

## Chapter 2 Asia-Pacific Regional Institutions and North-South Relations: The Roles of APEC and ASEAN+3

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### 1. Introduction

With trade and foreign direct investment growing by leaps and bounds and financial markets moving toward ever greater integration worldwide, regionalism today continues its march around the globe as exemplified by the integration of the European Union (EU) and the establishment of the North American Free Trade Agreement (NAFTA) <sup>(Note 1)</sup>. In the Asia-Pacific region, Asia-Pacific Economic Cooperation (APEC) was established at the end of the 1980s, and the ASEAN+3 (Japan, China, and South Korea) cooperative framework grounded in “East Asia” was created in the latter half of the 1990s.

The purpose of this paper is to examine the functions and roles of APEC, ASEAN+3 and other regional regimes in improving North-South relations in the Asia-Pacific region. The paper will discuss the roles and functions that can be fulfilled by regional institutions, with a focus on states confronted by the need to change their economic structures to cope with international competition as well as the need to strengthen governance on a regional basis transcending national borders (through the establishment of common rules and schemes governing economic activities) in keeping with the rapid transnational expansion of economic activities via globalization.

### 2. The logic of “competition states” and regionalism

#### (1) Intensified international competition and “the competition state”

Companies today are seeking out new combinations of resources internationally – blending trade, investment, technology, and human resources to set up a multilayered international division of labor – and are establishing in-house divisions of labor within economic spheres spanning multiple countries. Finding it impossible to artificially expand their territory, populations, and natural resources, states during the age of imperialism expanded overseas in search of resources, territory and markets to increase their economic strength. Today, however, states can build economic spaces that transcend national borders without expanding their physical boundaries. Innovations in communications and transport have made it easier to centrally coordinate and manage company activities across

vast transnational spaces, and the worldwide permeation of free market principles and other changes in international regulatory regimes facilitating transnational production activities as well as the progressive integration of international capital markets underpin this corporate strategy (Note 2).

The burgeoning of transnational economic activities has changed the nature of competition between nations (Note 3). International market integration and the formation of transnational production networks have transformed the concept of “national interests,” and nations are finding it increasingly important to position themselves within international production networks that ensure efficient links between the elements of production (labor, capital, technology) and maximum access to markets in order to achieve their aim of economic prosperity. States must place their countries’ industries in advantageous positions within networks developed for the international division of labor. In other words, states must now secure new investment markets and export markets for industries extending their transnational economic activities if they are to ensure the economic welfare/security of their citizens. To that end, states must provide these industries with new trade/investment/financing rules governing transnational economic spaces. Although their significance as spaces (territories) for attaining economic prosperity has diminished, states now bear new responsibility for transforming broad economic spaces (regions and the international economy as a whole) into favorable environments for their companies.

At the same time, the resilience of states and the stability of state structures have taken on greater importance in responding to economic globalization and intensifying international competition. To win out in international markets, states must encourage investment and trade from abroad and must internationally harmonize their domestic economic regulatory systems and economic policies (Note 4). National governments must adopt measures that enhance the international competitiveness of their countries’ industries (improving the economic investment environment, strengthening international rules, and upgrading comprehensive domestic policies) and foster and solicit internationally competitive industries within their own borders to afford economic prosperity to their citizens.

Accomplishing these ends will require new policies (stronger governance) aimed at boosting international competitiveness, even in areas that have conventionally been considered domestic affairs – the maintenance of public order, macroeconomic and financial system stability, improvement of economic infrastructure, provision of highly-skilled technicians (upgrading of higher education), changes in welfare/social security policies, tax

reform, establishment of a fair and impartial judicial system, etc. It is imperative that domestic systems be enhanced for the sake of “maintaining international competitiveness.” States themselves must therefore become part of the market economy (“transformation into competition states”) (Note 5).

The attempts at economic reform being made in developed countries are part of this strategy. Developing countries, too, have begun to question the usefulness of conventional protectionist policies, and are instead promoting “structural adjustment,” developing human resources, implementing institutional reform domestically, and adopting other policies designed to strengthen governance. In fact, developing countries have in recent years given greater relative weight to capacity-building through systemic reform by making the transition to a market economy and developing human resources, and they have conceived economic development strategies involving active participation in the international economy.

## (2) “Competition states” and the functions/roles of regionalism

Regionalism can serve states as a potent tool for extending (incorporating) liberal international economic regulations into regions to augment the international competitiveness of their nations’ industries. One approach is the use of regionalism as a means of promoting domestic reform in developed countries. Japan’s regionalism strategy is positioned as a part of its “Japan reform” vision, which, for example, has opened up Japanese society further to the countries of East Asia, allowing a wave of liberalization to sweep over protected industries in Japan in the hope of achieving industrial advances as well as increasing benefits to consumers (Note 6).

