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# RIS Discussion Papers

## Strategic Relevance of Asian Economic Integration

**Eric Teo Chu Cheow**

RIS-DP # 90/2005



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## Strategic Relevance of Asian Economic Integration

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Eric Teo Chu Cheow\*

*Abstract:* As the spread of SARS had shown last year, the longer-term goal of an East Asian Community (ASEAN, China, Japan and South Korea) may already be crystallizing much faster than was initially thought, thanks to increasing people-to-people contacts and the freer movement of goods, services, tourists and expatriates across the whole region. India appears poised to be joining this Asian movement too.

### Growing East Asian Regionalism

Three regional aspects have strategically transformed Asia and contributed largely to the economic integration of Asia, as well as Asian regionalism as a whole; but this transformation has been more profound for the thirteen East Asian countries (under the “ASEAN+3” framework) till now, although it can be expected that India would increasingly join this accelerated “regional movement”, as its destiny gets more intertwined with that of East Asia and as its relations consolidate with East Asian countries.

Firstly, liberalization and globalization have indeed already transformed East Asia into one *de facto* community to a huge extent. SARS then helped create a new East Asian bonding; East Asians now realize that they have a common destiny with a region that is fast becoming interdependent and borderless. Secondly, for the region to really take off, East Asians have become, thanks to the SARS epidemic, more aware of a better and greater re-distribution

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of wealth, development, social and health benefits within the region. Otherwise, richer regions would never be exempt from social problems and diseases, which could originate from poorer and lesser-developed areas in East Asia and infect the richer and more developed ones. Development, growth and social equity must therefore be more quickly and effectively re-distributed across East Asia, and East Asians have clearly a role to play in ensuring this regional endeavour for themselves. Third, East Asia's economic growth and recovery this year could have been seriously stalled, if regional countries had succumbed to excessive fears of contagion, close their borders and restrict the movement of people, goods and investment flows. Furthermore, besides physical or geographical borders, East Asians should be careful not to close their minds to each other. Indeed, discrimination based on nationalities or race, as the SARS epidemic had shown, could be very dangerous, especially for callous, irrational or emotional reasons. Confidence, closer economic coordination and cooperation are necessary; a regional mindset change is thus shaping up, as the SARS epidemic or even the fight against terrorism may eventually help cement East Asia firmer together as a closer-knit and non-discriminatory community in the longer term. The twin scourges of SARS and terrorism may have in fact positively fuelled East Asian regionalism further and contributed to its consolidation.

**East Asian regionalism** has in fact increased in recent years, thanks not only to successive changes and transformations, but also to the three following economic and financial regional trends, which in turn have contributed to further East Asian economic integration:

- Firstly, intra-regional trade has substantially increased in East Asia (for the thirteen countries involved), from 36.1 per cent in 1985 to about 50 per cent in 2000 and then to 55 per cent in 2003, especially as China becomes an even greater big trading partner for all the East Asian economies.
- Secondly, the current account surpluses of the thirteen East Asian nations amount to more than US\$200 billion per year, this despite a shift towards more domestic-led growth in East Asian economies, thereby signifying a trend towards more matured economies in the region. These economies have also become more important competitors amongst themselves, besides being increasingly important markets for their neighbours too. Deflationary risks still exist across East Asia, as over-capacity may constitute a growing problem in many of the East Asian economies.

- Lastly, East Asia has become an enormous pool of foreign reserves, as it is estimated at some US\$1.5 trillion or more than 50 per cent of the world's total reserves. China's foreign reserves are now estimated at almost US\$500 billion, whereas Japan top the world's reserves with more than US\$750 billion (or almost 15 per cent of its GDP). East Asian are therefore the world's top savers (which is clearly recognized by Asians themselves), although a big chunk of these reserves are sustaining the US deficit through the Japanese' (and increasingly the Chinese') purchase of American T-bonds. In a way, this Asian wealth is largely "parked" outside Asia and thereby, not necessarily helping to build East Asia itself; these "excessive" reserves are also potentially destabilizing to the world economy as well.

Attempts at regional coordination and cooperation have begun timidly. Although Malaysian PM Dr Mahathir Mohamad's East Asian Economic Grouping/Caucus idea was shot down in the early 1990s, this grouping has been *de facto* created, thanks to efforts of coordination on the Asian side during preparations for the Asia-Europe Meeting or ASEM. Since then, this grouping of East Asian countries (thirteen states) has been dubbed "ASEAN+3", and is evolving as a viable regional framework. In turn, the habit of coordination and cooperation amongst the thirteen is facilitating a freer flow of ideas, and even probably in unofficially adopting an "appropriate" future economic model for Asia, as Asian policy-makers exchange notes on and discuss the "best" socio-economic model for the Asian Community.

### **The Economic Imperatives of Greater East Asian Regionalism : Strategic Economic Modeling In Creating the Economic Stimulus of Growth and Development**

In terms of strategic economic modelling, four **East Asian regional trends** are influencing the emerging East Asian socio-economic model, as follows:

- Firstly, there has been a clear shift away from the "flying geese model of vertical economic integration", which was centred on Japan vertically through capital flow, technological transfer and the supply of manufacturing parts, and based on market exchange and a clear regional division of labour and production networks (thanks primarily to the expensive cost of production in Japan and the strength of the yen after the Plaza Agreement). Today, according to a ADB Institute Research Paper in January 2003, this regional model appears to be shifting towards that of

“bamboo capitalism” or “parallel development”, based on FDI flows in the region, which create intricate intra-regional production networks, based on the exchange of parts, components and other intermediate products, and hence a “horizontal network of trade and capital”, with China at its core. This FDI-driven supply chain has indeed created diverse and vibrant local industries around the East Asian region; in fact, the further the supply chains are decomposed and extended geographically, the faster and the more profuse would be the proliferation of new enterprises and FDI flows across East Asia. There is therefore a new division of labour and production across East Asia.

