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### China and Economic Integration in East Asia: Implications for the United States

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East Asia is clearly, if gradually and unevenly, moving toward regional economic integration. Market forces are leading the process, as firms construct production chains across the area that exploit the comparative advantage of its individual countries.<sup>1</sup> Governments are now moving to build on those forces, and consolidate them, through a series of formal agreements to intensify their economic relationships and start creating an East Asian Community.

Unlike the European model, to which they sometimes profess to aspire, the Asians began the current phase of their intergovernmental economic cooperation in the financial sphere. In the wake of the financial crises of the late 1990s, and partly to avoid ever again being dependent on the Washington institu-

1. On China-ASEAN trade, for example, see Lardy (2006). China has now become the leading trading partner of Korea, Taiwan, and many other economies in the region.

tions (the International Monetary Fund [IMF], World Bank, and US Treasury), the Asians have built a network of bilateral swap agreements (subsequently relabeled the Chiang Mai Initiative [CMI]) to help insulate them from outside pressure in future crises.<sup>2</sup> Though the swaps, whose total remains modest (about \$70 billion) despite a recent doubling, have been overshadowed by the huge buildup of national foreign exchange reserves in most countries in the region, some Asians hope this evolution will eventually produce an Asian Monetary Fund (whether they call it that or not), which would provide them with an alternative to the IMF.

Regional trade initiatives have been even more active in recent years. At least half the East Asian countries are already linked through such agreements, and the linking of the remainder is well under way through ongoing negotiations or at least official studies. Such studies have been mandated to develop blueprints for both a Northeast Asia Free Trade Area (China, Korea, and Japan)<sup>3</sup> and a full East Asia Free Trade Area (those three plus the member countries of the Association of Southeast Asian Nations [ASEAN], also called the “10+3”). Japan has recently proposed broadening the group to a “10+6” including Australia, India, and New Zealand, but the countries of the region have declared the “10+3” to be “the main vehicle,” at least for now, for pursuing their “long-term goal” of an East Asian Community.<sup>4</sup>

These Asian economic integration schemes are not driven by any top-down, overarching political decision to unify the region, as was largely the case in Europe after the Second World War. Indeed, there has been no coordination even between the monetary and trade initiatives. The different pieces might be

2. For a review of the debate over the Asian Monetary Fund and the CMI, see Henning (2002).

3. The study of a China-Japan-Korea FTA commissioned by the three governments has been carried out by the Development Research Center of the State Council of China, the National Institute of Research Advancement (NIRA) of Japan, and the Korea Institute for International Economic Policy. The group recommended in 2005 the formation of such an FTA “as a mid-term goal” and reaffirmed “an increasing need” for the proposal in 2006. See NIRA (2007).

4. The countries specified their preference most recently at their latest summit in Cebu on January 15, 2007.

joined at some point in the future, and an East Asian Vision Group has proposed doing so via an East Asian Community, but each is currently proceeding on its own track and seems likely to continue doing so for the foreseeable future.<sup>5</sup>

China plays a central role in all these efforts. It (along with the United States) vetoed the original proposal for an Asian Monetary Fund in 1997, largely because it was a Japanese initiative intended to preserve that country's financial leadership of the region, but has contributed to the strengthening of the CMI and has agreed to study its multilateralization. It moved quickly after its accession to the World Trade Organization (WTO) to begin developing a free trade agreement (FTA) with ASEAN, which has recently been extended to cover some services, while Japan and Korea are still trying to conclude their belated efforts to catch up with parallel compacts. China has turned a cold shoulder toward Japan's effort to dilute Chinese influence by broadening the "10+3" to a "10+6" to include two more major powers (India and Australia, who are desperately seeking to get into the act) at the perimeter of the region.<sup>6</sup>

A key question for the United States, and the rest of the world, is how the evolution of economic integration in East Asia will affect the role of China (as well as vice versa). Will it further enhance China's power by enabling it to count on support from the rest of this large and dynamic region on key global issues, including multilateral trade negotiations (and rule-making) and responses to future financial crises (inside the region and elsewhere)?<sup>7</sup> Will it foster a set of increasingly close and extensive political-security relationships, thereby altering the regional security environment?<sup>8</sup> Conversely, and despite China's growing dominance of the region in both economic and security terms, will regional constraints limit China's ability to exercise its growing national power (just as the North Atlantic Treaty Organization [NATO] was once said to be intended "to keep the Soviet Union out, the United States

in, and Germany down" and many German leaders perceived European integration as a helpful context for normalizing relations with their neighbors)? Or, most likely, will the outcome represent a mix of these forces that will present new opportunities for the United States to exercise its influence but also challenges over how to do so?

