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## The EU at a Crossroads: The Eurozone Crisis under Globalisation

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Edited by Takamoto Sugisaki



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## **The EU at a Crossroads: The Eurozone Crisis under Globalisation**

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#### **Programme of the Conference**

## Acknowledgements

This work brings together papers presented at the international conference, *The EU at a Crossroads: The Eurozone Crisis under Globalisation*, held on 12<sup>th</sup> and 13<sup>th</sup> October, 2012 at Tsuda College in Japan as one of the projects of EUSI Tokyo. This work started under the EU Asia Japan Day Project at Tsuda College in October, 2011, when the first preliminary international conference had been held.

EUSI Tokyo is the EU supported academic consortium organised by Hitotsubashi University, Keio University and Tsuda College. This consortium was established in 2008, after the succession of EUIJ Tokyo established in 2004, and is now in its second four year term. *Review of EU Asia Pacific Studies (PEAPS)* is the web journal of the EUSI Tokyo, published by the Economics and Economic History Research Group. Financial assistance was provided by the EU.

The editor thanks all the contributors for their support and patience in publishing the proceedings of the conference. The editor is grateful also for the support of colleagues at Tsuda College, especially Professor Chris Burgess, Professor Hisahshi Yokoyama and Professor Ryosuke Amiya-Nkada. We would like to express our thanks to Ms. Akiko Kariatsumari, Ms. Akiko Kawamo, of the EUSI Tokyo Office, the International Centre at Tsuda College, and to Bun-Shin Co. especially Mr. Ryo Kitano for editorial assistance.

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# Introduction

**Takamoto Sugisaki**

After the US triggered the international financial crisis in 2007–08, its impact on the European area has been much debated around the world. This book is an outcome of the EUSI Tokyo International Conference ‘The EU at a Crossroads: The Eurozone Crisis under Globalisation’ held on 12<sup>th</sup> and 13<sup>th</sup> October, 2012 at Tsuda College, Japan, where academics from Europe and the Asia-Pacific region met to discuss European and Asia-Pacific regional integration in an uncertain era of globalisation following the international monetary crisis.

## Conference Purpose

The conference was designed to allow academics from Europe and the Asia-Pacific region to meet and discuss European and Asia-Pacific regional integration in an uncertain world and globalised economy.

First, the conference sought to address several economic and financial dimensions: How does this crisis differ from a traditional monetary crisis? Why do advanced economies now face a sovereign crisis?

Second, from a socio-economic dimension, the conference explored solutions to the socio-economic crisis and methods for the revival of a social, democratic Europe?

The conference witnessed in-depth discussions in the context of globalisation on the crisis that affected the Asia-Pacific area in a number of ways.

The hope was that Asians could learn something from this historic crisis, especially given that Asia is now at a crossroads as the power balance shifts between the US, the EU and Asian powers.

By discussing the European crisis along these dimensions, our aim was to consider and recognise the European solution and identify lessons for increased Asia-Pacific regional cooperation. Eventually, the Asia-Pacific region could learn much from the EU’s success in unarmed unification.

As the crisis spread from merely a US monetary crisis in 2008 to the sovereign crisis in Europe in 2011–12, it became necessary to consider the Eurozone crisis in the context of globalisation. European regional integration, which had been challenged by US-oriented globalisation, faced a crucial cross-road. The crisis could either have led to the EU’s dissolution and Europe’s re-Balkanization into small states, or spur greater integration, turning the EU into an increasingly powerful super-state.

Many economists used the optimum currency area model as a springboard to discuss how the currency, *euro*, should be dismantled to return to a more ‘rational one,’ such as a dual currency system, and

so on. At the same time, apart from the economic, theoretical viewpoint, we found a strong will among Eurozone nations to maintain a single currency.

We were required to examine the crisis not only in terms of modern impacts but also historically, and not only in terms of European impacts, but also from the viewpoint of the Asia-Pacific region, on the basis of the great transformation the world is currently undergoing.

## **Research Background**

In organizing the conference, a comprehensive historical approach was deemed necessary. Comparisons, between the Great Depression and the current crisis as well as between the European and Asia-Pacific approaches, might be necessary to understand the regional transformations, caused by globalisation, that are occurring today. Of particular note is how the crisis transformed from a financial problem to a social one, revealing identity problems that had festered unchecked in the European integration project. By managing the financial crisis, European countries found themselves having to deal with huge national debts—albeit much smaller than Japan’s—which has shaken both social integration and European identity itself. In this context, we have to consider the current European crisis not only from an economic dimension focusing on the monetary and sovereign crisis but also from a socio-economic dimension that concentrates on social integration in Europe. For this reason, we cannot discuss the crisis as merely a current problem but must also consider the historical viewpoint.