- Secondly, there have been fundamentally two models of economic development in East Asia, which tend to be “converging” today, thanks to their common experiences via the three waves of transformation and changes. One school of economic thought has been built upon the Japanese model of large industrial groups (like the Japanese zaibatsu, the Korean chaebols or the Singaporean Government-linked companies), which are sponsored and protected to a huge extent by the State and financed by State-led banks. The second school of economic thought was built on small-and medium-enterprises (or SMEs), which is almost synonymous with Taiwan, Hong Kong and post-Crisis Thailand under Thaksin Shinawatra; this model highlights a more private sector-led economic and business development, rather than a State-led approach. These two models appear to be “converging” today, as the “Japanese model” opens up to small private sector initiatives, just as the State “scales back”, even though it would still be playing an important economic regulatory role. On the other hand, the SME/private sector model appears to have a greater dose of governmental intervention to “lead” business, as in the cases of Taiwan and Hong Kong (thanks to the “hollowing” out of businesses towards China) or Thailand (thanks to the strong business personality of PM Thaksin Shinawatra himself, and buoyed by economic nationalism).
- Thirdly, the social dimension has drastically increased in East Asia. Either based on the shift from “flying geese” to “bamboo capitalism”, whereby production networks expand horizontally or with the “convergence” of the State-led and SME-led East Asian models, the social dimension is highlighted in both cases, especially in post-SARS Asia today. It appears therefore that the East Asian model is fast integrating the social dimension into its economic modeling, thus reducing the influence of the “pure” US model, based solely on productivity and shareholders’ value. The ultimate “economic integration model” for East Asia would undoubtedly need a

firm social dimension; otherwise, Asian socio-economic development, given its traditional communal base, would probably not be sustainable in the long run.

- Lastly, the rise of economic nationalism, given the current propensity of East Asia to boost domestic demand and growth, has clearly dampened its enthusiasm to be wholly export economies alone. Instead, they have seen the importance of building up domestic consumption, as the Asian consumer becomes more “enlightened” (vis-à-vis their governments and authorities), thus also becoming the critically important “voters” that governments would need in the post-Crisis and post-SARS East Asia of today. To build up this domestic consumption dimension and hence, more social equity in the system, East Asia’s economic model would undoubtedly have to balance American productivity and its hard-nosed capitalism with the Europeans’ “softer social model”, based on developmental rights, social equity and societal priorities (although Continental Europe appears to be also evolving towards a “less social” system of its own too). East Asia’s economic modelling is thus now in the process of consolidating together with rising East Asian regionalism.

Strategically, **East Asian regionalism is also necessary to spark off a revival of and constitute a stimulus for the East Asian economies.** There are at least three principal reasons why the “ASEAN+3” goal is now perhaps more acutely vital than ever, namely:

- A bigger and more diversified market for Asian economies to **stimulate growth** through greater East Asian trade (especially with China) and foreign investments (from Japan and South Korea, as well as by China and ethnic Chinese investments). A subsidiary but equally important question is whether Japan could effectively “use” East Asia to revive its own moribund economy, which appears to be case today.
- A new challenge for “laggard” countries within East Asia to **enhance their own national competitiveness through drastic reforms**, via a bigger and liberalized 2 billion-population market; for example, ASEAN countries face a real “challenge from within”, ie the so-called China challenge and would need this “internal competition” within East Asia to reform and enhance its own competitiveness so as to take on this immediate challenge; similarly Japan and South Korea could do likewise.
- **A new impetus in crisis and HRD management**, as the region “pulls” its resources together, ranging from a potential financial pool of more than US\$1.5 trillion in total reserves to increased monetary cooperation (Chiang

Mai Initiative) and the Human Resource Development and IT uplift programmes within the “ASEAN+3” framework.

### **Economic and Monetary Cooperation in Asia: Three Strategic Models for ASEAN+3+India (or JACIK)**

As a region and for the creation of a future East Asian Community, there are currently **three “regional integration models”**, which are being discussed. East Asian integration could either be done through:

- firstly, knitting or weaving a web of existing bilateral free trade areas (or FTAs) together region-wide, thus creating a huge East Asian Free Trade Area,
- secondly, finding the means to effectively use the mass of “unproductive” Japanese savings more efficiently (instead of letting them “fallow” in the banks with sub-zero interest rates or “lie” massively in T-bonds in the United States) in urgently developing the weaker economies of Asia through a sort of “Japanese Marshall for Asia”, although the latter economies must also create the conditions for fruitful and sound investments in their weak economies through vigorous and at times, painful reforms; and
- lastly, creating an integrated East Asian region, centred on China and its enormous potential economic development and growth, through trade (in both goods and services) and investments both ways (China-East Asia, as well as East Asia-China), as well as through a new integrated China-centred production chain-cum-demand network across the whole region; the current “ASEAN-China” FTA could be “expanded” both geographically and intellectually to Japan and Korea, as well as “deepened” beyond a mere FTA towards an East Asian Comprehensive Partnership or CPA.

These models for more intensified economic and monetary cooperation and integration within East Asia, or in “ASEAN+3” plus India, are not necessarily independent of each other. In fact, these are not exclusive models, and a combination of all three could in fact be used effectively to “integrate” this whole region of more than 3 billion in population one day.

These **three strategic integrative models for Asia** would include:

—*Firstly, there is a functional and economic trade approach* in both Northeast and Southeast Asia. Japan had begun negotiations for a Free Trade Agreement (FTA) with South Korea in 2002, stalled then restarted, whereas

Singapore has concluded its Japan-Singapore Third-Generation Economic Partnership in 2002. In parallel, the idea of a China-ASEAN FTA, mooted at the “ASEAN+3” summit in Brunei in November 2001, has been making good progress; the negotiations on the liberalization of goods has concluded and should be put in vigour by early next year. ASEAN itself had also already begun on 1 January 2001 to implement the first phase of its ASEAN-FTA or AFTA, with six countries participating in it initially; the AFTA will then be progressively “extended” to the other four newer members of ASEAN in an accelerated mode, hopefully before 2020. South Korea has also begun FTA talks with Singapore and is targeting to seal such an agreement with ASEAN around 2011 too. Finally, during the visit of PM Koizumi to Southeast Asia in January 2002, he had mooted enhanced cooperation between ASEAN and Japan, with a possibility of a region-wide FTA, which could then even extend to Australia, United States and New Zealand. This has resulted in Tokyo discussing bilateral FTAs with Thailand, Malaysia and the Philippines, which could then contribute towards a Japan-ASEAN FTA ultimately. It has been announced that an India-Singapore Comprehensive Trade Agreement could be concluded before the end of November 2004, which in turn could ultimately act as a “pathfinder” for an ASEAN-India trade and economic agreement. Talks of an ASEAN-India Comprehensive Economic Partnership Agreement should also begin soon, just as former Indian PM Vajpayee went even further at the ASEAN Bali Summit in 2003 to propose an Asian Economic Community (with ASEAN+3+India as its core nucleus), presumably based on this FTA-weaving process across Asia.