Another approach involves contributing to stronger governance in developing countries. The expansion of transnational economic activities has engendered a greater need for stronger economic governance in economic spaces extending beyond national borders. Above all, stronger governance in developing countries is essential. The expansion into Asia by Japanese companies has, for instance, necessitated stronger domestic governance within Asian countries (establishment of democratic political systems and transparent and fair administrative systems, improvements to tax systems that facilitate corporate activities, enhancements to industrial infrastructure, development of human resources, domestic legal systems that comply with international standards, etc.).

Regionalism provides a regional framework for promoting domestic economic structural reform based on liberal economic principles. Systematizing liberalization policies in the

context of regionalism has the signal effect of boosting the confidence of the international community in the continuity of ongoing liberal reforms. Regionalism as embodied in the ASEAN Free Trade Agreement (AFTA) segregates economic policy from domestic political wrangling and makes deviation from the path toward liberalization difficult by incorporating economic reform policies (policies toward integration with the international economy) within a regional framework. It is well known that an important motive behind Mexico's accession to NAFTA was its wish to segregate economic reform policy from domestic political disputes and reduce the possibility of a retreat from liberal economic reform by integrating Mexico's economic reform policies into a regional framework <sup>(Note 7)</sup>. APEC, too, has made retreat difficult by, for example, closely integrating China's reform policy of opening up to the outside world into the regional economy with the underlying aim of preventing China from again becoming isolated and destabilizing the region. Relations between the EU and the former Eastern bloc countries also demonstrate the desire to achieve a smooth transition to political democracies and market economies in the former Eastern bloc countries.

Regional regimes can also introduce international rules and regulations into regions (developing countries) by providing opportunities for mutual learning and by forming regional networks of persons knowledgeable about these rules and regulations. For example, APEC has recommended that its members participate in GATT and other international institutions and commit to international rules (e.g., support for domestic systemic reform to implement free trade regulations and GATT/WTO agreements); to this end, APEC has hosted seminars and conferences to provide opportunities for familiarization with international rules and has encouraged the development of domestic systems that comply with global rules. ASEAN+3 agreed in the Chiang Mai Initiative to conclude currency swap agreements, and the group is seeking to bring policy implementation in individual countries under international regulation by imposing conditionality similar to that of the IMF and the World Bank <sup>(Note 8)</sup>. Regionalism has become a powerful system for promoting the enforcement of international rules at the regional level.

### (3) Stronger governance in developing countries and regionalism

Regional institutions are able to play a meaningful role in the permeation of international rules and regulations regionally because these regimes serve as means of resolving issues unique to their respective regions that hinder the "internalization" of international rules. Shortcomings in legal systems and political institutions and shortages of trained personnel in

individual countries constitute major obstacles in spreading coverage of the GATT/WTO rules and regulations to the countries of the Asia-Pacific region. In this regard, APEC and ASEAN+3 can serve to buttress the socioeconomic infrastructure of member countries and promote the permeation of global rules by holding seminars to foster better understanding of international rules, cooperating in personnel training, and providing intellectual know-how and other economic and technical cooperation. Economic and technical cooperation (ECOTECH), one of APEC's three pillars of cooperation, is expected to transcend traditional economic assistance and contribute considerably to improved regional and global governance. The EU's intellectual assistance to the countries of Eastern and Southern Europe is one example of this (Note 9).

The significance of this characteristic of regionalism – that it can cope with issues peculiar to the region through assistance and physical support – can be understood by bearing in mind the changes made in the approaches taken by states in response to economic globalization. As has already been pointed out, states require new policies (stronger governance) to reinforce their international competitiveness in order to promote investment and trade and emerge victorious in international markets; these policies entail improving domestic legal systems and social infrastructure that are compatible to the global ones. However, many developing countries are lacking in the human and material resources needed to implement international rules. The variety of assistance that regionalism offers is of vital significance to the establishment of an environment that will enable these countries to survive international competition. By developing mechanisms such as development cooperation and structural adjustment assistance internally, regionalism can help strengthen the economic infrastructure of developing countries (Note 10). For example, regionalism can contribute greatly to reinforcing the domestic infrastructure of developing countries encountering difficulties amidst international competition by encouraging them to incorporate internally mechanisms to enhance governance, as seen in APEC's adoption of "economic and technical cooperation" as a major theme in its activities and in ASEAN+3's emphasis on cooperation to improve the economic infrastructure of developing countries (in ASEAN).