As the Mundell–Fleming trilemma praxis shows, free international capital mobility and independent monetary policy for domestic purposes are incompatible with stability of pegged foreign exchange rates (Mundell, 1963). Every state in the Eurozone was required to abdicate its own power over monetary policy to the European Central Bank (ECB). Despite the convergence of monetary policies, however, financial and budgetary problems remain far from convergence, as countries face different social problems. This means that the Mundell–Fleming trilemma model needs to be developed not only in terms of monetary policy but also for public finance policy, which is interdependent with the domestic social dimensions (Sugisaki, 2007).

In Asia, regional cooperation through programmes such as ‘ASEAN Plus Three’ has made little progress, stymied by the new tensions hanging over the region.

Asia faces several problems. One is the Trans-Pacific Partnership (TPP) talks, which are taking place without China and South Korea. Territorial disputes in the North–East area are ongoing sources of tension, along with economic problems related to Japan’s Yen depreciation policy and its influence on neighbouring countries.

The 1930s crisis demonstrated the importance of building a freer international trade system with a stable exchange rate based on regional and global cooperation. The lengthy history of European integration shows that the Europeans learned much from history, in contrast to the Asians. As scholars of EU studies in Asia, it is important to learn from history and understand the wisdom behind European integration and monetary unification.

## Construction of this Book

This book organizes the papers presented at the conference into three parts.

Part I, 'Euro Crisis and the Regional Integration Programme', contains two papers. Bernadette Andreosso-O'Callaghan's paper, 'Analyzing the euro crisis and the future of regional integration through the prism of the Irish case', explores the importance of Ireland, a typical open economy, in spreading the contagion of monetary crisis from the US to the Eurozone. O'Callaghan stresses the importance of 're-regionalization of finance' with regional financial cooperation acting as a buffer against future shocks and crises.

Henk Overbeek's paper, 'The Eurozone debt crisis and the future of the European integration project', highlights the similarities between the 1930s crisis and the current Eurozone debt crisis and proposes some measures to rescue the European integration project on the basis of democratization in decision-making at the social level.

Part II, 'The Impact of the Crisis and the Asia-Pacific Area', also contains two papers. Yeo Lay Hwee's paper, 'The impact of euro crisis on regionalism in East Asia', describes the trajectory of European integration and debates the importance of acknowledging the originality of East Asian regionalism, which cannot completely use the EU as a model.

Jiro Okamoto's paper, 'Australia-EU cooperation in the context of Asian engagement', shows that Australia and the EU have common interests as well as some differences in their Asian engagement. Since the multiple cooperation processes in Asia are quite different from the EU model, Okamoto argues that Australia's attitude towards Asian regionalism needs more flexibility than that required in the EU.

Parts I and II also contain commentators' remarks.

Part III offers four papers from the conference's special guest speakers. Fukunari Kimura's paper, 'The recent development of economic integration in Asia-Pacific', describes Asia's rapid economic development and integration on the basis of regional production networks. Kimura stresses the global importance of East Asian dynamism in the upcoming decade.

Deok-Young Park's paper, 'Legal aspects of Korea's FTAs', details Korea's Free Trade Area (FTA) hub strategy from a legal point of view and emphasizes issues surrounding the state of origin, especially its significance for economic cooperation between the two Koreas, using the case of 'Korean' products from the Gaseong Industrial Complex.

Kumiko Haba reproduces the presentation materials from the talk 'Asian Trans-Regional Integration and the Major Power's Power Shift: The US, China, Japan, and the EU', which shows the complexity of the power transition occurring in the Asia-Pacific region.



Hiroshi Watanabe's paper, 'EURO Crisis and Asia-Pacific', describes both the causes of the Eurozone crisis and the dynamism of the Asian region's economy. He emphasizes the role of public regional institutions in facilitating effective cross-border financing channels in the Asia-Pacific area. In his lecture, he used several visual aids, which unfortunately could not be reproduced in this book, to help participants understand his argument.

## **After the Conference**

Since the EUSI Tokyo Conference took place in October 2012, the Asia-Pacific region has changed drastically. First, tension has risen regarding territorial disputes between Japan, China and Taiwan, as well as between Japan and the Republic of Korea.

Second, worries over the re-emergence of militarism in Japan have been growing as discussions on amending Japan's Constitution, especially renouncing Article 9, have gained traction with the Liberal Democratic Party's (LDP) landslide victory in July 2013. These issues are further complicated by the growing viewpoint that seeks to raise questions about 'correct historical perceptions', especially with regard to Japan's colonial history.