It is now recognized that a web of FTAs could become the new economic trend of economic integration and regionalism across Asia (in parallel with the new trade rounds being considered, following the successful Doha WTO ministerial meeting in December 2002, its quasi-collapse last year and its revival this year), although there are still reservations expressed by some ASEAN countries and their Northeast Asian counterparts concerned. In the same vein, the three countries in Northeast Asia are believed to be engaging in more extensive trade links and cooperation; even a Northeast Asia FTA could be considered in the longer term. Both Japan and South Korea are already engaging China economically well, as many Japanese and Korean industries have established their manufacturing bases on the Mainland for cost-effective reasons, as well as to tap the huge Chinese consumer market, which is opening up; the Chinese economy is indeed funneling growth in both South Korea and Japan today too. It is thus not impossible that Tokyo and Seoul may eventually

conceive the idea of a Japan-China and ROK-China FTA separately, especially if intra-Korean entente ultimately bears fruits and the region stabilizes further. By then, it would not be inconceivable to even envisage a Beijing-Tokyo-Seoul FTA in the Northeast of Asia, and with a consolidating AFTA in Southeast Asia, then bring the whole of East Asia under an East Asian FTA or EAFTA. Likewise, India will increase its trade ties and links increasingly with both Northeast and Southeast Asia and weave FTAs with both groups, although it is a much later comer to trade links with East Asia and this increasing FTA set-up in Asia.

Obviously, one major stumbling block would be the sensitive issue of agriculture in these FTAs, an issue, which concerns almost all countries in “ASEAN+3”. Japanese, Korean, and even Chinese, Indian and ASEAN agricultural (and fishery) lobbies are strong and can be expected to hold such eventual FTAs hostage. Feuds over garlic between South Korea and China, and over reeds and mushrooms between China and Japan have already erupted in the past two years. Policy decisions on agricultural subsidies must be clearly arrived at in individual countries and political courage would have to be effectively mustered. Moreover, it could even be envisaged that such policy discussions be undertaken within the “ASEAN+3” or JACIK frameworks, in order to facilitate better coordination of agricultural liberalization within the Asian zone!

The functional approach would thus be to “weave” a web of FTAs, in a building-block process across the whole region, which could then result in a region-wide “ASEAN+3+1” FTA. ASEAN countries could now champion this worthy cause as an Asian end goal. It should hence, like Europe, **envision an Asia or “ASEAN+3+India” Free Trade Area or Comprehensive Partnership (comprising the free flow of trade in goods, services, investments, human resource/development and ideas) in the future, as a common and ultimate goal.**

— *Secondly, there is the model of a Japan-led East Asian growth.* There appears to be some theoretical basis today to reflate and stimulate Japan via East Asia’s present “ASEAN+3” framework. Like the American-led Marshall Plan after World War II, Japan could help to build up this region, whilst boosting its own domestic consumption, “saving” Japanese MNCs, and thereby stimulating the Japanese economy. The key is for Japan to mobilize its huge domestic savings and private capital in order to “tap” the vast market of these

fourteen nations and their 3 billion-population (or almost half of the world’s population). There is great potential for market integration and competition within this “ASEAN+3+1” economic space, as Japan corporations could seek production integration, according to a region-wide division of labour. There is also scope for a bigger market share of Japanese services region-wide; Japanese banks could benefit from fast developing markets in China, India and ASEAN, at a time when the Japanese economy seems to have reached a high level of economic maturity. Furthermore, this region also has total reserves of some US\$1.5 trillion, including the world’s top five foreign reserves (Japan, China, Taiwan, Hong Kong and Singapore), which can be progressively mobilized as fruits of this Japanese-led Plan take shape, and as the growing reserves of China, Hong Kong and Singapore (and even Taiwan, if cross-Straits relations could improve) supplement Japanese funds progressively.

However, there are at least **four** important obstacles to overcome before such a Japanese “Marshall Plan” could be seriously considered or put into action. Firstly, Japan must continue opening up its economy and reforming its present excessively bureaucratic system. Five formidable sectorial lobbies in Japan would have to be “tamed” and restructured, viz retail, construction/property, agriculture, post/logistics and the financial sector. These five lobbies have strong roots in conservative Japan and maintain strong links to local inward-looking politicians from the ruling party as well as protectionist elements in the upper echelons of its disgraced bureaucracy, who have managed so far to impede reforms necessary for the “third opening” of Japan. Secondly, there are doubts if PM Junichiro Koizumi could really overcome these local chieftains and bureaucrats to reform Japan, as a strong leadership seems indispensable to address Japan’s present structural woes. With PM Koizumi’s popularity plunging from almost 80 per cent a year ago to about 45 per cent lately (and even worse, with more disapprovals over approvals in latest polls), a strong PR campaign is now needed to reach out urgently to an “awakening” people, who realize the critical need for radical reforms at this stage of Japan’s development, but encounter the political stranglehold of local vested interests. The effective reform of the Japanese postal system would prove to be a crucial test for Koizumi and the ruling LDP in Koizumi’s second term.