## INITIAL SKIRMISHES

There have already been a series of skirmishes between the United States and Asian countries over the budding initiatives toward East Asian regionalism. Some have been bilateral while others have raised broad systemic issues. None has yet been of great moment, but they indicate the potential for more serious conflict.

As already noted, Japan's initial proposal for an Asian Monetary Fund in 1997 elicited very sharp opposition from the United States (as well as China). The proposal was made in the midst of the financial crises of 1997–98 and was viewed by the United States as a potentially fatal disruption of the IMF, on which it was relying to counter them. The United States has moderated its opposition to the subsequent, and more modest, CMI but continues to insist that any such regional arrangement must be consistent with the global institutional order (i.e., IMF) to ultimately be acceptable to it.<sup>9</sup> In particular, the United States wants CMI lending to be linked to IMF programs and their conditionality—which is what some Asians want to escape.

On the trade side, the United States has grown increasingly uneasy over the prospect of an East Asian bloc, which could discriminate significantly against US exports. It has responded to date in two ways, both of which have already produced modest disagreements with some Asians and could do so much more widely in the future.

One US response is to counter the intra-Asian network of FTAs with bilateral FTAs of its own. After concluding an initial agreement with Singapore in 2002, it has undertaken negotiations with Thailand (which have now stalled), Korea, and Malaysia and has begun to talk about possible initiatives with Indonesia and Japan. The potential conflict here is over the terms of the agreements: Most of the intra-Asian FTAs to date, especially those including China, are of relatively low quality in terms of issue coverage and effective liberalization, while the United States consistently seeks (even if it does not always obtain or even accept itself) "gold standard" FTAs with comprehensive coverage and extensive (even intrusive) reduction of impediments to trade and investment.<sup>10</sup>

5. One leading Japanese analyst of the process characterizes it as "regionalization without regionalism," with the latter defined as "an articulated idea of creating a region with specific goals in mind." See Tanaka (2006). Fukushima (2006) views the challenge as "how to transform a web into a network."

6. One Chinese observer argues, however, that "it is impossible for China to lead the regional integration process" because it is a latecomer (far behind ASEAN) to that process, has too many domestic problems, and provokes too many suspicions from others both inside and outside the region. He believes that Japan is also unsuited for a leadership role and concludes that "ASEAN is the only qualified driver." See Qin Yaqing (2006). A similar Japanese view can be found in Fukushima (2006). This is consistent with the series of "10+1" FTAs, centered on ASEAN, that have dominated the regional trade process so far. At a minimum, however, China must be an active participant if regional initiatives are to prosper.

7. Antkiewicz and Whalley (2004) note that "in China, the argument is made that (its FTA with ASEAN) may be the first step for China in creating an economic counter force to the United States and Europe...."

8. As argued by Frost (forthcoming 2007).

9. Henning (2006) discusses how such consistency should be promoted.

10. A useful analysis of China's early regional trade agreements can be found in Antkiewicz and Whalley (2004). They stress the very sharp differences both

President George W. Bush launched the second and more comprehensive US response in late 2006 by proposing that the Asia Pacific Economic Cooperation (APEC) forum “seriously consider” the creation of a Free Trade Area of the Asia Pacific (FTAAP), which would embed the Asia-only trade initiatives in a broader framework that included the United States itself and would thereby avoid (or at least sharply limit) any new discrimination against it. The APEC leaders at Hanoi agreed to do so, and APEC is conducting studies of the issue to prepare for its further consideration at the Sydney summit in September 2007 (Bergsten 2007).

