

Crafting a US Response to the Emerging East Asia Free Trade Area

by Christopher Martin

Few would dispute Asia's growing economic importance in the 21st century. While China and India have held the spotlight recently, their rise may not constitute the region's most important economic shift. Japan is still by far the richest economy; while South Korea's formidable industries are the envy of many. Furthermore, the ten-country coalition that makes up the Association for Southeast Asian Nations (ASEAN) boasts such economic dynamos as Singapore and Malaysia. Together, China, Japan, South Korea, and ASEAN (commonly referred to as ASEAN+3) account for 20 percent of global output, nearly 20 percent of global trade, and hold well over 50 percent of the world's international monetary reserves. Moreover, the region is ripe for growth. It accounted for 31.4 percent of the world's population in 2005 (more than Europe and the Americas combined) and the IMF's 2008–2011 outlook figure clocked growth at 7.9 percent for Asia, dwarfing the 2.5 percent for major developed countries. How would the world's economic landscape shift if these thirteen countries were to join together in some form of economic union? More importantly, how should the United States respond to such an event? It is a question the US needs to answer today.

In January, the heads of state of the ASEAN+3 countries led the second East Asia Summit (EAS) in Metro Cebu, Philippines. Among other initiatives, ASEAN+3 countries reaffirmed their commitment to examining the possible creation of an East Asia Free Trade Area (EAFTA) between their respective economies, of which a study of feasibility is already underway. With continued uncertainty surrounding the Doha Round of multilateral trade negotiations, the summit included discussion of a regional trade agreement. Host Philippine President Gloria Arroyo declared last August that the East Asian countries must “draw up a collective response” to Doha's failure. Though the EAS includes non-East Asian nations like India, Australia, and New Zealand, much of the summit focused on hastening the emergence of agreements between ASEAN+3 countries, where trade negotiations have come the furthest.¹ The summit itself is the culmination of a variety of forces and the indicators are clear; East Asia is quietly coming together. The trend is gaining

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momentum in a variety of policy forums, though the economic realm demonstrates the strongest coalescence. A number of important intra-regional free trade agreements (FTAs) have already been ratified, while an array of others are in the works. According to Fred Bergsten, Director of the Peterson Institute for International Economics, “virtually every possible combination of the core Asia group—consisting of the original members of ASEAN along with China, Japan, and Korea—is already engaged in active integration efforts.”²

How would the world’s economic landscape shift if the ASEAN +3 countries were to join together in some form of economic union? More importantly, how should the United States respond to such an event?

Yet to date, the US has pursued no comprehensive policy towards the possible emergence of EAFTA. Simple disinterest, preoccupation elsewhere in the world, and the existing ties to the region have all been proposed as reasons for what has been called America’s “benign neglect” of East Asian integration.³ Tellingly, the US was not invited to attend the East Asia Summit, underscoring a strengthening East Asian independence. In economic terms, EAFTA’s possible creation is the most important aspect of this emerging trend, and America’s policy response at this juncture is critical to guiding the region in a way that enhances US prosperity.⁴ Thus the US faces several options. It could continue to do nothing on EAFTA and press ahead solely in building direct ties to East Asia through the Asia Pacific Economic Community (APEC) or through bilateral treaties. The US could also actively support EAFTA, attempt to halt the treaty, or conditionally support it on US inclusion as a member.

The best way to increase US prosperity is a hybrid policy. The US should support EAFTA while simultaneously reinvigorating talks around the creation of parallel trade treaties, either within the framework of APEC and/or bilaterally. The evidence suggests that such a course has the best chance of improving US prosperity, given the characteristics of EAFTA’s establishment and America’s position in relation to the trade group. Furthermore, even if US support of EAFTA impinged on some US economic interests, doing nothing or attempting to upset integration efforts may hurt the US even more. The upcoming analysis follows this line of reasoning.

