The importance of the BRICS framework has evolved around the relationship between the emerging powers and the existing international order characterised by the Washington Consensus. One of the chief purposes behind the BRICS formation is thus to represent the voices of emerging economies and to increase its influence in the global economic governance through expanding mutual currency swap arrangements, establishing its own development bank, and possibly appointing representatives from the emerging economies to the top position of international organisations such as the World Bank, all of which respond to China's interest.

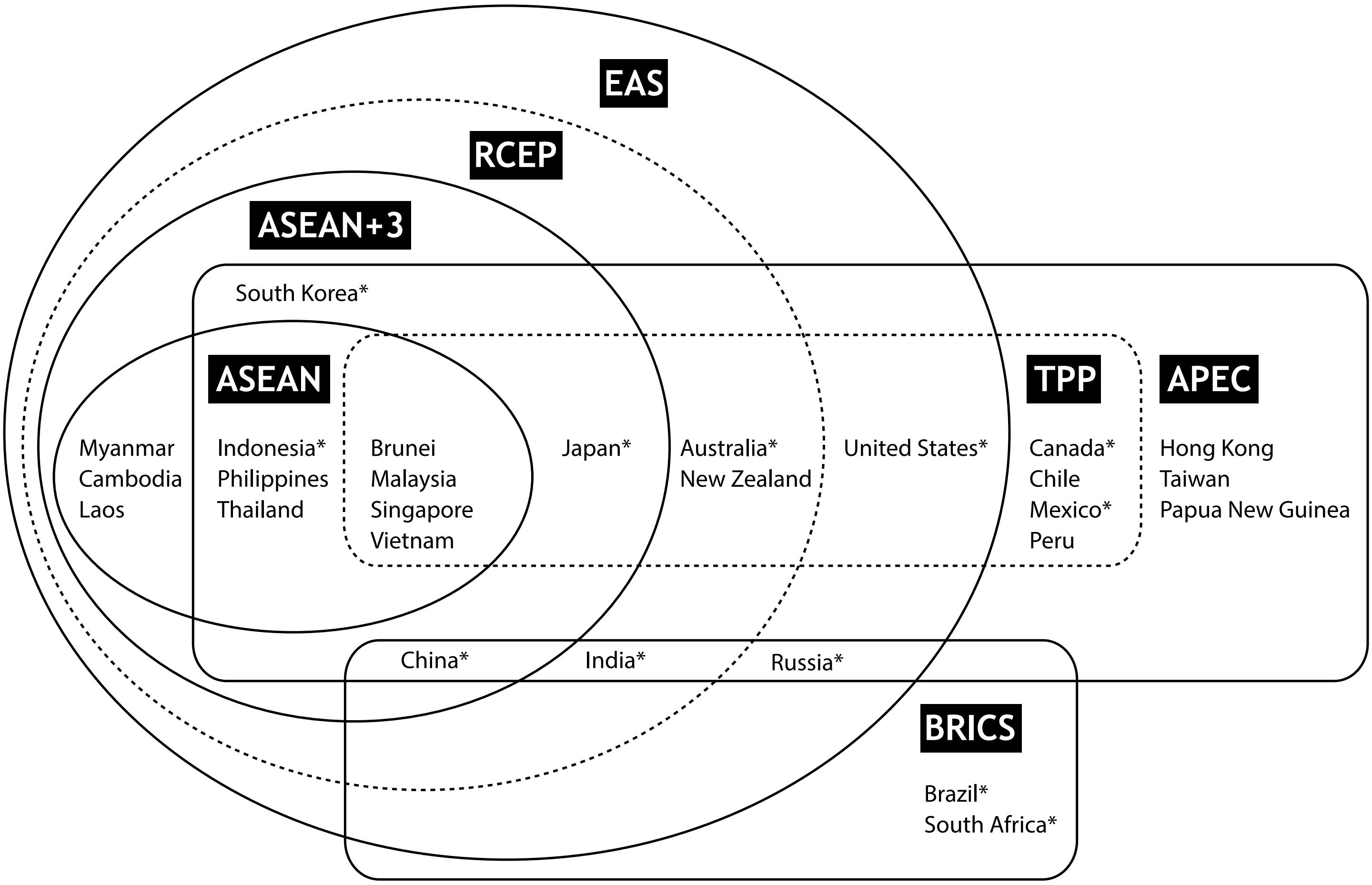
The BRICS members have not formed any single bilateral FTA among themselves and have not shown interest in establishing a single trading bloc, proving a lack of coherence as an economic unit. This was evident in the Doha Round negotiations. This observation, however, highlights their more profound shared interest in the financial field, concentrating the political leverage for the IMF reform. China's views on the desperate need for reform of global financial mechanisms have been clearly indicated by President Xi Jinping, who states that "global economic governance system must reflect the profound changes in the global economic landscape, and the representation and voice of emerging markets and developing countries should be increase". This view then led to his proposal of establishing an Asian infrastructure investment bank to fund development projects in ASEAN and other developing nations in the region, announced in October 2013.

