

Chapter 1

The Strategic Framework for Deepening Integration

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Chapter 1

The Strategic Framework for Deepening Integration

Fukunari Kimura

INTRODUCTION

This paper tries to provide a strategic framework for deepening economic integration in East Asia, with special reference to the fragmentation theory and new economic geography. The de facto economic integration in East Asia is “uneven,” and this unevenness actually generates economic dynamism in the formation of international production/distribution networks. We can thus find a way to pursue both deepening economic integration and narrowing development gaps in parallel by utilizing globalizing forces.

To effectively make use of international production/distribution networks, we need to recognize that countries/regions at different development phases face different policy challenges. The fragmentation theory and new economic geography provide useful policy guidance in the framework of two-dimensional fragmentation and agglomeration. This paper argues that more institutionalized economic integration can be a powerful driver for designing and implementing required policy packages. The paper also suggests that the open architecture of free trade agreement (FTA) networking in East Asia may have a benevolent influence on the construction of a new international economic order at the possible conclusion of the Doha Development Agenda.

2. CURRENT STATUS AND SPECIAL FEATURES OF ASEAN/EAST ASIA

2.1. *De facto* economic integration and regionalization

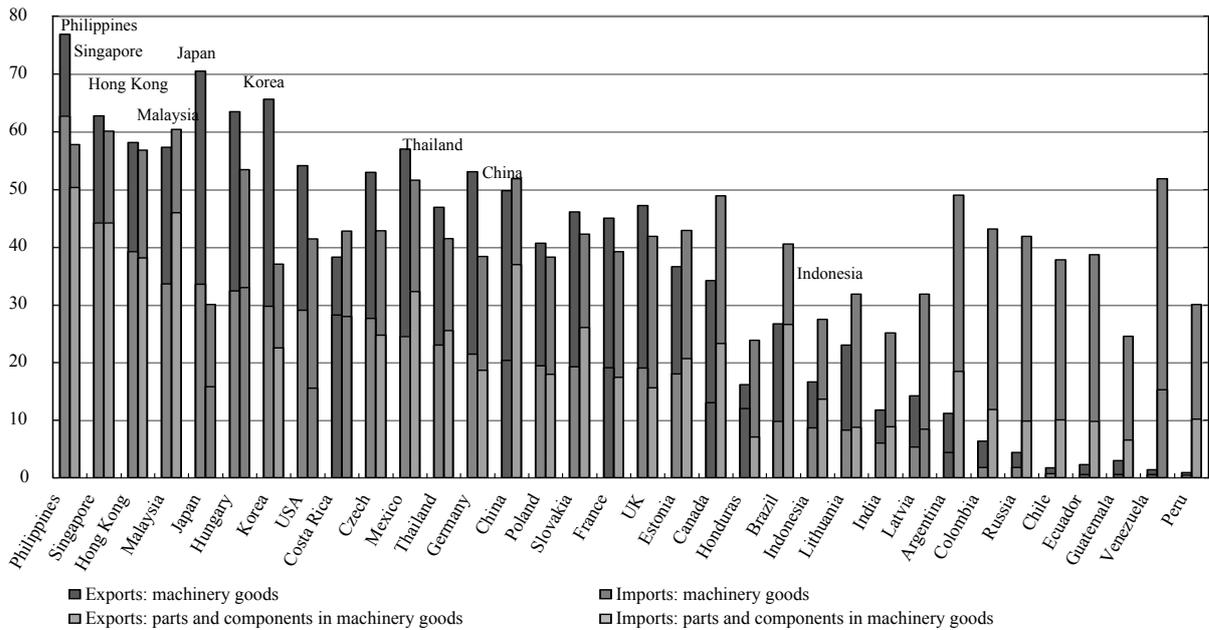
The international trade theory defines the “integrated world economy equilibria” as the extreme of economic integration where the world’s total production and consumption are equivalent to the equilibria in which all economic elements are perfectly mobile or the world economy has zero dimension¹. Starting from such a pure theoretical concept of economic integration, we can assess the degree of economic integration in two ways: by evaluating the mobility of economic elements and by measuring price convergences. The former method is to check the “process” of economic integration: The diversification of international transaction channels and international mobility of various economic elements such as goods, services, investment flows, human capital, labor, information and technology, and others are to be examined. The latter is to evaluate the “result” of economic integration, judging on how thoroughly arbitrage, where price differences for various economic elements exist, is exploited.

Such assessment vividly reveals the nature and characteristics of economic integration in East Asia, in sharp contrast with the European economic integration. In the case of Europe, particularly the economic integration of core European Union (EU) countries, the high degree of price convergence has been accomplished; for both goods and productive factors, not much room for arbitrage remains. In contrast, East Asia presents an “uneven” pattern of economic integration. For some economic elements, economic integration in East Asia has already been accomplished at a high degree; trade in parts and components and cross-border manufacturing activities are such cases. However, it does still have some economic elements that are far from complete integration: Unskilled labor as well as information and technology are examples.

Domestic and international income/welfare disparity is not at all desirable; so, this certainly should be corrected. However, it is also true that “uneven” characteristics of East Asian economic integration have generated region-specific dynamism through the

formation of international production/distribution networks. In this context, we should be able to pursue both deepening economic integration and narrowing development gaps at the same time.