Before moving on, critics might argue that the prospect of East Asian economic integration through EAFTA is so far off that it requires little attention. Any such conclusion is wrong. Restraints to regional integration certainly exist—they often include the history of Sino-Japanese antagonism, the difficulties in coordinating integration across such a wide range of economic levels and political systems, and the powerful agricultural lobbies throughout East Asia. But such restraints did not prevent the EU from overcoming German-French antagonism nor did they prevent NAFTA or Mercosur from uniting varying types of states. Furthermore, special

interest groups have slowed, but rarely prevented, economic integration. While some analysts have questioned the rationale for EAFTA, its unhurried but steady emergence is undeniable. Appropriate US engagement in the union's early formation will be key to securing a more prosperous and stable East Asia that serves to support America's own prosperity. Supporting EAFTA is the best option available to achieve this goal. Recognizing this requires recognizing three things: the steady increase in East Asian integration, how EAFTA's establishment affects US economic interests, and how US indifference or opposition to EAFTA would impinge on vital US interests in the region.

REMAPPING EAST ASIA

For much of the past fifty years, economic integration in East Asia was best characterized as passive and without any strong institutionalized approach or formal government direction.⁵ Some analysts have termed this type of economic cooperation, absent official treaties, "regionalization without regionalism."⁶ ASEAN, the first and only functioning institution until recently, was initially aimed at coordinating political and security affairs. Though its members did establish a preferential trade area in the late 1970s, cooperation was extremely limited.⁷ The only other initiative to speak of is the Bangkok Agreement of 1975. This particular treaty still exists, but only includes three East Asian countries (the others are South Asian), has no secretariat, is managed through the UN, and is generally considered a failed FTA.⁸

However, economic integration in East Asia is proceeding rapidly, leading some observers to suggest that a "remapping" of the region is currently underway.⁹ The proposal for the ASEAN FTA (AFTA) led the way in 1993, followed by the creation of the East Asian Vision Group by ASEAN+3 governments in 1998. It was this group that recommended the formal establishment of EAFTA in 2001. Integration efforts have only picked up speed over the last five years, with the formal ratification of AFTA, the Japanese-Singapore FTA, and the ASEAN-China FTA that will come into effect in 2010. Another fourteen bilateral and regional FTAs are either in the proposal or negotiation stage, including many that may stand as the bulwark for EAFTA, like the ASEAN-Japan, ASEAN-Korea, and China-Japan-Korean FTAs. Yet the traditional motives for regional integration—such as increased market access, efficiency, bargaining power, and strategic concerns—leave one wondering why it took East Asia so long.

A number of factors play into the increased drive for more institutionalized integration today. The Asian financial crisis of 1997 served a twofold role in uniting the region by fostering both an appreciation of East Asia's economic interdependence and disillusionment with the assistance of the US and IMF in the wake of the crisis.¹⁰ The perceived failure of an APEC free trade pact and slow movement on the multilateral front through the WTO have also sparked integration efforts.¹¹ Regional concerns over being excluded from the growing web of preferential deals, as well as using FTAs to catalyze difficult domestic reforms and

promote emerging political objectives, like engaging China, may all play a role as well.¹²

To be sure, previous East Asian integration efforts were not met with the greatest aplomb by US policymakers. The idea for a pan-East Asian economic union was first proposed in 1990 by Malaysian Prime Minister, Mahathir Mohamad. Former US Secretary of State James Baker quickly quashed the idea then, suggesting it would be akin to “drawing a line down the Pacific.” America’s short dismissal of Japan’s proposal for an Asian Monetary Fund following the 1997 crisis again illustrates US resistance to East Asian economic regionalism. These first indications of economic integration helped drive the formation and continued US commitment to APEC, an agreement founded upon US inclusion. While enhancing US economic ties to East Asia is still good policy, this time around it needs to be coupled with full support for a trade pact in East Asia. The region’s economic conditions suggest that EAFTA could greatly benefit the US

CONDITIONS FOR CREATION

Judging the economic effects that EAFTA would produce is no easy task. A great deal of debate surrounds the benefits of FTAs in general, as their effects hinge on a number of conditions. The core of the dispute centers on two related issues: how agreements affect the welfare of FTA members and nonmembers, and the effects of FTAs on the multilateral trading environment.¹³ Little theoretical convergence exists on this second issue, and studies provide little insight into the possible effects of EAFTA on the multilateral system.¹⁴ Therefore, this analysis focuses on the theory around member and nonmember welfare gains from FTAs and examines the evidence regarding EAFTA. The analysis suggests that US support for EAFTA would greatly enhance US prosperity.