Thirdly, China, India and ASEAN must also quickly set their own houses in order to boost the confidence of potential investors and investments from

Japan. The rule of law and corporate governance are urgent pre-requisites, before we can expect Japan to encourage private funds massively to build the Asian region, together with funds from the richer countries in the region and the overseas Chinese and Indian networks. Adequate assurance must be given to this private capital that their investments in the greater region would not be squandered. This confidence could certainly be shored up by successful ASEAN-China and ASEAN-India FTAs and the present attempts to boost ASEAN's general competitiveness, as highlighted at ASEAN Informal Summit in Brunei in 2001. Lastly and probably most importantly, there is a dire need for a real Sino-Japanese entente, after overcoming its scarred past and present anxieties about each other. Beijing and Tokyo (and New Delhi) can co-lead the "ASEAN+3" development (and extended to India as well), by bringing together Japan's capital and technology, with China's (and India's) manufacturing prowess and its growing capital and technology pool. However, a true political understanding must now be urgently reached between Beijing and Tokyo, if the two Asian giants were to carry this East Asian plan forward, together ultimately with India. Koizumi's speech at the Bo-ao Forum in Hainan in April 2002 had been hailed as "significant", especially in his full support for East Asian regionalism and in dismissing speculation that Japan sees China as a threat. The ensuing bilateral yen-yuan swap agreement is another milestone in Sino-Japanese bilateral cooperation; it has even led to some speculation of resuscitating the former Japanese-inspired Asian Monetary Fund and a common Asian currency, eventually based on the yen and the yuan together in some combination. Likewise, Sino-Indian rapprochement would be critical, but latest moves also augur well in this direction, especially when the new Congress government seems even more intent in developing better relations with Beijing and vice versa. Fundamentally, Asian integration should take off only when Beijing-New Delhi-Tokyo relations stabilize at the summit of Asian regionalism.

This is indeed the best opportunity (and strategically too) to do so, as Japan is currently emerging from its own economic doldrums and powering its economy up again. China's economy is still probably too strong and needs to cool down further and India is powering ahead in growth, especially in the IT sector; between Tokyo and Beijing, the "economic coupling" is thus right to secure a long-lasting rapprochement and economic partnership, thereby creating the best opportunities for a rational approach to co-lead, with India, this emerging Asia and its economic integration.

*—Lastly, there is potential for a China-led (and eventually, an India-co-led) growth model.* Based on the China-ASEAN FTA or partnership (or "ASEAN+1"), there seems to be ample scope for a building block process of networks of partnerships across East Asia, but directed and dictated by market forces. The central focus in this case would be the vast potential Chinese market, especially as it successfully develops westwards in its "Go West" policy. Japan, South Korea and ASEAN could further tap into the vast Chinese markets, as it is already doing so, by increasing economic and monetary cooperation, through trade of goods and services and investments, just as China modernises its structures further. It would then entail for ASEAN, Korea and Japan to dovetail their industries and "plug" into the vast Chinese market, especially looking for "niches" in China's industrial and economic development strategy. This is the new regional division of labour in the making, which would include more mobility in terms of human resource deployment, out-sourcing in third countries and flexible supply and logistical chain management between China and its neighbours. The Chinese reckon that the "ASEAN+3" framework could be built upon a successful ASEAN-China FTA, as the first building block or initial foundation for regional cooperation. The Chinese envision that the Koreans and Japanese would eventually join in, thus building a greater East Asian Cooperation Entity, of which the "ASEAN+3" framework is supposed to provide for. Hence China intends to "grow" the "ASEAN+3" from what they now affectionately dub the "ASEAN+1" today!

The basis for an ASEAN-China FTA or Economic Partnership ("ASEAN+1") is premised on the need for China to ensure that there is stability in its southern flank (in Southeast Asia or ASEAN) for its own developmental goals and objectives. Its willingness to accord special "early harvests" privileges to the ASEAN countries for agricultural products and "Most Favoured Nation (MFN) facilities" to Cambodia, Laos and Vietnam (even before they join the WTO) and ahead of reciprocity from them was a major Chinese concession to ASEAN. There will be inherent difficulties in negotiating the agricultural and manufacturing sector access in the FTA, as China will also face some internal pressure as well; but given its strong government, China should be able to accede to these "concessions", viz for more access to the Chinese market by ASEAN, especially as a political gesture to the latter. Chinese investments outwards are expected to increase, as China takes a larger stake in key areas and sectors in ASEAN countries, like the purchase of Spanish Repsol by CNOOC for US\$600million, thus giving China a strategic foothold in Indonesia's crucial oil industry; more of such strategic Chinese investments would follow. Chinese

ODA (which may be increasingly “tied”) would also increase towards the less-developed countries in ASEAN, in order to help encourage the implementation of the ASEAN-China FTA/Economic Partnership, and thus increase China’s stake, bargaining power and influence in the region.

Building on the ASEAN-China FTA or “ASEAN+1”, and instead of outright competition in the region, the other countries would then try to complement and satisfy China’s vast potential needs (as the acknowledged centre-piece of growth in the region) and thus tailor their niche industries accordingly. Japan could “offer” high-end technological industries and research as well as provide capital and financial services, whereas Singapore and Korea would “plug” into China’s needs for hi-tech industries and services of all sorts. They could also take in Chinese labour and students, and “service” China’s emerging market. Mid-range economies, like Malaysia would have to find niche markets to be effectively competitive, as well as supply agricultural products and their derivatives, like in the cases of Thailand, Philippines and Vietnam, to the vast Chinese market. All these countries could also be potential tourism markets for enriching Chinese, who would thirst to travel abroad; last year some 10 million Chinese are supposed to have travelled, both within and outside China (especially to Singapore, Thailand and Malaysia within ASEAN).

This model of centering “common growth” in East Asia on China and its potential economic development is *de facto* gathering steam, especially if China manages to maintain its phenomenal 7-9 per cent economic growth annually for the next ten years or more. FDI’s would continue to go into the region and their direct or indirect spin-offs could “trickle” down to the “peripheral” countries in terms of goods, services, tourism or educational needs. (In fact, China had reported that in 2003, its trade totalled US\$400 billion and its investments reached US\$53 billion.) Financial flows throughout the region will be enhanced by the growing monetary stability, as a result of the ChiangMai initiative and the bilateral swap agreements thus signed. It is foreseeable that China could eventual lift the inconvertibility of the yuan or RMB for capital accounts, once this stability is achieved, and as the economy grows further. By that time, the yuan, probably together with the Japanese yen, could then form the basis of a common Asian currency, especially if their combined reserves would then probably amount to half of the world’s total reserves.