Third, in the economic sphere, the depreciation of the Yen against Asian currencies and Japan's entry into the US-led TPP free trade initiatives have been recognised as posing great challenges to Japan's foreign policy in the Asia-Pacific region.

Developments are occurring at break-neck speed. Plans to build on bilateral FTAs and establish an FTA in the Asia-Pacific region to form a comprehensive regional partnership are emerging. Plans are also afoot to pursue the latter, as negotiations have been accelerated for the Trans-Pacific Strategic Economic Partnership Agreement (TPSEP) on the basis of the US-led Asia-Pacific Economic Cooperation (APEC). In addition, the Regional Comprehensive Economic Partnership (RCEP) seeks to establish an ASEAN-centred ASEAN Plus Six group by adding India, Australia and New Zealand to the ASEAN Plus Three (Japan, China and South Korea). At the same time, the ASEAN Plus Three meetings are ongoing, whilst a proposal for another ASEAN Plus Eight has been made to comprise a practical cooperation unit under the platform of ASEAN defence meetings plus eight dialogue partners, the United States and Russia, has started to become a reality. In addition, several bilateral free trade negotiations between the EU and Asian countries continue to make progress.

These integration and cooperation activities—and their widespread support—indicate that intimate partnerships are developing, which in turn suggests that deeper regional cooperation will become a vital force in the development of the Asia-Pacific area. Admittedly, despite a solid economic basis for development, Japan and neighbouring countries face stumbling blocks in cooperation due to conflicts over territorial and historical recognition problems. These issues, in particular, are ones where Japan can learn from the lessons of European integration and German efforts to atone for WWII aggression.

As the editor, my final question is this: Who is standing at a crossroads, the Eurozone, the Asia-Pacific region or both? In the next few years, the Asia-Pacific region and the world will face massive transformations. The editor hopes that the proceedings of the conference will be a step closer to a deeper understanding of these issues and further develop research cooperation among academics in Europe and the Asia-Pacific region.

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## Part I

### **Euro Crisis and the Regional Integration Programme**

# Analyzing the euro crisis and the future of regional integration through the prism of the Irish case

Bernadette Andreosso-O'Callaghan

## Abstract

The role played by Ireland in the propagation of the US sub-prime market crisis to the euro-area deserves special attention. Once classified as an EU 'cohesion country', this fast growing small-open economy shows a number of striking similarities with the US economy. This article shows that the inappropriate responses to the crisis, focusing solely on the banking sector, have damaged further the Irish labor market and the innovation capability of the country, posing a serious threat to its future economic growth. The inability of EU institutions to acknowledge the 'systemic' nature of the crisis has resulted in second-hand muddling-through strategies. However, political change since 2011, combined with the tacit acknowledgement of previous failed strategies should lead to a renaissance of the EU project.

## Introduction

The specific case of Ireland in the management of the euro crisis is particularly relevant given the role of the country as the *propagator*, to the euro-area, of what was commonly referred to as the 'US sub-prime market crisis'. The Irish economy was indeed the first European country to enter into recession, with year-on-year negative GDP growth rates registered for the first two quarters of 2008 (CSO, 2012).<sup>1</sup>

Although the study of the *impulse* (or root causes of the crisis) is beyond the remit of this paper, analyzing the specific reasons for which the US financial crisis propagated to the euro-area through the Irish door is worthy of attention and it will therefore be the objective of the first section of this paper. In a second section, we will highlight the systemic nature of the crisis. Going beyond the many imperfections of the chosen type of EMU (Economic and Monetary Union), the third section will call for what can be termed the 'renaissance' of the EU project, something that transcends the boundaries of the financial and purely economic spheres. Some conclusions will be suggested in a final section.

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<sup>1</sup> And before Iceland, a non euro-area and non EU member country, which was also hit by a severe banking crisis in 2008. Iceland could nevertheless use a number of policy instruments to exit from the crisis such as the introduction of capital controls, instruments that are not available in the case of euro-area member countries.

## 1. Ireland as the propagator of the US sub-prime crisis in the euro-area

The first question that springs to mind, is the following: why was Ireland the propagator of the US financial crisis in Europe and in particular in the euro-area?