The economic impacts of FTAs on members and nonmembers depend primarily on the static and dynamic effects of the agreement. Static effects focus on whether an FTA creates or diverts trade between states. An FTA can create trade if lower tariffs between members help enhance production where costs are lowest and production is most efficient. For instance, EAFTA would likely create more imports of rice to Japan and more exports of high-end semiconductors to Thailand, simply because other EAFTA countries like Thailand maintain a comparative advantage in production of rice and Japan in semiconductors. FTAs can also, however, divert trade by shifting import-export patterns towards non-efficient member producers whose costs may be higher but who can now trade more cheaply within the union due to the lower tariffs, while better and more efficient producers in nonmember states suffer from the respectively higher and exclusionary tariffs in the post-FTA environment. Extending the EAFTA example above, imagine the US produced semiconductors more efficiently than Japan and originally traded more of them with Thailand. If EAFTA drew down tariffs between Thailand and Japan so much so that imports of Japanese semiconductors actually became cheaper compared to US ones, not because they were produced more efficiently but simply because the US now

faced respectively higher external tariffs in Thailand, that would be trade diverting, because Japan would supply semiconductors to Thailand and not the US. In general, trade creation is good for members and does not hurt nonmembers, while trade diversion hurts both members and nonmembers.

Yet, even if trade diversion occurs, an FTA's dynamic effects may offset or override such concerns. The important dynamic effects for nonmembers generally center on new opportunities that larger and more efficient FTA markets create. FTAs expand economies of scale and scope, improve competitiveness, and drive technological innovation. This not only enhances investment opportunities for nonmembers, but can lead to product improvements and lower prices that benefit both members and nonmember economies alike. But how do these play out for EAFTA?

Theories to date have reached no definitive conclusions on the exact static and dynamic effects of FTAs, though the existence of certain conditions seems to point to trends that suggest that the US would gain from EAFTA. First, trade creation is more likely and diversion less likely where prospective FTA members are already natural trading partners with high trade flows, primarily because an FTA reinforces natural trade patterns rather than artificially distorting them. EAFTA economies satisfy this condition in spades. Trade volumes between ASEAN+3 countries expanded to \$317 billion in 2005, continuing the average annual 16 percent increase that has persisted since 1975.¹⁵ Including Hong Kong and Taiwan, the share of inter-regional trade stood at 52% in 2005, higher than that of even NAFTA countries.¹⁶

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Second, FTAs generally lead to less trade diversion where higher pre-FTA tariffs between members exist. ASEAN+3 countries generally fulfill this criterion as well, with average applied tariffs ranging from a low of 0 percent in Singapore to a high of 16.8 percent in Vietnam. The numbers look even more divergent when examining bound rates, which vary from 2.9 percent in Japan to 83.6 percent in Burma. These numbers lend further credibility to the claim that EAFTA will create rather than divert trade.

Furthermore, FTAs are generally less diversionary when tariffs are lower between members and nonmembers after FTAs come into effect. While it is impossible to precisely predict EAFTA's external tariff rates *ex-ante*, the point illustrates an important dynamic in gauging the economic effects of the agreement on the US. The US is the biggest trading partner and export market for many ASEAN+3 countries, enjoying relatively good trade relations and low tariffs with these nations. Two-way trade between the US and ASEAN reached \$122 billion in 2003. The US and Singapore signed a bilateral FTA in 2004, and new agreement between the US and Vietnam is paving the way for Vietnam's entrance into the

WTO. The US also serves as the leading export market for seven EAFTA member economies, including China and Japan. Given that East Asian countries maintain such close trade ties to the US, it is unlikely that the creation of EAFTA with US support would prompt any of these countries to raise barriers in a way that might threaten these interests.