Likewise, India’s impressive economic growth could also center Asian growth and integration on the country progressively, besides China alone. India

would also need to “integrate” more pronouncedly with the rest of East Asia for it to share center-stage of development with China in this Asian economic integration exercise, ranging from attempts to “join” (even symbolically) the Chiangmai initiative to consolidating trade and investments between India and the thirteen East Asian countries. It would thus eventually contribute towards a model of centering Asian growth and integration on the twin pillars of both China and India one day.

Through one or more or all of the three above models, economic and monetary cooperation in East Asia will definitely grow and intensify. In all the three cases, **the East Asian model for economic and monetary cooperation would be less of an institutional model (as in Europe), than a functional one.** Either through an intertwining web of FTAs consolidating towards an “ASEAN+3” FTA, or a Japan-investment-led model, or a China/India-inspired East Asian growth and consolidation model, the Asian integrative model should be incremental and functional in nature. The “ASEAN+3” and JACIK frameworks should constitute the primary vehicles to drive this economic and monetary cooperation forward.

**Market forces will be fundamentally at play and the *de facto* creation of an Asian Economic Community appears to be already in the works,** though timidly and very progressively. All that is critically needed now is political will and a real sense of community and commonality in East Asia.

#### **A Strategic Political Dimension of Asian Economic Integration: Shifting American Perception of the United States & Its Engagement in Asia**

Just as the Asian perception of the United States has shifted substantially in the past two years, the American perception of Asia is also under-going a dramatic transformation, which could inevitably alter the geo-political and geo-economic power of balance in this region in the next ten to twenty years and contribute further towards Asian integration.

US Defence Secretary Donald Rumsfeld’s statement in early June at a conference of Asian and Pacific defence ministers (also dubbed the “Shangri-la Dialogue”) clearly highlighted the changing US perception of international security. Referring to South Korea and Germany, Rumsfeld stated that the US would have its forces where people wanted them, and not where they were not desired.

South Korea's case was highly significant, as many young Koreans have incessantly called for an American military withdrawal from South Korea; to call the bluff, American negotiators surprised Seoul with a proposal to pull out a third of American troops by 2005. Though delayed at the request of the South Koreans, this partial withdrawal will still take place within two years. It is believed that the present domestic political situation (after the elections and the "return" of President Roh Moon Hyun) and the initial delay in sending Korean troops to aid the US-led coalition in Iraq have also contributed to a growing perception in Washington that South Korea may no longer be such an erstwhile ally in Asia, unlike Japan. Seoul's "divorce" with Washington over *rapprochement* with Pyongyang also appears clear. Furthermore, Seoul is believed to be moving closer to Beijing in a strategic *rapprochement*, especially in six-party talks whilst consolidating its economic ties with the Chinese economic giant. This point weighs in with neo-conservatives in Washington, who seem to evaluate their friends around the world according to their affinities with Washington's rivals or competitors, like China.

Another indicator of this American shift in perception is a recent book, entitled "The Pentagon's New Map: War and Peace in the 21<sup>st</sup> Century" by Thomas Barnett, a professor and strategist at the Naval War College. Barnett divided the world into "The Core" and "The Gap"; the former being the group of "supremely developed" nations, like the UK and Japan, whereas "The Gap" comprises a band of backward states, stretching from Central and South America through Africa, the Middle East, former Soviet Central Asian countries into Indonesia. Barnett advocated a military and financial effort by "The Core" to help "The Gap" become connected through the Internet and trade, so as to end war and thus guarantee peace. This idea could largely represent the neo-conservatives' view of the world, and that of the present Bush Administration in Washington in its war against global terror.

Also key to the shifting American perception of East Asia is the fight against international terror and the danger of rising Muslim fundamentalism. Indonesia, clearly identified as a country in "The Gap", is a major concern, together with southern Thailand, Southern Philippines and even Malaysia; the "controversial" proposal to send American military personnel to help patrol and guard the international waterway, the Straits of Melaka, is another such illustration. Washington is concerned that these countries, because of their Muslim populations, would not dare pursue anti-terrorist action aggressively, which could then make them fertile breeding grounds for terrorist cells, thus

complicating Washington's fight against international terror. Their "soft approach" has clearly dismayed Washington; but these same countries have also accused Washington of "double standards" on the Israeli-Palestinian issue and not fully understood their own dilemma in coming out too hard on potential terrorists for fear of radicalizing further their moderate Muslim constituencies.

Pursuing "The Core" concept further, the US appears worried about the domestic state of affairs in the Philippines, which besides its growing dependence on Washington to maintain its security and fight Muslim terrorists in the South, may be poised for turbulent political and economic times ahead.

But besides these problems, which the US is facing in East Asia, this changing US perception of Asia can also be attributed to a confluence of **four geo-political and geo-economic shifts in regional power balance**, which "disadvantage" Washington.

- Firstly, the subsiding of the "China threat" to its Asian neighbours, which had till recently counted on the US to provide them the protective shield against Beijing's ideological and "expansionist" threat, has made Washington's Asian allies feel secure with Beijing's "peaceful rising"; they could thus adopt a "distanced" view of the US or even condone a rise of anti-Americanism in their countries, like in the cases of South Korea or Thailand.
- Secondly, Washington's war on international terror, its invasion, occupation and travails in post-Saddam Hussein Iraq, as well as the perceived unilateralist tendencies under President George W Bush have contributed to a nett deterioration of the United States' image in Asia.
- Thirdly, the rise of Asian regionalism after the 1997 Asian Crisis within the framework of "ASEAN+3" (comprising China, Japan, South Korea and the ten countries of ASEAN), as well as with India, has given a decisive boost to intra-Asian trade, investments, tourism, people-to-people exchanges, technical and human resource development cooperation; this emerging Asian regionalism would inevitably focus the attention of East Asian countries on their region, thereby "distancing" further the US in Asia's strategic thinking.
- Lastly, a new generation of East Asian leaders is now in control in many of the countries; they are no longer shackled by scars of the last Great War or the ideology of the Cold War. President Roh Moon Hyun in South Korea, Premier Thaksin Shinawatra in Thailand and even Prime Minister Abdullah Badawi in Malaysia are re-defining their countries' relations with Washington in more "un-emotional" ways.