Figure 1: Machinery goods trade: Shares in total exports and imports in 2005 (%)



Source: Ando and Kimura (2008).

Figure 1 presents the importance of machinery/machinery parts and components trade in East Asia in 2005². The ASEAN forerunners, notably the Philippines, Singapore, Malaysia, and Thailand, as well as China were active back-and-forth traders of machinery parts and components. We observe similar trade patterns between the United States and Mexico/Costa Rica, and between Germany and the Czech Republic/Slovakia/Hungary/Poland, but the extensiveness of production networks is distinct in East Asia.

The regionalization of the East Asian economy has obviously advanced, particularly in the context of production networks. Table 1 presents intra- and interregional exports of machinery goods (parts and components, and finished products) in East Asia in 1990 and 2005. The explosive increase in intra-East Asia trade in machinery parts and components presents the regionalization in the formation of

production networks. At the same time, however, we must note that the connection with non-East Asia, particularly for machinery finished products, still maintains its importance. Production/distribution networks are not exclusive to East Asia only but rather have an open-end design to outsiders. Also considering the active operation of non-East Asian multinationals in production/distribution networks in East Asia, the de facto economic integration in East Asia has developed in an open architecture.

Table 1: Intra- and inter-regional machinery exports in East Asia

(a) Intra- and inter-regional exports		(millions US\$)				(b) Factors of growth in exports (1990-2005)	
		1990		2005			
	Value	%	Value	%			
Machinery goods: parts and components							
Intra-East Asia	54,336	39.6	399,882	52.6	<Intra-East Asian exports>		
Inter-regional	82,915	60.4	360,823	47.4	(i) Growth in intra-East Asian exports		
(U.S.)	(39,624)	(28.9)	(108,213)	(14.2)	All products		321%
Total	137,251	100.0	760,705	100.0	Machinery goods (total)		522%
					- Machinery final goods		400%
					- Machinery parts and components		636%
Machinery goods: final goods							
Intra-East Asia	50,932	23.2	254,738	35.6	(ii) Contribution to the growth (all products)		
Inter-regional	168,597	76.8	460,832	64.4	Machinery goods (total)		63%
(U.S.)	(70,183)	(32.0)	(188,911)	(26.4)	- Machinery final goods		23%
Total	219,529	100.0	715,570	100.0	- Machinery parts and components		40%
Machinery goods: total							
Intra-East Asia	105,268	29.5	654,620	44.3	<Inter-regional exports>		
Inter-regional	251,512	70.5	821,654	55.7	(i) Growth in inter-regional exports		
(U.S.)	(109,807)	(30.8)	(297,124)	(20.1)	All products		224%
Total	356,780	100.0	1,476,274	100.0	Machinery goods (total)		227%
					- Machinery final goods		173%
					- Machinery parts and components		335%
All products							
Intra-East Asia	270,465	38.5	1,139,821	44.9	(ii) Contribution to the growth (all products)		
Inter-regional	432,736	61.5	1,401,216	55.1	Machinery goods (total)		59%
(U.S.)	(174,978)	(24.9)	(473,093)	(18.6)	- Machinery final goods		30%
Total	703,201	100.0	2,541,037	100.0	- Machinery parts and components		29%

Data source: authors' calculation, based on UN COMTRADE

Note: "East Asia" here includes China, ASEAN4, NIES3, and Japan. Due to lack of data available from UN COMTRADE, (i) Taiwan is not included in East Asia, (ii) data for China in 1992 and Hong Kong in 1993 are used in calculating intra-East Asian exports in 1990, (iii) data for the Philippines are not included in calculating intra-East Asian exports in 1990. Growth rates are in nominal terms.

Source: Ando and Kimura (2008).

2.2. Varying approaches for countries at different development phases

Countries at various development phases obviously face different issues in development. Particularly in the context of international production/distribution networks, the variety of location advantages potentially provides economic dynamism, although the proper business environment must be prepared to effectively utilizing globalizing forces. It is important to prescribe proper policy suggestions for countries

that are at different development phases so as to dissolve bottlenecks and take advantage of the mechanism of production/distribution networks.

In the context of utilizing the mechanism of international production/distribution networks, East Asian economies could be categorized into four groups. The first group is about to participating in international production/distribution networks. The issue is how to attract the first wave of production fragmentation from industrial agglomeration nearby. The second group is the phase wherein industrial agglomeration are formulated so as to stabilize the industrial structure. The effective use of positive externalities from industrial agglomeration becomes a crucial issue in this phase. The third group is facing competition from both lower-income and higher income countries. How to upgrade a nation's industrial structure as well as enhance its social welfare up to the level of advanced countries is vital. The fourth group is a major source of foreign direct investment. How to avoid "hollowing out" becomes an important issue for this group.

The benefits from production/distribution networks do not, of course, cover all aspects of economic development. However, the experience of East Asia in the past few decades suggests that the effective use of production/distribution networks is crucial to accelerating economic development. Resolving bottlenecks of production/distribution networks also seems to be helpful in developing other aspects of the economy. Considering the region's successful experience in development so far, it is ideal therefore to design and construct the integration strategy in an "East Asian way".