China approved the APEC declaration, and President Hu Jintao did not comment on President Bush’s strong support for the idea at the leaders’ meeting. At the preceding APEC ministerial meeting, however, China reacted negatively to Secretary of State Condoleezza Rice’s equally strong advocacy of the idea, arguing that it would undercut the Doha Round of global trade negotiations in the WTO and delay implementation of APEC’s own commitment (the Bogor Goals) to achieve “free and open trade and investment” among the advanced countries in the region by 2010. At the first 2007 meeting of APEC senior officials, in mid-January, China posed a long list of questions about the initiative. Hence its position on the FTAAP is unclear at this time.

China’s stated objections do not have much substance. It is not pursuing Doha itself with any great vigor, and the round may fail anyway. It also knows that there is no possibility that APEC could achieve the 2010 goal. Hence its chief concerns about the FTAAP idea must lie elsewhere. One likely candidate is its opposition to including Taiwan in any trade initiative of the type envisaged, although it has been agreed (including by Beijing) since 1991 that Taiwan could participate fully in all APEC activities.<sup>11</sup> Another is its preference for trade agreements that are of low quality, do not require much new liberalization by China itself, and are largely motivated by political rather than economic considerations.<sup>12</sup> Yet another is

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among China’s initial agreements themselves—i.e., the absence of any common template—and between them and the much more precise agreements of the United States and the European Union.

11. This and other institutional objections to the FTAAP idea (e.g., that APEC is not a negotiating forum) could be met by pursuing the initiative outside of APEC. The United States and the APEC leaders’ statement itself have been careful to propose a Free Trade Area of the *Asia Pacific* (emphasis added) rather than an “APEC Free Trade Area.”

12. Sheng Bin (2006) concludes that China’s trade policy priority is clearly its regional FTAs compared with the Doha Round or other possible options including the FTAAP. He suggests that China’s doubts about the FTAAP also include old-fashioned protectionism (“protection of sensitive sectors”) and the implied institutionalization of APEC procedures. He also argues, however, that “China would undoubtedly benefit from joining (a high-quality) agreement and therefore would be likely to join,” although he opines at the same time that “achieving a high quality agreement is highly unlikely” (p. 65).

its fear that the United States might thereby hijack and wind up dominating the Asian regionalism process (Wu 2006).

Other APEC members, including Japan, have tried to reconcile the contrasting views on the future architecture of the region by suggesting pursuit of both the Asia-only and Asia-Pacific ideas. Most have proposed doing so on a sequential basis, however, with the 10+3 or 10+6 to be accomplished first and viewed as a “building block” for the FTAAP. Such sequencing is, of course, unlikely to satisfy the United States in light of the likely very long gestation period for any of the Asia-only configurations. Both the Taiwan issue and especially the very different views on the basic architecture of the region could produce clashes between China and the United States as the FTAAP process unfolds. As with so many of these topics, one will not know until the Chinese view becomes much clearer.<sup>13</sup>

### **At the moment, the “Asian model” of trade agreements appears to be on a collision course with that of the United States.**

A final Asia-US skirmish, also minor to date but potentially of greater magnitude over time, has arisen over participation in the annual East Asia summits. Some officials of the US government and Americans outside the government, and at least a few Asian countries themselves, believe that the United States should be invited to such gatherings in view of its traditional deep involvement in Asia and its keen interest in the topics that the Asian leaders are discussing. Many Asians (and some Americans, including this author) believe it would be inappropriate for the United States to attend and note that Asians are not invited to the periodic Summits of the Americas (and that neither Americans nor Asians are invited to the frequent summits of the European Union). This disagreement obviously carries political as well as economic overtones, of course, and could become much more salient if the substance of the Asian summits—especially with respect to meaningful economic integration in the region or to important security questions—was to become more serious than has been the case to date.

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13. Japan’s effort to counter China’s rising dominance in the region by attempting to include Australia and India via its 10+6 proposal is puzzling. It would seem more promising for Japan (and others fearing China’s rise) to align with the United States in broadening the 10+3 to the Asia-Pacific context instead.

## TWO FUNDAMENTAL ISSUES

Two fundamental issues, one bilateral and the other systemic, arise for the United States (and the rest of the world) from the growing prospect of an East Asian economic bloc. Since China will inevitably play a central role in the evolution of East Asia, these issues will also be of increasing salience in US relations with that country. The United States will need to devise a strategy to counter both aspects of this new component of its increasingly complex relationship with China.<sup>14</sup>

The bilateral issue is “simply” the discriminatory impact of East Asian regionalism on the United States. Based on earlier in-depth analysis of a wide range of possible pan-Asian and Asia-Pacific trade configurations (Scollay and Gilbert 2001), I have estimated that the United States could immediately lose as much as \$25 billion of annual exports as a result of the initial static effects of the tariff discrimination that would result from truly free trade in East Asia (on the “10+3” model).