Utilising the ASEAN+3 framework, an institutional body for regional integration in East Asia, ten ASEAN members together with China, Japan and South Korea beefed up the existing financial cooperation framework, especially the CMIM. To better address the needs of the regional financial cooperation, ASEAN+3 countries gradually strengthened the move towards the multilateralisation of the CMI arrangement, putting pressures for reforms of U.S.-backed rules of global governance.

This is evident in the inaugural statement made by Wei Benhua, the first director of AMRO in Singapore in March 2012: "the IMF has to get used to emerging Asian countries wanting more say in economic reform plans… This is the new reality. The IMF has to accept this even if it is not so happy… A regional agency can understand the needs of neighbouring nations more clearly than the IMF can do". The rise of China has meant that a traditional political power now emerges as a superpower, whose political influence is now also backed by continuous high economic growth, influencing both political and economic spheres on a global scale. This assessment has bolstered the above message by Wei, a former senior official of the People's Bank of China, who stressed the inevitability that the IMF would be increasingly challenged by regional financial bodies, especially one in East Asia backed by a rising China.

The view that East Asian financial mechanisms have been useful to shape a collective voice or increase the influence in the global settings such as the IMF was then revealed by Premier Wen Jiabao in October 2011: "China is ready to work closely with ASEAN... to gradually put in place a stable and mature regional capital market and enhance the region's ability to resist international financial risks". By playing up the importance of strengthening regional organisations in response to a transatlantic financial crisis, East Asia formed a consensus that financial cooperation such as the CMIM could serve as a way of boosting East Asian influence in gaining more IMF votes and capital shares. ASEAN+3 finance ministers had already "called for an urgent review of the quota of the Asian countries in the IMF to properly reflect the current realities and their relative positions in the world economy" in May 2005.

It should be, however, noted that China is a substantially different state with regard to its financial policy implementation and domestic governance system, compared with the Western status quo powers such as the United States. The exchange of the renminbi with other currencies, a key policy tool to reduce the reliance on the U.S. dollar, is still strictly controlled by the Chinese financial authority, so it is doubtful that foreign companies are motivated to utilise the renminbi to settle their trade and investment transactions. One of the approaches which may change this perception will be China's decision to carry out the internationalisation of the renminbi by making it float on the international currency market.



Adapted from *Australia's Participation on Regional Economic Architecture*
(http://www.dfat.gov.au/trade/downloads/Australias-Participation-in-Regional-Economic-Architecture-Diagram.pdf).
The diagram does not reflect bilateral free trade agreements.

* G20 member

- - - Trade agreement/negotiation group

About the Centre for Multilateralism Studies

The Centre for Multilateralism Studies (CMS) is a research entity within the S. Rajaratnam School of International Studies (RSIS) at Nanyang Technological University, Singapore. The CMS team conducts cutting-edge research, teaching/training, and networking on cooperative multilateralism in the Asia Pacific region. The Centre aims to contribute to international academic and public discourses on regional architecture and order in Asia Pacific. It aspires to be an international knowledge hub for multilateral and regional cooperation.

Our Objectives

- To conduct scholarly and policy research on multilateral and regional issues.
- To facilitate policy dialogue and academic debate on regional cooperation and integration.
- To enhance the capacity of current and future leaders, officials, professionals, and students through executive and graduate education.
- To network and collaborate with other academic and research institutions.