Gary Hufbauer and Yee Wong support this position in a report on the prospects for regional free trade in East Asia. They note that the growing economic regionalism need not be feared given that these countries do not seem to be building a “fortress Asia” trade bloc.¹⁷ Instead, Hufbauer and Wong argue that a great number of inter-regional FTAs, including those with the US, exist alongside growing intra-regional ties. Moreover, almost all of ASEAN+3 are members of the World Trade Organization, which assures the US legal access to their markets at the lowest rates afforded to other WTO members through most-favored nation tariff regulations.

To examine every condition surrounding EAFTA that might affect US trade interests is beyond the scope of this essay, but it should already be apparent that there is, at the very least, some indication that EAFTA will not divert much trade away from the US on theoretical grounds. That leaves the question of FTA effects open to an emerging body of empirical evidence.

The most recent studies suggest that EAFTA will probably not harm—and may greatly benefit—US prosperity. A 2001 study by Scollay and Gilbert indicates that EAFTA will provide strong welfare gains to its members, while incurring only a negligible welfare loss to the US (.03 percent of GDP), a finding that is confirmed in more recent studies.¹⁸ However, these studies all acknowledge that their estimates may be rather conservative given that they do not incorporate the potentially important dynamic effects discussed above nor do they adequately model trade in services that could lead to systematic understatement of the welfare gains for the US.¹⁹ A 2004 study by Lee and Park even argues that a regional FTA in East Asia could increase nonmember trade anywhere from 8.9 to 55 percent depending on a variety of factors.²⁰ As the range of these numbers and arguments suggest, the empirics of FTA analysis are less than perfect gauges as to the effects an EAFTA might have on the US, though they seem to indicate either a very negligible negative impact or a significant positive one.

BETTER TRADE, INVESTMENT, AND MONEY

Regardless if trade flows between the US and EAFTA member countries increase, decrease, or are unaffected, the US may derive other important economic benefits from the agreement. Most importantly, a good number of US companies own or are joint partners with firms and factories operating in East Asia. From Dell computers to Nike shoes, these companies source their products through East Asian supply chains. As many of these suppliers are based in a variety of countries throughout the region, the static and dynamic trade gains will mean greater profit returns to US-based firms operating in EAFTA countries simply because of gains from more efficient internal trade flows. Such benefits may be especially significant

because EAFTA would likely not only focus on tariff reductions, but could also lead to a “deepening of trade” through facilitation measures aimed at lowering transaction costs.²¹ Enhanced customs procedures, standardization, freer mobility of labor, and increased e-commerce technology would all greatly benefit US firms operating throughout the region.

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Another promising aspect of EAFTA concerns the increased investment opportunities that the US might enjoy. These arise not only from the dynamic gains from trade mentioned earlier, but also because of the way in which EAFTA may promote more flexible investment regulations for US firms. The recent bilateral FTA between Japan and Singapore in 2002 and the studies underway on the China-Japan-Korea, as well as the Korean-Japan, FTAs, signal a distinct shift towards investment-enhancing rules in ASEAN+3 trade agreements.²² There is little reason to believe EAFTA would depart from this trend. Entrenching more open regulatory structures throughout the region would serve the interests of both hot-money American equity investors and US companies with longer-term capital investments in fixed assets.

Investment liberalization is not the only non-trade aspect of economic integration in East Asia that could benefit the US. The region has bucked the norm in improving monetary supports, and EAFTA would strengthen these efforts. Whereas it took Europe years of discussion and a history of open regional trade before it began to candidly consider cooperation in other areas, Asian financial integration may even be preceding trade in some areas. Following the 1997 crisis, ASEAN+3 governments agreed in 2000 on a network of bilateral currency swap agreements to provide mutual protection in case of new financial emergencies.²³ Known as the Chiang Mai Initiative, these agreements originally served to provide a total of approximately \$39 billion between all the partners. In 2005, ASEAN+3 countries decided to roughly double that amount, as well as double the percentage of emergency funds available for distribution without the recipient country implementing an IMF program.²⁴ Lu Feng at the China Center for Economic Research describes these parallel movements in finance and trade as “the most noticeable feature of East Asian regionalism.”²⁵ Undoubtedly, the tandem evolution in financial stability measures alongside and within the framework of EAFTA trade negotiations serves to benefit American interests in a host of industries, both in East Asia itself, and anywhere else that might benefit from sound Asian financial markets.