### **The systemic issue...is the potential clash between a China-led Asia and a US-led “West” for leadership of the global economy.**

These numbers could increase over time as dynamic economic effects, especially with respect to new investment patterns, are triggered. On the other hand, the impact could be reduced to the extent that the East Asians exempted “sensitive products” and otherwise diluted their new trade arrangements and the extent to which the United States negotiated FTAs of its own with some members of the East Asian bloc, as discussed in the previous section.

The systemic issue is the potential clash between a China-led Asia and a US-led “West” for leadership of the global economy. China itself is already the second or third largest economy in the world and will shortly become the second largest trading nation. Supported by a cohesive Asian bloc, it could ascend even more rapidly toward a high degree of influence in, and indeed leadership of, global economic norms and institutions. At a minimum, it could undermine the functioning of the current institutions—as its blatant

manipulation of its exchange rate is already undermining the IMF norm against competitive currency undervaluation and producing huge current account surpluses that make it much harder for other countries, including the United States and the Europeans, to maintain open trade policies and support the WTO system.

China and much of Asia are indeed already offering an alternative to US leadership of the global trading system, with their emphasis on low-quality FTAs driven largely by political considerations, and to the principles of the monetary regime of flexible exchange rates, through their active currency management to prevent reduction of their external surpluses. Failure of the Doha Round would discredit the existing multi-lateral system based on the WTO to a considerable degree and provide an opening for such new leadership. The weakening in recent years, and related reduction in political legitimacy, of the IMF (and its G-7 steering committee) provide an equally opportune opening for China and a possible Asian Monetary Fund on the financial side.

This is, of course, not the first time that the United States has faced the creation of a megaregional economic bloc that discriminated substantially against its trade and challenged its systemic leadership. The European Union has represented a similar case over the past 50 years, evolving from a simple customs union at its outset in 1957 into a comprehensive Economic and Monetary Union. Despite some ambivalence throughout this period and sporadic sharp clashes over particular issues, notably agriculture and exchange rates but also several of the EU bursts of membership expansion, the United States has accepted and basically supported the enterprise.

There were three fundamental reasons for this benign outcome. One was the adherence of the European Union to the GATT requirement to cover “substantially all trade” (and, indeed, to go far beyond it) and the plausible argument that its economic union created more trade for outsiders than it diverted from them. A second was Europe’s willingness, sometimes reluctant but to date always eventually realized, to enter into global negotiations to subsequently reduce its barriers (and newly created discrimination) toward outsiders through reciprocal negotiations in the GATT/WTO; the creation, and subsequent broadening and deepening, of the European Union in fact contributed significantly to the globalization of the past half century by catalyzing the process of “competitive liberalization” (Bergsten 2001). The most important was the overriding US security goal of supporting creation of a unified Europe that could never again drag the world into military conflict, the cardinal purpose of the European leaders themselves who initiated and carried through the integration of the continent.

14. A third, predominantly security, issue is that the creation of effective East Asian regional arrangements could undermine the US security alliances and quasi-alliances in the region. This important topic will not be addressed in this brief.

**Figure 1 Competing models of trade integration**

	<b>High quality</b>	<b>Low quality</b>
<b>Asia only</b>	Japan's economic partnership agreements and "10+6" →	China's free trade agreements and "10+3"
<b>Asia Pacific</b>	US free trade agreements	← Free Trade Area of the Asia Pacific?

A fourth factor should be mentioned as well in explaining US attitudes toward European integration. That process began when the United States was still the dominant economy, as well as top military power, in the world. The European Union was already well into its unification process by the time the United States began to worry about foreign competition, and even the early stages of that modification in the American mind-set focused heavily on Asia (initially Japan, then the newly industrialized countries as well) rather than Europe. Hence both America's global economic position and the geographical locus of perceived threats to it are important factors in understanding US attitudes toward the evolving European Union and how they might be different in the case of evolving Asia.