Our Activities

In meeting its objectives, the Centre works through the following scope of activities:

- Annual conferences and workshops
- Research Fellow programme
- Curriculum development
- Policy-relevant research outputs

CMS is committed to generate a regular stream of high-impact scholarly and policy-oriented research as well as to disseminate them through myriad formats, media and outlets—targeted at policymakers, think tanks and academic audiences.

Our Research

The Centre's research agenda includes international and global forms as well as expressions of cooperative multilateralism:

- **Economic multilateralism**
  Research areas include trade, monetary, and financial integration in ASEAN, ASEAN+3, South Asia, and Central Asia; evolving linkages between various Asian sub-regions and with countries/sub-regions outside the region (such as the Asia Pacific Economic Cooperation, APEC and Trans-Pacific Partnership, TPP); and developments in the global economic architecture (including the Group of Twenty, G20) to ensure complementarity between global and regional initiatives.

- **Diplomatic and security multilateralism**
  Research areas include inter-governmental and non-official arrangements such as the ASEAN Regional Forum (ARF), ASEAN+3, East Asia Summit (EAS), Shanghai Cooperation Organisation (SCO), Six-Party Talks, the Council for Security Cooperation in the Asia Pacific (CSCAP), and the like. Initiatives in defence diplomacy include the ASEAN Defence Ministers' Meeting (ADMM) and ADMM Plus, the Shangri-La Dialogue, and alliances.

For more information about CMS, please visit www.rsis.edu.sg/cms.

About the S. Rajaratnam School of International Studies

The S. Rajaratnam School of International Studies (RSIS) was established in January 2007 as an autonomous School within the Nanyang Technological University. Known earlier as the Institute of Defence and Strategic Studies when it was established in July 1996, RSIS' mission is to be a leading research and graduate teaching institution in strategic and international affairs in the Asia Pacific. To accomplish this mission, it will:

- Provide a rigorous professional graduate education with a strong practical emphasis,
- Conduct policy-relevant research in defence, national security, international relations, strategic studies and diplomacy,
- Foster a global network of like-minded professional schools.

Graduate Education In International Affairs

RSIS offers a challenging graduate education in international affairs, taught by an international faculty of leading thinkers and practitioners. The Master of Science (MSc) degree programmes in Strategic Studies, International Relations, Asian Studies, and International Political Economy are distinguished by their focus on the Asia Pacific, the professional practice of international affairs, and the cultivation of academic depth. Thus far, students from more than 50 countries have successfully completed one of these programmes. In 2010, a Double Masters Programme with Warwick University was also launched, with students required to spend the first year at Warwick and the second year at RSIS.

A small but select PhD programme caters to advanced students who are supervised by faculty members with matching interests.

Research

Research takes place within RSIS' six components: the Institute of Defence and Strategic Studies (IDSS, 1996), the International Centre for Political Violence and Terrorism Research (ICPVTR, 2004), the Centre of Excellence for National Security (CENS, 2006), the Centre for Non-Traditional Security Studies (Centre for NTS Studies, 2008); the Temasek Foundation Centre for Trade & Negotiations (TFCTN, 2008); and the Centre for Multilateralism Studies (CMS, 2011). The focus of research is on issues relating to the security and stability of the Asia Pacific region and their implications for Singapore and other countries in the region.

The school has four professorships that bring distinguished scholars and practitioners to teach and to conduct research at the school. They are the S. Rajaratnam Professorship in Strategic Studies, the Ngee Ann Kongsi Professorship in International Relations, the NTUC Professorship in International Economic Relations, and the Bakrie Professorship in Southeast Asia Policy.

International Collaboration

Collaboration with other professional schools of international affairs to form a global network of excellence is a RSIS priority. RSIS maintains links with other like-minded schools so as to enrich its research and teaching activities as well as adopt the best practices of successful schools.

For more information about RSIS, please visit www.rsis.edu.sg.

S. RAJARATNAM SCHOOL
OF INTERNATIONAL STUDIES
A Graduate School of Nanyang Technological University

S. Rajaratnam School of International Studies, Nanyang Technological University,
Block S4, Level B4, Nanyang Avenue, Singapore 639798
TEL 65-6790-6982 | FAX 65-6793-2991 | EMAIL wwwrsis@ntu.edu.sg | WEBSITE www.rsis.edu.sg