While this may all be true, critics will argue that the US can do better. Particular sectors of the US economy will certainly bear the brunt of economic costs regardless of potential benefits, and studies have shown that EAFTA’s creation might reduce US exports by as much as \$25 billion.²⁶ This represents a relatively small fraction of

the US economy, but it can mean high costs for particular firms and affected communities. Critics will ask why the US should support EAFTA if it could get a better deal with other options, such as an APEC FTA that includes the US, or direct bilateral treaties. Indeed, US policy has, so far, focused in these areas. Unfortunately, APEC and bilateral deals alone are not enough.

BRIDGING THE PACIFIC

The current US strategy to engage East Asia solely through APEC and bilateral trade pacts, while remaining indifferent to integration efforts that do not include the US, is perilous policy for three reasons. First, APEC is not currently a viable policy option with regard to trade. While an important forum in bringing together a wide array of powers and interests on both sides of the Pacific, the prospect of an APEC trade group faces considerable political hurdles. Hopes for a trade pact are dim abroad, and protectionist rumblings in the halls of Congress have made domestic agreement on such a large FTA unlikely anytime soon. Near failure of CAFTA in 2005, a much smaller agreement in economic terms, underscores this constraint. That is not to say that the US should jettison efforts on APEC. Rather, the US should continue to support APEC, but focus even more on bilateral deals that face fewer political obstacles and pass much more quietly through the US legislature. To its credit, the US has met with some success in this area, including completed free trade agreements with Australia, Singapore, and Korea, and ongoing negotiations with Thailand and Malaysia.

However, such ties to key East Asian trade partners are worth much less to the US without a clear position on EAFTA. US apathy to internal ASEAN+3 integration efforts have allowed these new intra-linkages to proceed without significant US input. Despite the vague US commitment to free trade in East Asia, the absence of an explicit unified policy towards any regional integration not crossing the Pacific has muted the US voice in shaping EAFTA, what may become the strongest economic union in the world. Indifference rarely makes for good foreign policy.

Lastly, the US can no longer afford to ignore either the imminent regional momentum towards integration or the potential benefits that a wide-spread East Asian trade pact could bring the US. Increasing US ties through APEC and bilateral agreements is laudable policy, but only if it accompanies a clear US message on EAFTA. The best message the US can offer is its full support. Not only is the current disinterested policy undesirable, it now seems that any attempt to halt movement toward the agreement would hurt the US. Given the pace of economic integration and emerging political dynamics in ASEAN+3 countries, the negative repercussions that US disapproval of EAFTA might entail are grave. Any US efforts to either completely disrupt EAFTA, or quash it should the US not be included as a member, may serve to only slightly detour East Asian integration at the cost of US prosperity.

SITUATIONAL CONSTRAINTS

The past two US administrations actively worked against any formalized East Asian economic integration exclusive of the US, but the circumstances suggests that such a policy is unworkable today. Efforts against EAFTA could certainly slow any formalized treaty, as the agreement is in its preliminary phases and the US still maintains great influence in East Asian affairs. Undercutting EAFTA, however, would be folly. Not only may such efforts be in vain, attempting to crush the agreement could also significantly hinder US prosperity goals by sapping valuable diplomatic resources and undermining ever more tenable regional perceptions of the US.

American opposition to EAFTA is a costly proposition because it would drain political capital needed to meet other important economic and security threats in East Asia. The surging economic regionalism that some predicted would soon subside has not done so. Therefore any opposition to it would demand diplomatic resources and political capital that are in short supply given the array of challenges facing the US throughout the region. Dealing with a nuclear-armed North Korea, calls by China to rein in Taiwanese independence, and coordinating responses to an avian flu pandemic are difficulties that the US has no choice but to confront. Furthermore, America's war on terror requires that it maintain constructive relations with all its East Asian partners, especially those in largely Muslim countries like Indonesia, who may greatly benefit from EAFTA. Instructing East Asian countries to shun EAFTA (or the smaller bilateral and regional pacts that will become the backbone of the agreement) contradicts standing US policy on free trade, and does little to promote the critical US-Asian bilateral deals mentioned earlier.