At the moment, the "Asian model" of trade agreements appears to be on a collision course with that of the United States. As depicted in figure 1, there are in fact two considerable differences. The substantive difference lies in the quality of the agreements, with the United States continuing to insist on comprehensive coverage, including sensitive sectors like agriculture, while the Asian compacts are far from meeting such standards.<sup>15</sup> The geographical difference, now brought into sharp relief by the US proposal and APEC decision to "seriously consider" an FTAAP, is that the United States wants to embed Asia-only trade arrangements in a broader Asia-Pacific construct to counter both the bilateral and systemic implications of Asian regionalism.

15. The Asians including China argue, correctly in legal terms in the case of most of their FTAs to date, that they are not bound by the higher standards because they are (self-declared) developing countries covered by Part IV of the WTO rather than the "substantially all trade" and other criteria that apply to advanced countries. Moreover, the United States does not always itself adhere precisely to those standards, as when it excludes sugar altogether from its FTA with Australia and insists on "yarn forward" rules of origin to maintain important protection for its textile industry. Nevertheless, there is a substantial qualitative gap between US and Asian FTAs to date.

As noted in figure 1, there are several possible compromises between the currently polar positions of the United States and China. Japan's proposals for "economic partnership agreements" (EPAs), which have already been implemented across the Pacific (with Mexico) as well as within Asia, include some of the same ambitious objectives as US FTAs (e.g., regarding investment and some services) while excluding some others (especially agriculture). An FTAAP could offer an opportunity for constructive amalgamation among the competing models and the evolution of a new Asia-Pacific template, for trade liberalization and eventually economic integration, that might differ from the traditional GATT/WTO/US/EU approach.

The arrows in figure 1 indicate the direction of deviation of the Japan and FTAAP "models" from the columns in which they are listed: Japan's EPAs and its "10+6" proposals are not always of the *highest* quality (e.g., largely excluding agriculture), and an FTAAP would hopefully be of considerably higher standard than China's current compacts and "10+3" ideas. The matrix nonetheless displays the important differences across the two key variables in the policy debate on these issues.

The security aspect of the issue is necessarily even more conjectural, particularly because of the rivalry between China and Japan for leadership of Asia. On the one hand, creation of an Asian community that eliminated the risk of conflict between those two countries, as advocated by former Secretary of State George Shultz,<sup>16</sup> would be of benefit to the United States comparable to the creation of a European community that ruled out future conflict between Germany and France. On the other hand, the Sino-Japanese rivalry—and the absence of any Monnet-type vision and consensus within the region that integration is essential to rule out such conflict—raises profound questions about the prospects for meaningful

16. In conversations with the author.

integration. It also preserves a temptation for the United States to oppose regional cooperation in favor of maintaining and seeking to exploit its traditional bilateral relationships—especially with Japan but also with Korea, Taiwan, Australia, and even Singapore and Thailand—to balance China as advocated by former Secretary of State Henry Kissinger.<sup>17</sup>

**An essential pillar of a new US strategy is to accept, unambiguously and with articulation at the highest level, the legitimacy and desirability of economic integration in East Asia.**

At this point in time, it would be futile to speculate on either the timing or the substantive outcome of Asian economic integration. It is quite possible, however, that the results will be contrary to US interests in several respects:

- substantial discrimination against US trade;
- without the mitigating benefits of either full economic integration or meaningful political union and perhaps even without much constraint on China's behavior from its Asian partners;<sup>18</sup>
- and perhaps without a willingness to reduce its new economic preferences through subsequent negotiations with nonmembers (either globally via the WTO or regionally via an FTAAP or even bilaterally);
- increasing acceptance, outside as well as inside the region, of low-quality and highly politicized trade agreements that would undermine the traditional US emphasis on high-standard trade deals along with global rules and institutional arrangements centered on the WTO;
- steady buildup of a network of Asia-only financial agreements, and perhaps eventually an Asian Monetary Fund, that would undermine the global stewardship of the IMF; and
- increasing leadership, even domination, of the process by China with resulting augmentation of its international economic (and perhaps political) clout.