2.3. Keeping optimism in utilizing globalizing forces

Anti-globalism sentiment has recently proliferated all over the world. In particular, skeptical views on outsourcing and offshoring in North America and Europe have been presented not only in journalistic literature but also among academic intellectuals³. However, East Asians have predominantly kept their optimism over welfare-enhancing globalization. Indeed, East Asia has been the region that has most successfully utilized globalizing forces for its economic development. It is extremely important to maintain such optimism for both the region and the world. To do so, the region has to

continuously prove that globalizing forces can work well if the policy is right.

3. UTILIZING FORCES OF FRAGMENTATION AND AGGLOMERATION

3.1. Mechanics of international production/distribution networks

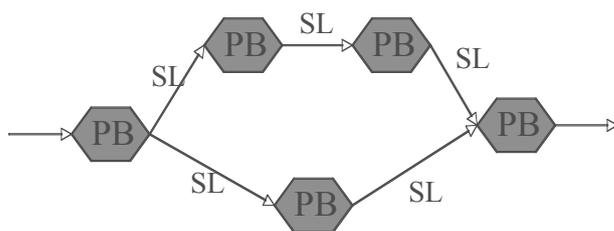
Since the beginning of the 1990s, East Asian economies have experienced an unprecedented development of international production/distribution networks, particularly in machinery industries. The mechanics of international production/distribution networks have recently been analyzed intensively by the fragmentation theory and new economic geography⁴.

Figure 2: The original concept of fragmentation: An Illustration

Before fragmentation



After fragmentation



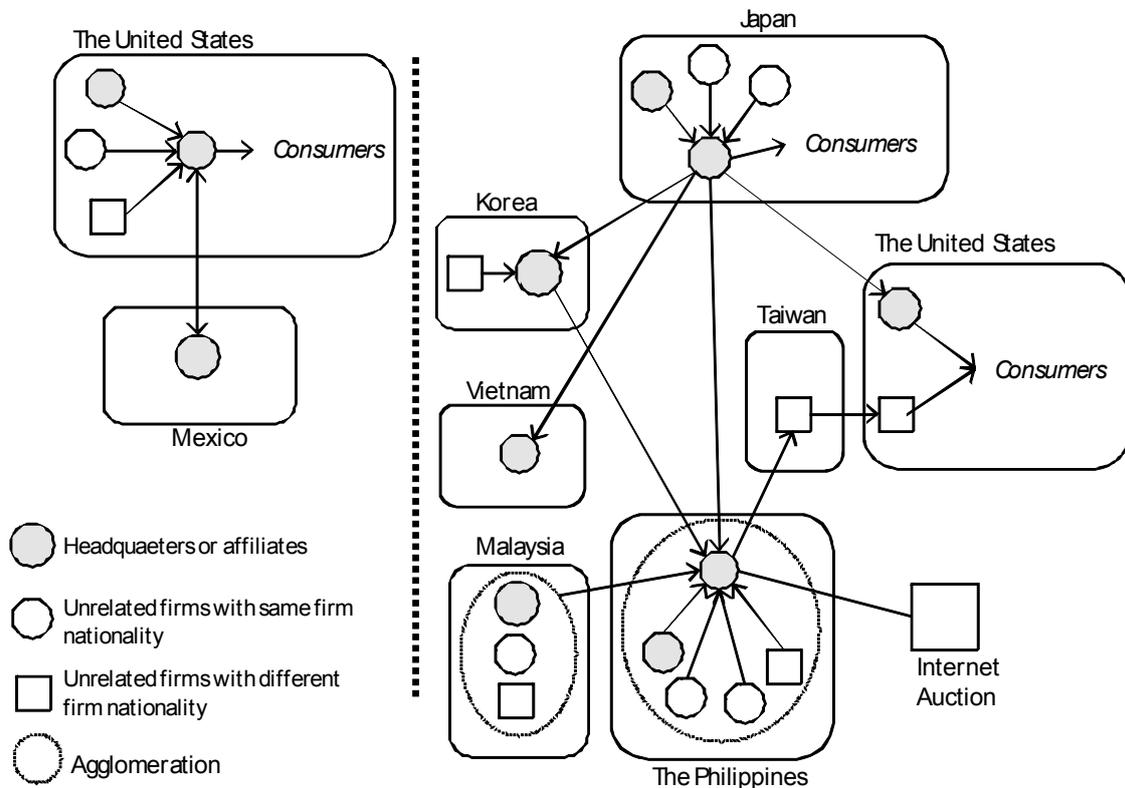
PB: production block
SL: service link

Source: Kimura (2006).

The fragmentation theory started from the seminal work of Jones and Kierzkowski (1990). Figure 2 illustrates the original idea of fragmentation. Suppose that a large factory producing electric products initially exists in a developed country and covers a long value chain from upstream to downstream. A closer look at the detailed nature of

the production processes might suggest that some operations require intensive monitoring by technicians while others may simply be unskilled labor-intensive. Fragmentation, i.e., locating fragmented production blocks in different locations, becomes cost-saving when the production cost per se drastically falls and the cost of service links for connecting production blocks is low enough.