The US is thus clearly assessing its own engagement in Asia after years of strategic dominance in East Asian security, thanks to the Cold War, the “China threat” and its utter domination of world economics, trade and finance. Once these fundamentals have shifted, Washington, as well as its Western allies and friends, have no choice but to re-define and re-assess alliance patterns and relationships across the Asia-Pacific too.

Of particular concern to Washington strategically has been the decision of the Philippines to withdraw its 50-odd troops from Iraq, a month ahead of the scheduled August withdrawal, in order to spare the life of a Filipino truck driver by Iraqi *ihadists*. It was a small, but symbolically significant contingent, and despite Washington’s appeal, President Gloria Macapagal-Arroyo, fresh from an electoral mandate for the next six years, took a difficult decision to withdraw from Iraq, acknowledging grave consequences for Manila’s alliance with Washington.

However, the Filipino decision could also be linked to declining US credibility, influence and clout in Asia, thanks to its current “overstretch”. As Bush battled domestically his growing number of critics amidst an electoral campaign (which was inevitably “fought” over Iraq), Washington’s credibility and influence world-wide appeared to have diminished, as underscored by a growing chorus of critics from the intelligence and diplomatic communities of Washington, the academia, NGOs and even from within his Republican Party, as well as from Asia.

Indeed, more to the Philippines’ unilateral decision to withdraw its troops from Iraq are other indicators in Asia of declining US credibility, influence and clout.

Firstly, both Washington’s traditional allies, Japan and South Korea are facing growing anti-American (or more precisely, anti-Bush) sentiments. PM Koizumi is bracing for increasing challenges from the opposition Democrat Party (which did exceptionally well in the Upper House polls) and the Japanese people to pull out the 600-strong Japanese technical contingent from Iraq, whereas President Roh would probably take a more “neutral” line vis-à-vis Washington in the six-party talks on the Korean Peninsula, at a time when many South Koreans increasingly see the Bush Administration as the major obstacle to an eventual intra-Korean rapprochement.

Secondly, Malaysia and Indonesia have bolstered their Muslim stance and defied the United States publicly on issues, ranging from Israel-Palestine to the US proposal to help patrol the Melaka Straits. Although non-belligerent in public, Malaysian and Indonesian leaders fear that another George W Bush presidential term could stir Muslim sentiments further in the region (against Washington), thus endangering moderate Islamic regimes here. Malaysian PM Abdullah seemed to have offered Malaysian medical assistance to Iraq from a position of strength, when he met Bush recently in Washington, but the offer was reportedly “conditional” on being “tied to the United Nations and a successful election in January 2005.

Thirdly, India, though warming its relations with the United States, has not been willing to be included in President Bush’s “coalition of the willing” and to send troops to Iraq, thus maintaining its neutrality and “independence” vis-à-vis Washington. New Delhi has categorically refused to commit troops to Iraq, despite incessant American pleas, and is perceived in the region as “balanced” despite its own strong anti-terror agenda, for domestic and region reasons. Although cooperation with Washington would increase, even in the military field, New Delhi has thus far maintained a “balanced” position, which many Asian countries (including China and Southeast Asia’s Muslim countries) would appreciate, especially at a time when it is also scheduled to seek a permanent seat in the UN Security Council.

Lastly and probably most importantly, China appears to be reading the Bush Administration’s current weakness in Asia in very clear terms. Beijing has decided to raise the anti-US and anti-Taiwan *ante* by publicly warning Washington not to “encourage Taiwan’s independence lobby”. A stern warning, issued by Chinese Embassy spokesman in Washington, just days after the visit of US National Security Advisor Condelezza Rice to Beijing, against any American arms sales to Taiwan probably coincides with recent indications that Beijing’s leaders may have given up hope on the Bush Administration moderating Taiwanese President Chen Shui Bian and his pro-independence supporters. Beijing has thus decided on a tough offensive to warn both Washington and Taipei against renegeing on the “one China” policy. On the other hand, Beijing could now hope that Washington could progressively tilt towards China and distance itself away from Taiwan after the surprise pronouncements of Secretary of State Colin Powell on CNN and Phoenix TV on Taiwan’s reunification; the upcoming Sino-American Summit in Chile will provide another occasion for President Hu Jintao to test President George W

Bush out on a possible US “mellowing” over the Taiwan issue. Chinese assertiveness over Taiwan and other regional issues would therefore increase, just as US credibility and influence in the region decline.

As US credibility, influence and clout decline, Asia is already reading and analyzing these signs and reacting in ominous ways that could cause some real concern to Washington. On the other hand, Asia’s trade and interaction with China have increased so spectacularly that it is now conceivable for the rest of Asia to increasingly “balance” the declining American with the rising Chinese power in the Asian region. This is the crucial lesson that Washington must draw from the current power shift in Asia, which inevitably consolidates Asian integration and regionalism.

### **The Strategic Importance of Asian Economic Integration vs The “Obstacles” of History in Asia**

Conventional wisdom has it that reconciliation would take place between warring nations with growing economic “enmeshment” and increased people-to-people contact. Such was one of the aspects of the model adopted by France and Germany in healing the deep scars of World War II.

But recent incidents in Northeast Asia prove that this approach may encounter certain limits, as history is proving to be a far more profound determinant between Asian nations than it has been once envisaged. History also has a profound implication on the future of Northeast Asia as a region and of Asia as an entity.

The intra-Korean Peninsula remains a tragedy, with the Cold War and recent contemporary history being the basic determinants for the failure of rapprochement, despite the growing will of the people across the 38<sup>th</sup> parallel to reunify. *Realpolitik* has brought in four other parties to on-going six-party talks, as China, Japan, Russia and the United States have all played significant roles in Korean history.