17. In conversations with the author.

18. For example, China's neighbors have a major current interest in appreciation of China's currency, but, aside from a few statements on the issue by Japan and Korea a couple of years ago and by Thailand recently, they have been unwilling to pursue it. It is unclear whether China's domination of its neighbors on such topics would be greater with or without more formal Asian economic links.

## A PROPOSED US STRATEGY

Such outcomes have now become sufficiently plausible that the United States needs to adopt policies to try to tilt the Asian integration movement in directions that would be more compatible with US interests. Fortunately, the Asian process is still at an early enough stage that a thoughtful and skillful US strategy should be able to have such an impact. Fortunately too, some of the Asian countries themselves want to avoid creating new sources of contention with the United States and would indeed prefer to strengthen rather than jeopardize transpacific ties. Moreover, other non-Asian countries presumably share the US objectives and should be willing to cooperate with the United States in seeking to affect the course of the Asian process. Working especially closely with cooperative Asians and non-Asians, the United States should thus adopt a strategy that tries to influence and help shape the pattern of Asian economic integration in directions that will promote its interests across both the bilateral and systemic considerations highlighted above.

An effective US strategy toward the East Asian integration movement would have three components:

- acceptance and indeed support of the basic concept;
- insistence that the Asian agreements be embedded in broader *Asia-Pacific* arrangements; and
- strengthening of both the substantive capabilities and political legitimacy of the global economic institutions, especially the WTO and IMF, to minimize the need for (and appeal of) new Asia-only regional compacts.

An essential pillar of such a strategy is for the United States to accept, unambiguously and with articulation at the highest level, the legitimacy and desirability of economic integration in East Asia. The model is US acceptance, despite the occasional difficulties and even crises, of the economic (and broader) integration of Europe. The rationale would largely be the same: the potentially substantial benefit to the United States, in economic and especially security terms, of a united Asia that would both create more trade than it would divert and put to rest the traditional intraregional rivalries (especially between China and Japan). These outcomes could strongly reduce the risk of economic and especially military conflict in the region that drew the United States into three major wars in the 20th century.<sup>19</sup>

19. A similar Chinese view can be found in Qin Yaqing (2006), who argues that "East Asian regionalism is not a zero-sum game between China and the United States" and that "there is a huge amount of room for the United States to play several roles in these areas (of the East Asian integration process)." For

The Asian consensus in favor of regional integration has already progressed beyond the point where the United States could block the initiative unless it devoted major resources to the task and was willing to bear the considerable costs that would result. Indeed, such a US effort at this time could create such a backlash in Asia that it would accelerate integration and further encourage the Asians to shut the United States out, as well as alienating even its best friends in the region.

The United States could maintain its current wait-and-see attitude, postponing any clear expression of policy to see how quickly, and in what direction, Asia evolves. Such a posture may have been appropriate, even into the recent past, while it was unclear whether the pan-Asian movement was serious. But the growing commitment of the region to unify, to at least a degree in some important areas, suggests that this cautious approach now primarily feeds Asian suspicions that the United States is basically hostile to their effort.<sup>20</sup> This in turn undermines the United States' ability to discuss those efforts candidly with the Asians and help steer them in constructive directions. Hence the time has come to clearly articulate US support for East Asian economic integration, to create a basically cooperative framework within which US suggestions on the specific outcomes—and especially the external relationships—of that integration will be taken seriously and hopefully accepted.<sup>21</sup>

Second, the United States (and the other non-Asian members of APEC, especially Canada and Mexico) should seek to embed any new Pacific-Asia trade arrangements in a broader Asia-Pacific framework.<sup>22</sup> President Bush has already

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a contrary view, see Gordon (2006), based on judgments that “any movement toward Asian economic integration” will intensify Sino-Japanese rivalry, have other adverse effects on US security interests, and generate domestic political resistance in the United States.

20. See Wu (2006). He even reports “widespread suspicion in China that the United States, concerned with possible Chinese domination in (the East Asia summit process), was actually behind the idea” advanced by Japan to dilute the 10+3 by adding Australia, India, and New Zealand. He also indicates, however, that “the attitude that Washington adopts toward East Asian cooperation is perceived to have a crucial impact on the process.”