US resistance to the union may not only be futile and dear in terms of opportunity costs lost on other vital interests, it may also directly damage US influence that is already under fire in the region. Like many other places, the US faces a public image problem in East Asia.²⁷ Disenchantment stemming from scandals involving American troops stationed in Korea and Japan has only been inflamed by post-9/11 American foreign policy in places like Iraq. Such sentiment is beginning to encroach on heretofore staunchly pro-American positions in the region. The Philippine withdrawal of its small contingent of troops from Iraq ahead of schedule in exchange for the safe return of a kidnapped Filipino truck driver is one such worrying example of a decline in US clout. Muslim states in particular, such as Malaysia and Indonesia, have broken with the US publicly on issues ranging from Israel-Palestine to US offers to patrol the Strait of Malacca.²⁸

Thus US opposition to EAFTA could be costly whether the agreement comes forth quickly or not. Trying to squelch EAFTA, even if successful in the short-run, would embolden opponents of the US within East Asian governments to fan regionalist and anti-American flames by highlighting continual US meddling in national affairs. Were EAFTA to go forward anyway despite US objection, opposition would inhibit the potential for the US to influence the development of

treaty provisions. The US would forfeit its ability to bend the agreement towards its economic interests in a number of important areas. Pushing down the union's bound external tariff rates on important US exports, decreasing the prevalence of non-tariff barriers like customs procedures and other transaction costs to US business, and easing paths for American investors might all suffer from the US losing the ears of its allies within ASEAN+3 governments.

It can be argued that if the benefits of an EAFTA crafted towards US interests makes its passage more attractive, then the US should neither completely obstruct nor support EAFTA as is, but go one step further and use its powerful position in East Asia to force US inclusion as a member of the union.²⁹ Inclusion in EAFTA would provoke much of the same response by opponents of the US within East Asian governments, and could prove even worse. US insistence on inclusion in a regional FTA not only smacks of economic imperialism, but its very notion is counter to the idea of a regional pact. The idea of the US joining the EU or Mercosur sounds a little ridiculous. Would EAFTA be a credible exception? US inclusion in EAFTA is somewhat illogical because the US is already committed to APEC. Shifting priority to EAFTA inclusion would falter for the same political reasons as APEC, and signal a final end to any successful use of APEC as a vehicle for building economic and political ties between the East and West.

Given the momentum towards regionalism, the potential benefits to the US from EAFTA, the need for a clear US policy, the array of other important challenges, and shifting perceptions of the US in East Asia that effectively constrain US opposition to integration, neither outright obstruction nor conditional acceptance of EAFTA make for good policy. The US should resolutely support EAFTA. This is not to say that support is without problems, but it is the best option available.

A LITTLE LESS INFLUENCE AND A LITTLE MORE TRADE

The US is currently the sole undisputed economic and military power, both in the world and in East Asia. It will remain so in the world for some time, but its role in East Asia is changing. In 2004, China surpassed the US as Japan's largest trade partner. This change portends a trend that the US need recognize. It is not a quick or drastic shift, but one that is slowly but surely occurring: America's economic dominance is waning in East Asia. And this is not a bad thing.

EAFTA's emergence is just one outgrowth of this shift, one that need occur everywhere if healthy foreign economies are to grow and become solid economic partners with the US. Europe's early economic integration is a good example of how a union like EAFTA may one day lift American prosperity to new and greater heights. According to a Congressional Research Services report issued in May, "Not only is the US-EU trade and investment relationship the largest in the world, it is arguably the most important. Agreements between the two economic superpowers have been critical to making the world trading system more open and efficient."³⁰

While East Asia is not Europe, both regions encompass the largest economies outside of the US. The size and strength of the EU's integrated market aided

American trade and investment opportunities immensely. In 2004, annual two-way trade flows of goods, services, and investment between the United States and the EU exceeded \$1.3 trillion.³¹ With every large American investor and business involved in some way in East Asia, the further integration of Asian markets could prove an incredible boon to US prosperity.