Secondly, Sino-Japanese relations, the most critical in the region, are still undoubtedly plagued by deep scars of history, emanating from the first Sino-Japanese War in 1895 and then World War II. The recent hostility of Chinese spectators towards the Japanese Asian Cup team playing in Beijing during their historic finals on 7 Aug undoubtedly recalled to many Chinese, the Japanese invasion and occupation of China and the atrocious “rape of Nanjing”. The

burning of Japanese flags outside the stadium, the chanting of anti-Japanese slogans and the stinging attacks of Japan on the Chinese internet testify to frigid relations between the two Asian giants, 59 years after the end of the last World War.

To make matters worse, the four visits of Japanese PM Junichiro Koizumi to the Yasukuni Shrine since the beginning of his premiership, as well as the more recent 15 Aug visit of Japanese ministers there this year, despite Chinese pleas, continue to incur the ire of Chinese, Koreans and other Asians, who were severely subjugated by Imperial Japan.

On this third point, Japan-Korean relations are still scarred by Tokyo’s occupation of Korea for 35 years, although relations between Seoul and Tokyo have markedly improved, thanks to their co-hosting of the 2002 World Cup and Seoul’s decision to allow Japanese cultural products to enter South Korea in the last five years. The leader of South Korea’s majority Uri Party, Shin Ki Nam, was recently forced to step down after admitting a cover-up of his father’s past collaboration with the Japanese Imperial Army, during the latter’s occupation of Korea. On the other hand, Tokyo’s ties with Pyongyang are still bogged down by the scars of World War II and Cold War history, ranging from the demand by North Korea for war reparations to the kidnappings of Japanese citizens by the Pyongyang regime; the nuclear factor fuels another dimension in the current North Korean-Japan feud.

Lastly, a new historical incident is now blowing up between China and Korea over the former’s claim over the ancient kingdom of Koguryo as its own. Apparently, Seoul’s “love affair” with China, given its sound economic “enmeshment” and cooperation, its “dependence” on Beijing for moderating Pyongyang at the six-party talks, as well as Chinese cultural advancement into South Korean society, has somewhat dissipated over what Koreans now perceive as their bigger neighbour’s “encroachment” into Korean history. The “distortion” of Koguryo’s history is seen as shaking the foundation of Korean national identity and seen as “a flagrant violation of Korean history”, especially when China intends to revise their textbooks depicting it as part of its own history. Korean nationalism has never been stronger as old and young rally against China over this historical fact; in fact, many Korean fans were reported to have even supported the Japanese Asian Cup team against China, although Korean ire against Tokyo, its former colonial master, had always run deep in Korean society. The South Korean Government and Parliament (especially the

ruling Uri Party) are now making the Koguryo issue their prime political *demarche* against Beijing.

These examples of historical rifts and failed reconciliation in Northeast Asia emphasize the lingering importance of history and the critical need for political will to achieve sustainable reconciliation. If not, nationalism would rise and scar regional cooperation; this phenomenon could be explained by the ironical relationship between the advancement of globalization and the increasing need for national identity, pride and affirmation. Clutching onto history is a means of affirming this identity and a rallying point for societies and nations, amidst globalization; but history is also a growing impediment to economic integration and regionalism across Asia, and especially in Northeast Asia.

### **Strategic Importance of Asian Economic Integration : The Ultimate Goal of Reconciliation in Asia, Based on Experiences from Europe**

What was obvious in the Franco-German reconciliation was the signing of the historic 1963 Elysees Accord between French President Charles de Gaulle and German Chancellor Konrad Adenauer. The historic agreement signed between Japanese Keizo Obuchi and South Korean President Kim Dae Jung in 2000 had also helped paved the way for reconciliation between Seoul and Tokyo. The present reconciliation between Germany and Poland is yet another example worth following, as German Chancellor Gerhard Schroeder attempts to bridge the German-Polish historical gap, now that both countries are in the enlarged EU.

Historically, political reconciliation at the highest level of leadership has been necessary to seal such a historic reconciliation between two countries and peoples. Economic “enmeshment” and cooperation may help alleviate the pain of history, but political will is still the only real antidote against history and its unfortunate scars.

It therefore remains to be seen if on the occasion of the 60<sup>th</sup> anniversary of the end of World War II in August 2005, China and Japan could ultimately reconcile, just as Sino-Korean and Sino-Japanese ties could hopefully strengthen. This year’s Normandy beach commemoration, celebrating the 60<sup>th</sup> anniversary of the beach landings, was organized by French President Jacques Chirac as a massive act of reconciliation in Europe, not only between the Allies and

Germany, but with Russia too; Schroeder and Russian President Vladimir Putin were there to seal this historic reconciliation.

It is hoped that Chinese, Japanese and Korean leaders would come together in August 2005 to ultimately put history behind them and seal Asia’s ultimate reconciliation. Political will is absolutely necessary; Chinese President Hu Jintao, Japanese Emperor Akihito, PM Koizumi, South Korean President Roh Moon Hyun and North Korean leaders Kim Jong-Il must take the political step forward together towards the ultimate reconciliation of their countries; India and Southeast Asia could and should be associated as well. Political will at the highest level is undoubtedly the only antidote against historical rifts and animosities in Asia, and an absolute necessity to further economic integration and regionalism across the Asian Continent.

A leaf of History should be taken from Europe this year for next year in Asia.

The Western allies had gathered on the beaches of Normandy on 6 Jun this year to celebrate the 60<sup>th</sup> anniversary of D-Day, when the liberation of Europe from nazism first began. As this celebration was perhaps the last time veterans of World War II could actually be physically present, in view of advancing age, this D-Day commemoration took on added significance by ultimately closing the World War II chapter and sealing ultimate Western reconciliation.

Sixty years after the atrocities of Omaha Beach, Arromanches, Juno Beach and Caen, where thousands of lives were sacrificed, “three symbolic reconciliation” in fact took place amidst festivities and pomp, specially orchestrated by French President Jacques Chirac before seventeen Heads of State and Government.