Figure 3: Production/Distribution Networks Between the United States and Mexico and in East Asia: An Illustration

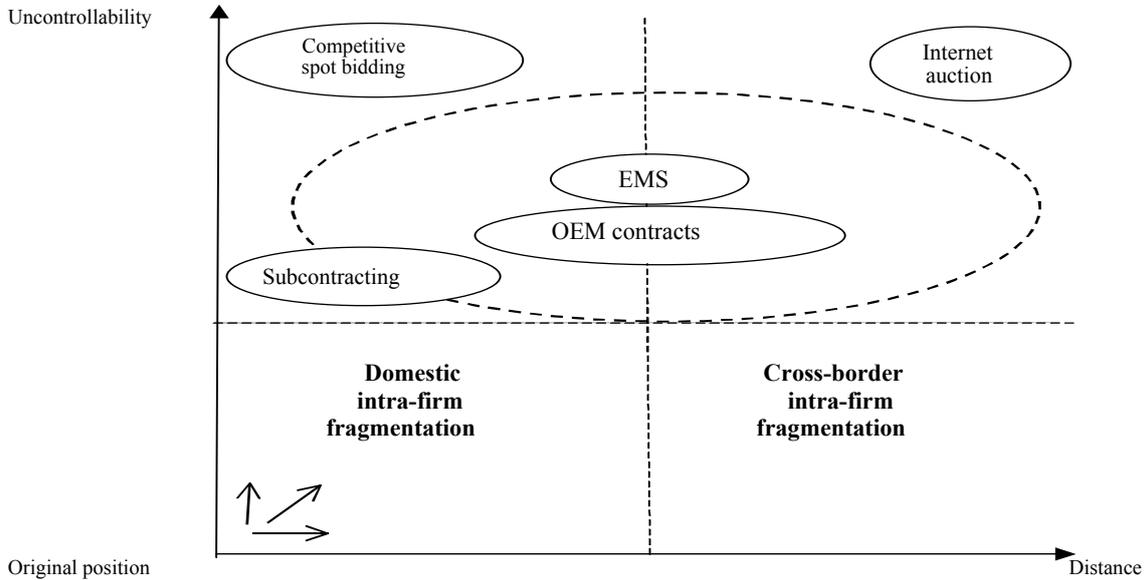


Source: Ando and Kimura (2008).

The original idea of fragmentation primarily deals with a relatively simplistic cross-border production sharing that is, for example, observed between the United States and Mexico. It is a simple back-and-forth production sharing and mostly intra-firm (Figure 3). However, international production/distribution networks in East Asia have developed beyond such a pattern and reached much more complicated forms as illustrated in the right-hand side of Figure 3, including both intra-firm and arm's-length transactions, and some expansion of the analytical framework is inevitably

needed. Kimura and Ando (2005) propose the concept of two-dimensional fragmentation, particularly to analyze the mechanics of networks in East Asia.

Figure 4: Fragmentation in a two-dimensional space



Source: Kimura and Ando (2005).

Figure 4 displays various types of fragmentation in a two-dimensional space. The horizontal axis denotes geographical distance. From the original position, located at the origin, a production block can be detached and placed at a geographical distance. The dotted line in the middle is a national border, separating cross-border fragmentation from domestic fragmentation. On the other hand, the vertical axis represents the disintegration or uncontrollability of a firm. A fragmented production process may be conducted by either intra-firm establishments or unrelated firms. The dotted line is the boundary of a firm, separating arm's-length (inter-firm) fragmentation or outsourcing from intra-firm fragmentation.

Fragmentation and agglomeration occur at the same time. The concentration of fragmented production blocks occurs through the following two channels. First, local minimal points of service link costs tend to attract a large number of fragmented production blocks. Moreover, service links are often accompanied by strong economies of scale. Second, the concentration of production blocks may be enhanced because of the close relationship between the service link costs along the disintegration

axis and geographical proximity. Service link costs in arm's-length fragmentation are extremely sensitive to geographical distance. The closer the distance to one's business partners, the smaller the service link cost in searching for potential business partners, consulting detailed specifications of products, controlling product quality and delivery timing, solving disputes over contracts, and monitoring business partners. The latter economic logic, in particular, seems to greatly contribute to the formation of industrial agglomeration in East Asia.

New economic geography links with the fragmentation theory in a consistent manner. New economic geography claims that industrial agglomeration generates both concentration forces and dispersion forces. The logic behind the formation of agglomeration as described by the fragmentation theory is consistent with the mechanism of generating concentration forces in a new economic geography. The dispersion forces, on the other hand, generate another layer of fragmentation from a center to peripheries.

An important aspect of international production/distribution networks is their effective utilization of uneven economic integration. In the fragmentation of production processes, low service link costs as well as the high degree of freedom in cross-border corporate activities are important while differences in location advantages, including wage gaps, provide room for possible cost savings in production blocks. Positive and negative externalities generated by industrial agglomeration also provide development opportunities for both centers and peripheries.

The effective use of arbitrage gaps has been effective in East Asia's economic development. Rather than immediately considering the artificial correction of domestic/international income disparities due to social concerns, we should first try to take advantage of uneven economic integration. To do it, careful policy designs for different development phases are crucial. The fragmentation theory and new economic geography provide a useful framework for identifying bottlenecks and providing policy diagnosis.

3.2. Further utilizing fragmentation and agglomeration forces

In the formation of production networks in East Asia, policy support has certainly

played an important role. However, such policies have largely been the result of passive responses to large and small requests raised by the private sector. Policy environments favorable for international production/distribution networks arose from the accumulation of trouble-shooting solutions, rather than from a well-planned grand strategy. To further activate and extend the utilization of fragmentation and agglomeration forces, we should explicitly evaluate and reorganize the policy environment.