Today, South Korea presents the perfect avenue toward implementing the hybrid policy suggested here of pushing EAFTA alongside parallel US trade agreements. The US should declare its outright support for EAFTA with encouragement and pressure to conclude a critical precursor FTA underway between Korea and Japan. Simultaneously, the US Congress should follow up on the successfully negotiated bilateral deal with Korea and pass the treaty by the end of 2007. Effecting this dual strategy with Korea and other important ASEAN+3 partners will enhance US economic access to the region and best position the US to make the most of budding East Asian integration.

While EAFTA's emergence may further reduce America's economic influence in the region, that does not mean it will hurt US economic interests. On the contrary, if EAFTA is to follow the path of the EU in any measure, the benefits to US prosperity could be immense. There is little that the US can do to stem its waning economic influence in the long-run. To partake of the rise of Asia in the 21st century in a way that best helps America, the US should support EAFTA and further develop America's economic bonds with its neighbors across the Pacific. A little less influence may go a long way.

Notes

¹ The Chairman's Statement of the Tenth ASEAN+3 Summit on January 14, 2007 "welcomed the East Asia Free Trade Area (EAFTA) as a fruitful avenue of integration." While the ASEAN+3 summit leaders noted the possibility of other EAFTA configurations that include other EAS members, the most important trade commitments agreed to in Cebu involved those of ASEAN+3 members, including an agreement on trade in services between ASEAN and China, and Japan's proposal to create an Economic Research Institute for ASEAN and East Asia (ERIA). Furthermore, the current difficulties to win the ASEAN-India FTA negotiations suggest a larger FTA grouping, beyond ASEAN+3, may be infeasible anytime soon.

² Fred Bergsten, "Embedding Pacific Asia in the Asia Pacific: The Global Impact of an East Asian Community" (speech at the Japan National Press Club, Tokyo, September 2, 2005).

³ Bergsten, "Embedding Pacific Asia," 3. See also Simon Tay, "East Asian Community and the United States: an East Asian perspective," *Pacific Forum CSIS, Issues and Insights* 5 (2004): 24–25.

⁴ While security concerns are also vital to American interests in East Asia, EAFTA's immediate impacts center on its economic effects and are thus the focus of this analysis.

⁵ Jong-Wha Lee and Innwon Park, "Free Trade Areas in East Asia: Discriminatory or Non-discriminatory?," *World Economy* 28, no. 1 (Jan 2005): 23.

⁶ Feng Lu, *Free Trade Area: Awakening Regionalism in East Asia*. Working paper no. E2003010. China Center for Economic Research, Peking University, 2003. Lu makes the distinction between "top-down" government led action with reference to particular formal agendas and mechanisms as opposed to "bottom-up" integration occurring naturally in the market.

⁷ Malaysia's Prime Minister, Mahathir Mohamad, said at the First ASEAN Economic Congress in 1987 that "in its first 20 years, the main thrust of ASEAN has been political." See Lu, "Free Trade Area," 10.

⁸ Saman Kelegama, "Bangkok Agreement and BIMSTEC: Crawling Regional Economic Grouping in Asia," *Journal of Asian Economics* 12 (2001): 106.

⁹ T.J. Pempel, "Emerging Webs of Regional Connectedness," in *Remapping East Asia: The Construction of a Region*, ed. T.J. Pempel (Ithaca: Cornell University Press, 2005).

¹⁰ Simon Tay, "East Asian Community and the United States," 16.

¹¹ Ibid, 16–17.

¹² Chang Jae Lee, “Towards an East Asia Free Trade Area: A Korean Perspective,” Presentation to the Korea Institute for International Economic Policy, Seoul, September 1–2, 2004.

¹³ This analysis excludes the debate around the benefits of free trade and assumes the general consensus that free trade is positively related to economic growth and efficiency. For a recent review of many of the issues, see Jagdish N. Bhagwati, *Free Trade Today* (Princeton: Princeton University Press, 2003); and Douglass Irwin, *Free Trade Under Fire* (Princeton: Princeton University Press, 2003).