The developing countries have been active in following the lead of developed countries toward regionalism. Developing countries battling intense international competition and their own economic difficulties are seeking to make active use of regionalism to secure access to markets in, and investment from, developed countries and to firmly establish domestic reforms based on liberal economic paradigms. ASEAN's pursuit of a regional free

trade agreement (AFTA), for instance, has been prompted by a serious decline in the investment from overseas that had previously sustained Southeast Asia's economic development following the end of the Cold War, the 1997 currency crisis, and the emergence of China as a production base, as well as a desire to overcome current problems via the liberalization of trade and investment and the improvement of member countries' industrial infrastructure.

Another important element when examining the role of regionalism in strengthening governance within developing countries is the considerable impact that these attempts at greater regional integration have had on the domestic political processes in developing countries. Economic development through participation in globalization and close interdependence with countries outside the country has changed the balance of domestic political power among groups within developing countries as well. Companies actively promoting international trade and investment (companies generating domestic wealth) have in fact acquired growing domestic influence, and these companies as a group constitute a powerful lobby within their nation's decision-making process. Advocates of closer and stronger relations with the international community have grown in influence vis-à-vis proponents of protectionist policies, generating the momentum needed to open their country's economy to the international community.

Augmenting state governance through regionalism has the effect of further strengthening the political foundation (cooperation between government elites and industrial capital) of domestic political forces backing an outward-looking development strategy (Note 11).

China serves as a good example. One of the key issues for the 21<sup>st</sup> century will be whether or not China sees its future in the context of cooperation with the international community, and China is proceeding toward commitment to economic deregulation and liberalization despite questions about such issues as China's human rights record and missile transfers and its own concerns about the Japan-US Defense Guidelines and TMD. Economic development has sparked changes in China's domestic political processes, allowing forces to emerge within China that seek to gain tremendously from the creation of wealth available through the solicitation of foreign companies, joint ventures with foreign companies, and international trade. Their political influence appears to be on the rise, reflecting the emergence of an "international faction" in Chinese politics.

It should be noted, though, that the political influence of these elements in China is by no means decisive. Nonetheless, the support of citizens wishing to improve their lot through

closer ties to the international economy perhaps lends them enough political influence to prevent China from once again rejecting interdependence with the international community and reverting to an isolationist stance. Greater economic interdependence between China and its neighbors and stronger governance within China through regionalism could help build a larger domestic constituency (cooperation between government elites and industrial capital) for advocates of an outward-looking development strategy (Note 12).

### 3. "Competition states" and regional governance

#### (1) Institutional coordination

From the perspective of economic efficiency and for the sake of greater bargaining power in creating the rules that govern the international economy, "competition states" have little choice but to pursue the development of larger economic entities that transcend their national economies.

Joint ventures and outsourcing are establishing broader transnational production networks. Maintaining and improving these networks urgently require the construction of a systematic framework that enables countries to liberalize investment regulations, standardize products and production processes and coordinate transnational networks. A common regulatory system for transnational trade, investment and capital transactions would be a positive step allowing more sophisticated combinations of products, capital, technology and information. Disputes have frequently arisen between states in the course of integrating world markets as a result of the impact on economic competitiveness of rules and practices that differ by nation. With intra-industry trade on the rise, the incongruities in regulations within the borders of different countries have become a major topic in international affairs (Note 13).

Put another way, greater integration of markets internationally has created a pressing need for international standards and regulations governing areas that transcend territorial boundaries. Given the dramatic growth in transnational exchange, the international community today needs not only a regulatory system that covers the previously dominant focus of border measures but also coordination and improvement in areas involving systems, organizations, and practices within national borders. States will need to coordinate on investment regulations, competition policies, intellectual property rights, government procurement, and environmental and labor issues. Greater coordination of regulatory systems could reduce transaction costs in transnational economic exchange, permit the creation of more sophisticated corporate networks, and enhance the international competitiveness of companies within participating countries.

The times call for the implementation not only of traditional border measures such as tariff but also measures extending to domestic systems and social and cultural issues (coordination of regulatory systems across national borders). Trade and investment require that tariffs be lowered and investment restrictions abolished, that domestic regulatory regimes be improved and coordinated, that judicial functions be strengthened and that corporate accounting systems be harmonized on an international basis.