Table 2 presents fragmentation-related policies in a matrix form. Two rows represent two-dimensional fragmentation; i.e., fragmentation along the distance axis and along the disintegration axis. For each type of fragmentation, three kinds of costs are incurred: (1) the set-up cost to develop production/distribution networks; (2) service link cost to connect production blocks; and (3) production cost per se in production blocks. To further activate international production/distribution networks, policies should strategically be geared toward reducing these costs.

Note that the required policy weights in the 2x3 matrix differ across countries at different development phases. At the initial phase of participation in international production/distribution networks, fragmentation along the distance axis has primary importance. A country or a region should invite foreign direct investment by meeting two conditions, according to the fragmentation theory. First, production cost savings in a fragmented production block must be realized. Second, the cost of service links that connects remotely-placed production blocks must not be prohibitively high. Quick improvements of the investment climate in some limited areas would work if the overall improvement for the whole country cannot immediately be implemented. Bottlenecks can be removed by developing industrial estates and reducing service link costs. Once these are in place, some production blocks may be invited through dispersion forces from neighboring industrial agglomeration.

In the next phase, in which the formation of industrial agglomeration is targeted, both types of fragmentation become important. To turn into an industrial power, forming industrial agglomeration with dense vertical and horizontal linkages is essential. To attract a large mass of production blocks, the overall improvements for fragmentation along the distance axis is crucial; such effort includes the development of one-stop services for incoming foreign direct investment, logistics infrastructure,

multiple industrial estates, and stable legal/economic systems. As for fragmentation along the disintegration axis, it is crucial to invite various kinds of firms---including upstream and downstream firms---large and small enterprises, and firms from various nationalities. A package deal of upstream and downstream investment is also effective. In addition, fostering local entrepreneurs/firms becomes important.

Table 2: Policies for activating two-dimensional fragmentation

	Reduction in fixed costs to develop production/distribution networks	Reduction in service link costs connecting production blocks	Further cost reduction in production cost per se in production blocks
Fragmentation along the distance axis	<p><i>Various policies to reduce investment costs</i></p> <p>Examples: (i) improvement in stability, transparency, and predictability of investment-related policies; (ii) investment facilitation in FDI-hosting agencies and industrial estates; and (iii) liberalization and development in financial services related to capital investment.</p>	<p><i>Various policies to overcome geographical distance and border effects</i></p> <p>Examples: (i) reduction/removal of trade barriers such as tariffs; (ii) trade facilitation including simplification and improved efficiency in custom clearance/procedures; (iii) development of transport infrastructure and improved efficiency in transport and distribution services; (iv) development of telecommunication infrastructure; (v) improved efficiency in financial services related to operation and capital movements; and (vi) reduction in costs of coordination between remote places by facilitation of the movement of natural persons.</p>	<p><i>Various policies to strengthen location advantages</i></p> <p>Examples: (i) establishment of educational/occupational institutions for personnel training to secure various types of human resources; (ii) establishment of stable and elastic labor-related laws and institutions; (iii) establishment of efficient international and domestic financial services; (iv) reduction in costs of infrastructure services such as electricity and other energy, industrial estates services; (v) development of agglomeration to facilitate vertical production chains; (vi) establishment of economic institutions such as investment rule and intellectual property rights; and (vii) various trade and investment facilitation.</p>
Fragmentation along the disintegration axis	<p><i>Establishment of economic environment to reduce set-up costs of arm's length transactions</i></p> <p>Example: (i) establishment of economic system to allow co-existence of various business partners as well as making various types of contracts; (ii) various policies to reduce costs of information gathering on potential business partners; (iii) securing fairness, stability, and efficiency in contract; and (iv) establishment of stable and effective institutions to secure intellectual property rights.</p>	<p><i>Development of institutional environment to reduce the cost of implementing arm's length transactions</i></p> <p>Examples: (i) policies to reduce monitoring cost of business partners; (ii) improvement in legal system and economic institutions to activate dispute settlement mechanism; and (iii) policies to promote technical innovations in modulation to further facilitate outsourcing.</p>	<p><i>Various policies to strengthen competitiveness of potential business partners</i></p> <p>Examples: (i) hosting and fostering various types of business partners including foreign and indigenous firms; (ii) strengthening supporting industries; and (iii) various policies to promote the formation of agglomeration.</p>

Source: Kimura (2007).

3.3. Utilizing collective effort toward economic integration

From now on, East Asian countries should utilize the framework of formalized economic integration much more effectively than before. For relatively less developed countries and regions, “narrowing development gaps” is one of the regional commitments; thus, regional resources, both financial and intellectual, can be employed for this purpose.

In this regard, the removal of redundant tariffs is the first task at hand. The ASEAN Free Trade Area (AFTA) is about to see an eventual tariff removal in its six forerunner-countries and extends the free trade regime to latecomers. Such efforts should be continued in the extended East Asia as a whole.

Aside from the simple tariff removal, various efforts of trade/investment facilitation and institutional building for investment climate are required. Some of these policy elements could be incorporated into an economic integration framework that is exemplified in current free trade agreements between Japan and ASEAN countries. The development of economic infrastructure and improvement of capacity building for policy implementation are also of importance. The “development” aspect should be incorporated explicitly in East Asian economic integration efforts.