21. There have already been several US policy statements that move modestly in this direction. In June 2004 Assistant Secretary of State for East Asian and Pacific Affairs James A. Kelly testified briefly to the House International Relations Committee that “regional cooperation and integration in East Asia is part of an encouraging set of trends” in the region. More importantly, the joint statement from the White House in June 2005 of President Bush and President Yudhoyono of Indonesia “welcomed the development in the region of an open and inclusive institutional architecture that...contributes to economic development and prosperity.” Assistant Secretary of State for East Asian and Pacific Affairs Christopher Hill added in a speech in Singapore in May 2006 that “it is understandable that Asia is looking to strengthen its own regional initiatives—and we welcome it.” He added, however, that “we need to think hard and clearly about how we can integrate pan-Asian and transpacific forces (including APEC)...to determine how the pieces can fit better together.”

22. Non-Pacific countries that might support the US effort to tilt the evolu-

tioned the APEC member economies to “seriously consider” an FTAAP, as noted above, and the APEC leaders agreed to do so at their annual summit in Hanoi in November 2006. The United States should now try to move this process forward as quickly as possible, not least because the onset of Democratic control in the US Congress means that it will be difficult to extend trade promotion authority beyond mid-2007 without a major new initiative of this type, especially if the Doha Round remains stalled, and because the prospect of a Democratic president in 2009 means that it may be essential to commence such a negotiation in the near future if it is to get off the ground at all (Bergsten 2007). China and the other East Asian countries should support these goals, as they would be among the largest losers from the turn toward protectionism in the United States that would be implied from a cessation of US participation in new liberalizing initiatives.

The case for nesting regional economic agreements in a broader context is well known. The absence of such nesting may induce the smaller grouping to become content with its own arrangements, including their discrimination against outsiders, and to resist further external liberalization. The Southern Cone Common Market (Mercosur) is perhaps the best contemporary example of that reaction, as it has apparently become unwilling to make the concessions necessary to permit agreement on a broader Free Trade Area of the Americas or perhaps even a meaningful Doha Round in the WTO. The European Union, by contrast as noted, was always embedded in an effective multilateral system via the GATT along with an exceedingly thick network of transatlantic arrangements with the United States and Canada, which effectively countered its periodic proclivities to resist cooperation with nonmember countries.

At present, it would be risky to rely on the global system to provide such nesting since both the WTO, particularly in light of its stalemate over the Doha talks, and the IMF are themselves increasingly shaky. Hence the Bush administration has taken an important step by proposing an FTAAP, which could evolve in parallel with the Asia-only arrangements, avoiding the multiple economic and political risks of an Asia-only integration process. It would be essential for the Asia-Pacific and Pacific-Asia processes to proceed in tandem, however, as opposed to the idea currently being suggested by some Asians to create their “10+3” or “10+6” construct first and view it as a “building block” for a Pacific-Asia counterpart that would follow at some undefined, probably quite distant, point in the

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tion of East Asia in the suggested directions might balk at this component of the proposed strategy or at least seek to augment it with new arrangements of their own. The European Union, for example, might insist on pursuing an Asia-EU Free Trade Area, based on their Asia-Europe Leaders' Meetings, to parallel the FTAAP.

future.<sup>23</sup> To return to the analogy with NATO, in terms of transatlantic relationships in the early postwar period, a key goal of an FTAAP would be “to keep the United States in”—in the transpacific network in this case.<sup>24</sup>

The global system can still provide a useful context for any new Asian bloc, however, and it would in fact be highly desirable to imbed an FTAAP in such a system to make sure that it too did not become inward-looking. Thus the third part of the US strategy should be to redouble its efforts to shore up the global economic institutions, notably the WTO and IMF. Both are under severe threat at present because of their inability to successfully address their substantive agendas. The Doha Round is at risk of total collapse, or at least indefinite suspension, which would seriously undermine the entire WTO system and likely prompt its erosion. This in turn would reduce the prospect for diluting future discrimination by a new East Asia Free Trade Area against outsiders through the traditional approach of multilateral liberalizing negotiations (as well as increase the incentive for the Asians to create an East Asia Free Trade Area in the first place). The Fund has proven totally impotent—especially vis-à-vis the Asian surplus countries, most notably China with its substantially undervalued exchange rate and massive intervention to maintain that undervaluation—in addressing the huge trade imbalances and currency misalignments that it acknowledges are a major threat to the world economy.