## (2) Regional governance and regionalism

Attempts have been made in GATT and other forums to formulate transnational regulatory mechanisms. However, global forums with numerous participant countries require a great deal of time and energy to reach a consensus, and the time and costs entailed in international negotiations have become all the more staggering with a shift in emphasis in international trade negotiations from border measures to the harmonization of domestic systems. The complexity and protraction of GATT/WTO negotiations reflect this reality.

One reason that Japan has incorporated regionalism into its trade policy, traditionally entrusted to the multilateralism of GATT/WTO, is that the overseas shift of Japanese companies (especially to Asian countries) ongoing since the mid-1980s has compelled Japan to construct a regional framework (coordinate institutions) to facilitate transnational transactions within companies and consequently enhance the international competitiveness of Japanese companies <sup>(Note 14)</sup>.

While GATT has tackled issues of “shallow integration,” particularly border measures, economic regionalism can address issues of deeper integration (coordination/integration of domestic systems) between countries having the will and capacity to pursue this course. Coordination extending to internal state affairs is perhaps easier between neighboring countries with similar cultural and historical backgrounds, social structures, political systems and security interests than at the global level, and implementation can be more readily guaranteed. Together with the liberalization of trade and investment, regionalism has become an instrument for regime coordination.

Both APEC and ASEAN+3 assign greater priority to dialogue and discussions on coordinating regulatory systems across national borders than on liberalizing trade and investment; in APEC, this falls into the category of “facilitation” measures. Efforts to streamline logistics by establishing common and standard customs procedures as well as the issue of “APEC business visas,” while minor matters in and of themselves, reflect a move toward the harmonization of regulatory systems.

Regionalism can also be of significant help in restraining economic nationalism and in encouraging shared views on economic interdependence. Among the benefits that can be expected from regionalism are the availability of experimental forums for realizing deeper integration applicable multilaterally (technology standards, services, government procurement, national subsidies, competition policy, dispute resolution, etc.), easier

negotiations due to the fewer number of participating countries, and the codification and formalization of rules and regulations impacting on trade. Although these steps do not necessarily imply liberalization, they are very important for improving the transparency of rules and standards and preventing arbitrary or capricious application (Note 15).

#### 4. Conclusion: Japan and Asia-Pacific regionalism

As this paper has shown in its analysis, states must construct broad economic spaces transcending national boundaries (territories) and pursue advantageous positions (improve competitiveness) for their own economies in those spaces to secure the welfare of their citizens in the face of progressively integrating international markets, increasingly fierce competition, changes in the international regulatory structure (the international permeation of liberal economic norms), and the surge in corporate activities internationally. Meanwhile, states themselves must also change, acquiring through domestic reforms the resilience to withstand international competition. Regionalism measures reflect this new development strategy for states.

In addition, this paper has pointed out that regionalism can contribute to stronger governance in a region as a whole by enhancing domestic governance in member countries and creating common rules for the region.

The Asia-Pacific region is the most important region to the peace and prosperity of Japan. Economic interdependence between Japan and the countries of Asia has grown in recent years. The expansion of Japanese companies into Asian countries has climbed sharply, necessitating stronger governance in these countries (establishment of domestic systems that conform to international standards, creation and implementation of transparent and fair regimes, improvement and expansion of economic infrastructure, personnel training, etc.). Japanese companies are gradually widening their transnational division of labor across the Asia region, and this makes the coordination of systems between countries to facilitate the movement of goods and capital a crucial issue. Regional regimes such as APEC and ASEAN+3 have the potential to address these issues at a regional level.

One characteristic of today's regionalism is that it encompasses both developed and developing countries. There are obvious disparities in the economic might and level of economic development of countries in the Asia-Pacific region as well. Individual countries are working to improve the international competitiveness of their own industries in the context of rapid economic globalization, but they also face serious limitations on the human and material

resources available to them. Regionalism can deal with these issues at a regional level.

Prompted by the conclusion of an economic cooperation agreement with Singapore, Japan has begun discussions with countries in East Asia on the conclusion of bilateral economic cooperation agreements. These discussions will likely produce a variety of rules governing bilateral economic relations, but approaches toward stronger governance on a regional level are also essential as Japan seeks to improve the international competitiveness of its companies rapidly expanding overseas and to create a production network encompassing the entire region. The establishment of requisite legal systems and the development of human resources in developing countries – i.e., capacity-building in the broad sense – is of great importance for the continued economic prosperity of Japan. In this sense, the future roles of APEC and ASEAN+3 bear a great significance for Japan.