4. A PATH TOWARD FULLY DEVELOPED ECONOMIES

4.1. Relatively less developed services sectors

At higher development phases, countries inevitably face new challenges. They have already introduced globalizing forces and participated in international production/distribution networks. They have also successfully formulated industrial agglomeration. As the income level goes up, simple labor-intensive activities gradually lose international competitiveness. On the other hand, it is difficult to immediately jump to the level of a fully industrialized society and at the top of the product cycle. Capabilities of domestic firms and entrepreneurs are typically

insufficient for setting up their own business networks and innovation capability without help from multinational enterprises. These countries are facing competition from both lower-income and higher-income countries.

At this phase of development, the piecemeal, responsive, enclave-type policies may not work effectively. Rather, upgrading the whole society, including human resource development and overall business environment, should be accomplished. Since the pattern of economic development in East Asian countries has somewhat been biased toward a part of manufacturing activities, a better-balanced industrial structure should be required at this point in the development path. In particular, some parts of services sectors are prone to being underdeveloped and insulated from foreign competition. It is, however, important to develop competitive services sectors so as to pursue a more advanced industrial structure beyond relatively simple manufacturing operations as well as to pull national welfare up to the level of fully developed economies.

Economic integration initiatives must be fully utilized at this phase. Lessons from other countries' experiences would help. Integration initiatives generate benevolent pressure coming from international commitments.

4.2. Complication in deeper economic integration

It is, of course, a good thing that people are eager to pursue deeper economic integration beyond simple tariff removals. However, if we proceed to other policy modes such as trade facilitation, services, investment, and movement of natural persons, we have to realize that we are dealing here with issues quite different from simple trade liberalization.

This caveat is not a concern backed by the traditional argument of sequencing and gradualism. Logically, unwarranted claims of "liberalization" would rather yield pain and frustration with incomplete results, and reformers would lose their credibility in the long run. For example, the statement that claims "complete liberalization in services" does not make sense. We academic researchers should guide the liberalization momentum toward a constructive direction.

Once we go beyond simple tariff removal and step into wider policy modes, economic rationale for integration becomes complicated. First, traditional policy for

trade in goods primarily consists of border measures while other policy modes, such as policies on trade in services, are likely to be domestic policies. This means that international commitments step into the realm of domestic politics that may not be accustomed to foreign intervention.

Second, international commitments tend to go beyond the nondiscrimination principles and further incorporate measures for institutional convergence/harmonization, or a commitment on “behind-the-border” issues. The nondiscrimination principle simply calls for the removal of discriminatory practices against foreigners vis-à-vis domestic persons, allowing for international differences in legal systems or economic institutions across countries. However, some of the commitments in trade in services and intellectual property rights protection, for example, tend to include the elements that require one to remove differences across countries.

The nondiscrimination principle has a simple and robust logical background in economics, which claims that the removal of policy distortion is almost always desirable. In the case of institutional convergence/harmonization, on the other hand, the institution itself is justified as a policy tool for canceling out distortions, and thus it is logically difficult to find the first-best situation. In addition, even when convergence/harmonization is desirable, the adjustment cost may be asymmetric across countries. Whether we should go for institutional convergence/harmonization or not must be judged on a case-by-case basis rather than on a simplistic, general principle.

Third, the objective functions of the government may be different in the case of the traditional trade policy and the case of other policy modes. The context of trade policy tends to include “(static and dynamic) efficiency” only. On the other hand, in the discussion of other policy modes, efficiency may not be the only objective of the government. The government would rather like to have a social welfare function with social consideration.

There are caveats. Domestic political economy often uses above logics so as to protect vested interests. What we have to do here is to rely on the momentum of liberalization, to detect the political economy structure, and to promote liberalization and policy reform.

5. ARCHITECTURE OF MORE INSTITUTIONALIZED ECONOMIC INTEGRATION

5.1. Can ASEAN continuously lead East Asian integration?

The ASEAN has played an important role in constructing FTA networks in East Asia. Table 3 presents the current status of FTA conclusions in East Asia and beyond. In terms of tariff removal, ASEAN has led the initiative. That is, with the notable delay in FTA formation among Japan, Korea, and China, ASEAN has taken the driver's seat. ASEAN has also been active in negotiating and concluding FTAs with countries outside ASEAN+3, which have expanded the boundary of East Asia and has constructed an open architecture for East Asian economic integration.

However, going beyond simple tariff removal is not an easy task. Although The Asian Economic Community Blueprint is an important initiative that would lead deeper economic integration in the region, the current format itself may not become a regional model for extended East Asia. To design a convincing format of deeper economic integration, much more sophistication is required.