Even more fundamentally, the political legitimacy of both institutions is under intense challenge. Both have traditionally been dominated by the United States and the European nations that created them in the immediate aftermath of the Second World War. Both have been slow to adapt to the radical shift in global economic power deriving from the dramatic growth of Asia over the past few decades. The IMF has proved to be particularly rigid, in light of its more highly articulated quota system and voting structure, as opposed to the consensus nature and one country—one vote approach of the WTO (Truman 2006). The Fund is now seeking to realign

23. Wu (2006) in fact argues that “a vigorous APEC can contribute to the development of an East Asian Community” through the standard logic of competitive liberalization. APEC’s adoption of its initial trade liberalization goals in the early 1990s clearly energized ASEAN to attempt to accelerate its own integration process.

24. The most authoritative Chinese statement to date on these issues concludes that “If the FTAAP unfortunately fails...China would continue to pursue its building of an RTA/FTA network (and would) launch more RTAs/FTAs with other countries such as Brazil, Mexico and Russia. Particularly, it is highly likely that China will promote the establishment of an EAFTA.” The paper recognizes that “All these outcomes will exacerbate the US-China confrontation in APEC” though also acknowledging that China might “join the FTAAP at a later time” if it proceeded without China at the start. See Sheng Bin (2006).

its governance arrangements to provide a larger role for China and other Asian countries but the Europeans, who would have to give up most of the representation that needs to shift to Asia, are resisting tenaciously. In the WTO, Japan continues to participate periodically in the de facto steering committee of six or seven key countries, but China, pleading its “new member” status, has declined that responsibility, and no other East Asians are centrally involved.

### **The United States...should seek to embed any new Pacific-Asia trade arrangements in a broader Asia-Pacific framework.**

The United States has a major interest in maintaining the systemic primacy of these global institutions. It has been making modest efforts to address the problems cited here, but the priority it has attached to them, including the Doha Round, has been limited. The importance of preventing the potentially adverse implications that could flow from the emergence of a new Asian bloc should add considerable urgency and emphasis to this US policy effort over the period ahead. If the global institutions continue to weaken, East Asian integration will probably accelerate, and the risk of conflict with the United States will rise further.

### **CONCLUSION**

As with many of the other key issues on the US-China agenda at this time, as analyzed in Bergsten et al. (2006), the impact of China’s regional participation and initiatives raises more questions than it answers. Creation of an Asian bloc could significantly augment Chinese economic power and perhaps its global political clout as well if the new economic arrangements indeed turn out to carry broader implications, though it could also constrain Chinese behavior through moderating pressures from its neighbors. An Asian bloc could have positive effects on the world economy, by accelerating trade liberalization and providing additional financial resources to counter international monetary disturbances, or it could divert substantial amounts of trade and dilute future efforts to stabilize the financial system—thus adding to the backlash against globalization in the United States and other non-Asian countries. China and Japan could use the Asian integration dynamic to limit or at least contain their rivalry, reducing the risk of future conflict for the United States as well as for the region itself, or that integration dynamic could become a new

source of tension between the two that heightens their mutual suspicion and even hostility.

Given these uncertainties in the outlook, and regarding China's real intentions, the United States should proceed here, as with other aspects of China policy, by trying to tilt the outcomes in directions that would support its own interests as well as the global system more broadly. In this case, such a policy must focus on the evolution of Asian integration itself and the desirability of persuading its participants to move in directions that are both open in economic terms and consistent with an effective global order. This does not mean that China and Asia should be expected to uncritically accept existing US and international norms. They may indeed bring important and valuable ideas to the construction of a "new international architecture" that would provide renewed dynamism to the multilateral framework, which has been faltering in its efforts to keep pace with the rapid changes in the agenda and geographic composition of the world economy itself.

It is clear, however, that the time has come for the United States to take seriously the likely construction of new Asian economic arrangements since these arrangements could well have important consequences for the United States itself and for global economic (and possibly political) patterns and institutions. The United States must therefore devise a coherent strategy to respond to this evolution, in terms of its relationship with China (which will inevitably dominate the Asian movement) as well as with the region as a whole. This topic needs to be added to the list of issues to be addressed in the Strategic Economic Dialogue and other ongoing efforts to deal constructively with the China–United States relationship and its impact on the world economy.

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