#### Footnotes

1. Edward D. Mansfield and Helen V. Milner eds., *The Political Economy of Regionalism*, New York: Columbia University Press, 1997.
2. Technology development issues are tied to the internationalization of corporate activities. Even as the profits stemming from technological innovation continue to swell, the costs of technology development and maintenance are also growing. Consequently companies are making internationalization of their production activities (expanded scale of operations) a key consideration in drafting business strategies (investment strategies, etc.) to maximize the efficiency of their technology development.
3. There is a wide range of viewpoints on globalization. As bibliographical materials in Japanese, see the following: Yoshinori Yamamoto, "Changes in the International System: The Progress of Globalization," *International Affairs*, No. 489 (December 2000), pp. 2-21; Yoshiko Kojo, "Trends in International Political Economics – An Analytical Perspective of 'Economic Globalization,' the State and International Cooperation (Vol. 1/2), *International Affairs*, No. 456 (March 1998); Yoshiko Kojo, "A Reevaluation of Globalization – Points of Discussion and Present Status," *International Affairs*, (August 2001), pp. 2-12.
4. Susan Strange, "Rethinking Structural Change in the International Political Economy: States, Firms, and Diplomacy," Richard Stubbs and Geoffrey R.D. Underhill eds., *Political Economy and the Changing Global Order*, New York, St. Martin's Press, 1994, pp.103-115.
5. On the concept of "competition states," see Philip G. Cerny, "What Next for State?," Eleonore Kofman and Gillian Youngs eds., *Globalization: Theory and Practice*, NY, Printer,

1996, pp.123-137.

6. Naoko Munakata, "Whither East Asian Economic Integration", *CNAPS Working Paper*, Brookings Institution, June 2002.
7. Anne O. Krueger, *Trade Policies and Developing Nations*, Washington: The Brookings Institution, 1995, pp.72-73.
8. On the Chiang Mai Initiative, see the following: Herbert Dieter and Richard Higgott, "Exploring alternative theories of economic regionalism: From trade to finance in Asian cooperation," Centre for the Study of Regionalization and Globalization, University of Warwick(UK), Working Paper No 89/02, January 2002.
9. Similar efforts are being pursued in the area of security as well. The Korean Peninsula Energy Development Organization (KEDO), for example, is a regime for enforcing international non-proliferation rules at the regional level, but the issue of North Korea's nuclear development program could not be directly resolved within the NPT/IAEA framework as the matter was also linked to energy issues; the NPT/IAEA regime has no mechanism enabling energy assistance. By contrast, the regional regime of KEDO has been successful to a degree in halting North Korea's nuclear development program by providing a mechanism that offers alternative means of energy production.
10. This issue is important for "North-South integrated regionalism." The EU is presently engaged in intense discussions on the distribution of development cooperation funds for newly acceding former Eastern bloc countries. Such direct assistance was not provided under NAFTA.
11. Marc Busch and Helen Milner, "The Future of the International Trading System: International Firms, Regionalism, and Domestic Politics," R. Stubbs and G.R.D. Underhill eds., *Political Economy & Changing Global Order*, Toronto, Maclelland and Stewart, 1994, pp. 259-275. A leading advocate of regionalism in Japan is Nippon Keidanren, comprising leading companies that are expanding their production and sales activities internationally.
12. Marc Busch and Helen Milner, "The Future of the International Trading System: International Firms, Regionalism, and Domestic Politics," R. Stubbs and G.R.D. Underhill eds., *op.cit.*, pp. 259-275.
13. Robert Z. Laurence, *Regionalism, Multilateralism, and Deeper Integration*, Washington: Brookings Institution, 1996, p.60.
14. According to Hatakeyama, four factors altered Japan's trade policy: (1) concerns that Japan would become isolated if it fell behind the worldwide movement toward FTAs, (2) the

promotion of structural reform in Japan, (3) the time and effort required to achieve consensus at the WTO, and (4) the urgency of remedying the damage already suffered by Japan due to other FTAs. Noboru Hatakeyama, "Japan's New Regional Trade Policy", Second Whitman International Lecture, Washington: Institute of International Economics, March 13 2002. <http://www.iie.com/papers/hatakeyama0302.htm> Other observers have pointed to "concerns about the rise of China" as the reason for Japan's policy change. "Tokyo seeks FTAs with major trading partners," The Straits Times (Singapore), Nov. 10, 2001.

15. Linda Low, "Whither Multilateralism? Whither Asian Regionalism?," paper for Third Asian Development Forum on "Regional Economic Cooperation in Asia and the Pacific," organized by Asian Development Bank, June 11-14, 2001, Bangkok.