Firstly, Europe is finally reconciled, especially with the enlargement of the EU to twenty-five members, thus erasing the “great divide” of the Old Continent, inherited from the Cold War and the Second World War; the fall of the Berlin Wall on 9 November 1989 had marked the first step. The presence of German Chancellor Gerhard Schroeder and Russian President Vladimir Putin were especially significant.

Secondly, the reconciliation between the US and Europe, notably with France and Germany, took on a particular significance within the context of the

imminent 30 Jun Iraqi handover of power to the Iraqis. President Bush's presence at the Colleville-sur-mer and Arromanches ceremonies should benefit Bush domestically, as well as Franco-American and American-cum-allies reconciliation internationally.

Thirdly, the ultimate reconciliation between Americans, British, French, Russians and Germans should seal the Western alliance, especially after the recent fracas over Iraq; it could also help alleviate Russian misgivings regarding NATO's expansion to include its former "satellite states". Putin aspires for Moscow to be accepted by the West, after the demise of communism; this D-Day anniversary celebration was also designed by Chirac to "consecrate" Russia's place in the West.

But this reconciliation process in the West really begs a crucial question in the Far East. When would Asia ultimately reconcile, after World War II?

The Asian situation remains complex and difficult as the scars of the past still haunt many Asian countries, fifty-nine years after Hiroshima and Nagasaki.

Sino-Japanese relations remain troubled, scarred by the massacre of Nanjing and the memories of Manchukuo; they were "revived" in recent years by the repeated visits of Japanese Prime Minister Junichiro Koizumi to the controversial Yasukuni Shrine, the Shenyang Consulate incident of 2002, the 2003 mustard gas leaks in Northeast China and the 18 Sep 2003 Zhuhai orgy incident. The recent landing of Chinese activists on the Senkaku or Diaoyu Islands highlighted how tenuous Sino-Japanese relations really are, although there was also a lot of restraint on both sides then to play it down, especially in the run-up to crucial six-party talks in Beijing.

Japanese diplomats had attributed this souring of relations to the controversial visit of former Chinese President Jiang Zemin to Tokyo in 1999, when he repeatedly reminded the Japanese about their historical atrocities. The pro-China "lobby" within *Gaimusho* (Japanese Foreign Ministry) was then "decimated", together with the downfall of former Foreign Minister Makiko Tanaka. Since then, this pro-China camp appears to be rallying back and elite circles in Japan have begun contemplating how Japan could best contend with a "rising China". Recent scenarios drawn up by Japan's Defence Agency on possible Chinese attacks on Japan have underscored again Beijing's threat, as China's economic and military clout and political influence grow. But the

fundamental crux of the matter remains that Japan, like Germany, must apologize sincerely, and China should forgive in all sincerity, once apologized to; if not this hatred and threat perception would linger on between Asia's two giants.

Elsewhere in Northeast Asia, South Korean-Japanese and Sino-South Korean rapprochement seem to be yielding fruits. Seoul and Tokyo are sealing an entente sixty years after the last War, whereas Beijing and Seoul, which stood on opposite sides during the 1950-53 Korean War, have become "tactical allies" in resolving the intra-Korean issue and sound economic partners in trade and investments. But potential flashpoints still remain between Pyongyang and Seoul on one hand and Beijing and Taipei on the other, amidst this *rapprochement*.

Further south, China-ASEAN relations are now stabilized, as Beijing has effectively wooed the ten Southeast Asian nations by abandoning its previous ideological threat (via local communist parties in Southeast Asia) and shifted to the present "peaceful rising of China" philosophy; Beijing is consolidating trade, investment and tourist ties, which now propel economic growth in ASEAN. Negotiating an ASEAN-China FTA to create the world's biggest trade bloc by 2010 and intensifying cooperation with riparian states within the Greater Mekong Sub-Region in Indochina should consolidate ASEAN-China relations further. In a similar vein, ASEAN-Japan ties are sound, as Southeast Asians have so far been able to put past atrocities inflicted by Tokyo behind them in favour of economic cooperation.

India, which had not been in the foreground of wars and rivalries in Asia, except with China in the 1950s and 1960s, has also begun a process of historical rapprochement with China, with the settling of border disputes last and this year, during the Vajpayee government. Further attempts of Sino-Indian rapprochement (which seems to be also the firm intention of the new Congress-led government in New Delhi), after these previous border skirmishes and war, would greatly help in the ultimate Asian reconciliation. Economic enmeshment is the first step, but political will is absolutely necessary to seal this reconciliation ultimately.

## Conclusion

Building the East Asian House or Community within the "ASEAN+3" framework (of the ASEAN-10, China, Japan and South Korea), and extending it to JACIK (of fourteen) remain an over-riding priority for the whole region, although

troubled Sino-Japanese relations, as well as the Sino-Taiwanese and Korean non-reconciliation could still cloud the Asian horizon.

Asia, and especially East Asia (like Europe), would symbolically need a D-Day-type of ceremony and reconciliation to erase the painful memories of the last War and bury the awful past altogether, probably in 2005, viz the sixtieth anniversary of the War's end in Asia. This appears to be the over-riding strategic goal of the current increasing economic integration. But who could organize it and where?

There is no Asian Chirac or an Asian Normandy for such a setting. How then could Asians seal this "Asian reconciliation" formally, especially between Beijing and Tokyo? Or is Washington needed again to provide this impetus, given its equally important role in the 1942-45 Pacific War? Reconciliation indeed sadly remains elusive in Asia, although it is undoubtedly an aspiration for millions of Asians, this despite the accelerating trend of Asian economic integration.

But hopes are still remain. The most important strategic goal in Asian economic integration, probably with the JACIK as core, would be the ultimate reconciliation and peace in Asia, at a moment when US strategic goals and influence decline in the region, and especially, as Asians themselves want to be more "balanced" in their own relations with Washington.

Asian regionalism would undoubtedly rise with increased economic integration and regionalism; in fact, strategic political, social and cultural enmeshment is now poised to accelerate for China, India, Japan, the Koreas and ASEAN, as they reconcile, cooperate and partner each other to form the Asian Economic Community one day.

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