Table 3: Status of FTAs in East Asia and Beyond (as of January 2008)

	Russia	Mongolia	Japan	Korea	China	Philippines	Indonesia	Malaysia	Thailand	Singapore	Brunei	Vietnam	Laos	Cambodia	Myanmar	India	Australia	New Zealand	Chinese Taipei	United States	Canada	Mexico	Peru	Chile	
Russia	■			△												△									
Mongolia		■																							
Japan			■	○	△	◎	◎	◎	◎	◎	◎	◎	◎	◎	◎	◎	○	○			△	◎		◎	
Korea	△		○	■	△	◎	◎	◎	◎	◎	◎	◎	◎	◎	◎	◎	○	△	△		◎	○	○	△	◎
China			△	△	■	◎	◎	◎	◎	◎	◎	◎	◎	◎	◎	◎	△	○	○						◎
Philippines			◎	◎	◎	■										○	□	□							
Indonesia			◎	◎	◎	◎	■									○	□	□							
Malaysia			◎	◎	◎	◎	◎	■								○	○	○			○				○
Thailand			◎	○	◎	◎	◎	◎	■							◎	◎	◎			○			◎	
Singapore			◎	◎	◎	◎	◎	◎	◎	■						◎	◎	◎	△	◎	○	○	○	◎	
Brunei			◎	◎	◎	◎	◎	◎	◎	◎	■					○	□	◎							◎
Vietnam			○	◎	◎	◎	◎	◎	◎	◎	◎	■				○	□	□							
Laos			○	◎	◎	◎	◎	◎	◎	◎	◎	◎	■			○	□	□							
Cambodia			○	◎	◎	◎	◎	◎	◎	◎	◎	◎	◎	■		○	□	□							
Myanmar			○	◎	◎	◎	◎	◎	◎	◎	◎	◎	◎	◎	■	○	□	□							
India	△		○	○	△	○	○	○	◎	◎	○	○	○	○	○	■	△	△							△
Australia			○	△	○	□	□	○	◎	◎	□	□	□	□	□	△	■	◎			◎				○
New Zealand			△	△	○	□	□	○	◎	◎	◎	□	□	□	□	△	◎	■							◎
Chinese Taipei										△									■	△					
United States				◎				○	○	◎							◎		△	■	◎	◎	◎	◎	
Canada			△	○						○										◎	■	◎	○	◎	
Mexico			◎	○						○										◎	◎	■	○	◎	
Peru				△					◎	○										◎	○	○	■	◎	
Chile			◎	◎	◎			○		◎	◎					△	○	◎		◎	◎	◎	◎	■	

Note: ◎: Entered into force/signed

○: Under negotiation/agreed to negotiate (bilateral)

□: Under negotiation/agreed to negotiate (plurilateral)

△: Under consideration (G-G base)/feasible study initiated

Source: Author's compilation from the following web-sites. World Trade Organization (<http://www.wto.org>), Organization of American States (<http://www.sice.oas.org/>), Asian Development Bank (<http://aric.adb.org/regionalcooperation/>), Ministry of Foreign Affairs, Japan (in Japanese) (<http://www.mofa.go.jp>), Ministry of Foreign Affairs and Trade, Korea (<http://www.mofat.go.kr>), Ministry of International Trade and Industry, Malaysia (<http://www.miti.gov.my>), Department of Trade Negotiation, Thailand (<http://www.thaifta.com>), Ministry of Trade and Industry, Singapore (<http://app.fta.gov.sg>), Ministry of Commerce and Industry, India (<http://commerce.nic.in>), Department of Foreign Affairs and Trade, Australia (<http://www.dfat.gov.au>), Ministry of Foreign Affairs and Trade, New Zealand (<http://www.mfat.govt.nz>), Office of the United States Trade Representatives (<http://www.ustr.gov>), Foreign Affairs and International Trade Canada (<http://www.dfait-maeci.gc.ca>), Ministry of the Economy, Mexico (<http://www.economia.gob.mx>), Ministerio de Comercio Exterior y Turismo, Peru (in Spanish) (<http://www.mincetur.gob.pe>), Ministry of Foreign Affairs, Chile (<http://www.direcon.cl>).

Source: Kuno and Kimura (2008).

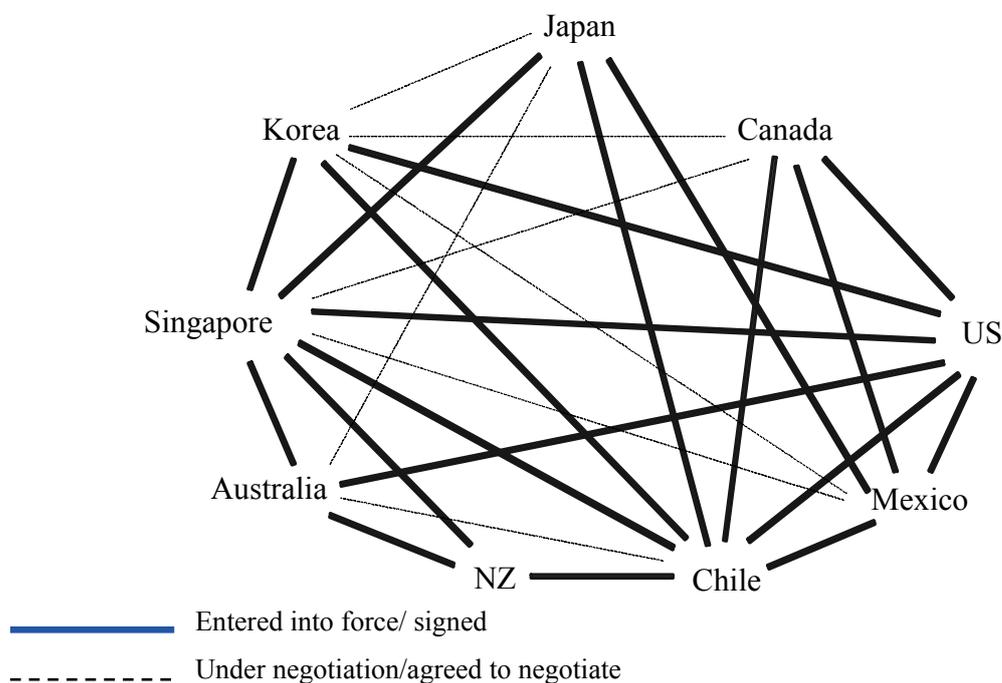
5.2. New open regionalism in Asia-Pacific?