¹⁴ Jagdish Bhagwati first posed the question of whether free trade agreements serve as “building blocs or stumbling blocs” in Jagdish Bhagwati, *The World Trading System at Risk* (Princeton: Princeton University Press, 1991). Since then, a variety of articles have surfaced arguing both ways. In Jagdish Bhagwati, David Greenaway and Arvind Panagariya, “Trading preferentially: theory and policy,” *The Economic Journal* 108 (1998): 1128–1148; the authors describe how increasing bilateral and regional preferential FTAs lead to an ever more complex and difficult trading environment—a “spaghetti bowl effect”—that inhibits economic benefits and liberalization. However, a recent study of Asian FTAs suggests that this is not the case in Asia; see Patrizia Tumbarello, “Are Regional Trade Agreements in Asia Stumbling or Building Blocs? Some Implications for the Mekong Countries,” Paper presented at “Accelerating Development in the Mekong Region—the Role of Economic Integration,” Siem Reap, Cambodia, June 26–27, 2006.

¹⁵ Joint Media Statement of the Ninth Consultations between the ASEAN Economic Ministers and the Ministers of People’s Republic of China, Japan and Republic of Korea (AEM Plus Three) Kuala Lumpur, August 24, 2006; and Matsuda Iwao, “Free Trade Vision for East Asia,” (CEAC Commentary, Council on East Asian Community, April 28, 2005)

¹⁶ Chang Jae Lee, “From East Asian FTAs to EAFTA,” Paper presented at the Second Conference of East Asian Institutes Forum on East Asian Economic Integration: Progress and Impediments, organized by Korea Institute for International Economic Policy, in Jeju, on October 13–14, 2006

¹⁷ Gary Hufbauer and Yee Wong, “Prospects for regional free trade in Asia,” (Working Paper No. 05–12, International Institute for Economics, Washington, DC, 2005).

¹⁸ Robert Scollay and John Gilbert, *New regional trading arrangements for the Asia-Pacific?* (Washington, DC: Institute for International Economics, 2001), 68; Urata and Kiyota find a similarly negligible welfare loss of .06% for the US from EAFTA; see Shujiro Urata and Kozo Kiyota, “The impacts of an East Asia FTA on foreign trade in East Asia,” (NBER Working Paper No. 10173, National Bureau of Economic Research, Cambridge, MA, 2003), 10.

¹⁹ Scollay and Gilbert, *New regional trading arrangements for the Asia-Pacific?*, 86.

²⁰ Lee and Park, “Free trade areas in East Asia: discriminatory or non-discriminatory?” 35. Their analysis suggests that trade gains to countries outside EAFTA depend on how the FTA would operate, in that it might operate more like NAFTA (which would then expand EAFTA extra-bloc trade by 8.9 percent) or more like AFTA (which would increase those gains to 55 percent). Furthermore, other studies indicate that FTAs in general tend to increase trade between members and non-members, especially when FTA markets also balance FTA liberalization with other liberalization efforts. See J. Frankel, *Regional trading blocs in the world economic system*. (Washington, DC: Institute for International Economics, 1997) for a summary of FTA coefficient estimates across studies.

²¹ Lee and Park, “Free trade areas in East Asia,” 41.

²² Ibid, 20.

²³ A currency swap is an agreement to exchange one currency for another and to reverse that transaction at a specified future date.

²⁴ Victor Mallet, “Support deal could become Asia IMF,” *Financial Times*, May 6, 2005. For an in-depth discussion of the Chiang Mai initiative, see C. Randall Henning, *East Asian Financial Cooperation*. (Washington, DC: Institute for International Economics, 2002), 11–31.

²⁵ Feng Lu, “Free trade area: awakening regionalism in East Asia,” 20.

²⁶ Scollay and Gilbert, *New Regional Trade Agreements for the Asia-Pacific?*, 140.

²⁷ Simon Tay, “East Asian Community and the United States,” 18.

²⁸ Eric Teo Chu Cheow, “Strategic relevance of Asian economic integration.” (RIS Discussion Paper 90/2005, Research and Information System for the Non-Aligned and Other Developing Countries, New Delhi, 2005).

²⁹ Simon Tay, “East Asian Community and the United States: An East Asian Perspective,” 25.

³⁰ Ibid, 2.