The FTA formation in Asia-Pacific is also in progress. Figure 5 highlights nine Asia-Pacific Economic Cooperation (APEC) participating countries that include seven Organization for Economic Cooperation and Development (OECD) member-countries, Singapore, and Chile. Out of 36 bilateral combinations, 19 have already been connected by FTAs. The idea of an APEC FTA that covers all APEC participating countries may not be realistic, but a path-finder approach with selected countries may be feasible once some of the major countries seriously start taking advantage of the momentum in regionalism. Furthermore, we have to note that some of the FTAs in Asia-Pacific are extremely clean and comprehensive in their liberalization coverage, particularly for trade in goods. Recently concluded FTAs by Australia, Singapore, and the United States, most notably the United States-Korea FTA, commit to an almost 100-percent liberalization for trade in goods within 10 years.

The recent emergence of clean FTAs may become a path-breaking move toward a new international commercial policy regime. To conclude completely clean FTAs with all major trading partners is, from the viewpoint of the country concerned, equivalent to accomplishing open regionalism. Trade economists have long criticized FTAs as a "dirty" policy tool in two aspects: first, FTAs virtually allow some exclusion from trade liberalization; and second, its alleged discriminatory treatment generates trade diversion and other complication such as rules-of-origin issues. However, if one country succeeds to come up with completely clean FTAs with all countries, the mentioned evils will be removed. It does not even have to stick to a geographical concept of "region" anymore; as far as free trade is pursued, any country can be a partner. Such "new open regionalism" shares the spirit of unilateral trade liberalization that trade economists have believed in but is different in that it effectively utilizes pressure against protectionism through the fear of possible isolation. A benevolent domino effect may accelerate trade liberalization in other countries.

Although policymakers are still obsessed with the belief that "FTAs are dirty" and do not intend to actively utilize such a powerful tool, we have to be prepared for the possible emergence of a "new open regionalism."

Figure 5: Bilateral FTAs Involving Countries in Asia-Pacific(As of August 2007)



Source: Kimura, Itakura, and Kuno (2007).

5.3. Link with the WTO framework

Except for the Information Technology Agreement (ITA) initiative in the latter half of the 1990s and China and Chinese Taipei's accession to the World Trade Organization (WTO) in 2001-2002, WTO has not led much improvement in the trade policy regime in East Asia. In most of the countries in East Asia, the WTO-committed tariff levels are now substantially higher than the actually applied most-favored-nation (MFN) tariff levels; i.e., tariff rate overhang is observed. Majority of East Asian countries are rather passive in using the WTO dispute settlement mechanism and admitted unilateral vehicles such as anti-dumping duties. The WTO has not been successful in incorporating new policy discipline that would reflect novel characteristics of globalization in East Asia.

However, after a possible conclusion of the Doha Development Agenda with a small package, East Asia may need to initiate exploring a new international economic order. East Asia has a number of elements for qualifying for such role. We have a superb economic growth record in effectively utilizing globalizing forces and know

what sort of policy environment is needed. We take more of a functional approach rather than a rigid legalistic approach prone to confrontation. We may lead a “new open regionalism” to accelerate global trade liberalization. In this sense, the East Asian economic integration may also have a profound value to the whole world.

6. POLICY RESEARCH AGENDA FOR ERIA

The integration study group in Economic Research Institute for ASEAN and East Asia (ERIA) has a very important mission in providing intellectual support for economic integration in East Asia. The immediate projects urgently needed include the following:

- (1) Further analysis on the interaction between de facto and de jure economic integration;
- (2) Post-evaluation of integration initiatives (e.g., text and implementation of FTAs);
- (3) Assessment of actual liberalization levels (e.g., scorecards for services);
- (4) Assessment of economic institutions and the necessity for convergence/harmonization (e.g., competition policy); and
- (5) Designing the architecture of economic integration (e.g., inputs for the ASEAN Economic Community and others).

Since these topics are highly policy-oriented, close communication with policymakers in the region is also required.

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NOTES

¹ Refer to a standard textbook of international trade theory such as Helpman and Krugman (1985).

² “Machinery” includes general machinery, electric machinery, transport equipment, and precision machinery. “Machinery parts and components” are defined at the six-digit level of HS classification. See Ando and Kimura (2005) for the details. Although production networks are observed in various industries such as textiles and garment, chemicals, and software, those in machinery industries are by far quantitatively most important in East Asia.

³ See, for example, Samuelson (2004) and Blinder (2006).

⁴ See Kimura (2006) and Hiratsuka (2006).