Whilst being a member of EMU since its inception in January 1999 when the exchange rates of participating countries were irrevocably locked, the Irish economy has nevertheless tended to display business cycles synchronized with those of the USA, rather than with those of countries in the EU and in the euro-area. The longest period of economic expansion in the history of the USA (Field, 2007) has corresponded to the period of high growth rates (or 'Celtic tiger' period, *i.e.* 1993-2007) in Ireland. According to EUROSTAT figures, Irish GDP per capita in PPP terms was multiplied by a factor of 2.5 between 1999 and 2007 and according to World Bank data, the country had the second highest average annual job creation rate in the EU between 1995 and 2009, after Spain and Bulgaria and at par with Greece, denoting a catching-up phenomenon.

As has been discussed in great length in numerous studies, US inward investment in the manufacturing sector, with its multiplier effects elsewhere in the economy, has been the major source of growth (or impulse) in Ireland during the so-called 'Celtic tiger' period.<sup>2</sup> US inward investment in Ireland accounts for more than 80 per cent of employment in technology-driven industries such as electronics, electrical/optical equipment and pharmaceuticals. The deep historical, cultural and economic connotations between the Irish and US economies are such that the two economies combined a number of pre-crisis similarities, such as:

- (i) the commitment to services (and in particular to financial services) as an engine of modern economic growth, leading, *inter alia*, to an oversized banking sector in Ireland;<sup>3</sup>
- (ii) downward savings rates;
- (iii) the unleashing of a property bubble. In the case of Ireland, this bubble was nurtured by EMU-driven policy tools in particular by low interest rates, a policy tool that did not suit the overheating Irish economy, exemplifying once again the a-synchronic nature of the Irish economy with respect to the euro-area core.
- (iv) unusually high financial asset prices over an extended period of time; in both countries, equity prices (in particular, bank shares in Ireland) were clearly over-valued and residential property prices hit record levels. To these typical symptoms of a financial crisis, one can also add unusually high prices for fine art, antiques, etc.

The elements above are the typical symptoms of an unfolding financial and economic crisis, and convey therefore a sense of *déjà vu*. France in the 1860s and Japan in the mid-1980s are two cases in point.

Because of the liquidity problem faced by US overseas companies and because of the uncertainty

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<sup>2</sup> The Interested reader can refer in particular to Barry (ed, 1999) and Begley, T. *et al* (2005).

<sup>3</sup> According to Deutsche Bank data, banking assets represented 360 per cent of Irish GDP in 2007. In 2009, the share of Ireland in all EU wholesale financial activity in the EU-27, including the activity of hedge funds operating in the Dublin-based International Financial Services Center was 5.3 per cent (Accenture, 2010). This compares with 13.1 and 10.7 per cent for Germany and France respectively, two countries that are 18.6 and 14.6 times the size of Ireland, respectively.

in the USA after the bankruptcy of Lehman Brothers in September 2008, worldwide restructuring implied the withdrawal of US-owned manufacturing plants from Ireland (DELL for example in early 2009). The manufacturing sector accounted therefore for a quarter of job losses between 2008 and 2011, the highest figure after that of the building sector, a sector that had nevertheless grown thanks to positive developments in the manufacturing sector.

As in the case of the Great Depression, the fall of investment, and in this case, of inward investment from the USA, is the mechanism by which the US crisis propagated to Ireland, unveiling thereby the up-to-then rather well concealed problem of the property bubble. Although presenting a number of differences, the two crises show nevertheless some striking similarities. In a well-documented account of the Great Depression, Termin (1989) shows how the fall of investment in the USA, as well as in Germany, unveiled the hidden problems of the major world economies at the time, summarized by the author as the clinging to an economic ideology represented by the Gold Exchange Standard, - with its tight monetary and fiscal policies - , a monetary arrangement that did not suit the economies at the time. A parallel can tentatively be drawn with the selected type of EMU that did not suit Ireland and other peripheral economies. A number of chain reactions show how the Irish labor market is dependent on US economic growth.

However, although the chain of causality ran from the US economy to the EU and euro-area economies, through Ireland, the many similarities between some of the EU economies<sup>4</sup> and the USA imply that the crisis could have easily found its source in Europe. The crisis has indeed revealed the unsustainability of a poorly constructed and incomplete economic and monetary union, an issue that had been discussed at some length in European economic circles (see for example De Grauwe, 2008). The trigger of the euro-area crisis happened to be the collapse of Lehman Brothers in the USA, but this does not diminish the fact that Lehman Brothers in the USA, Anglo-Irish Bank in Ireland and many other banking institutions in the EU have been modeled by policies shaping an unsustainable financial architecture with uncontrolled 'financial innovation', over-lending, poor regulation... It is thus the crisis of a specific system or 'systemic crisis', and the systemic nature of the crisis, with reference to Ireland, can be appraised more extensively in the next section.

## 2. A systemic crisis – fiscal and banking responses

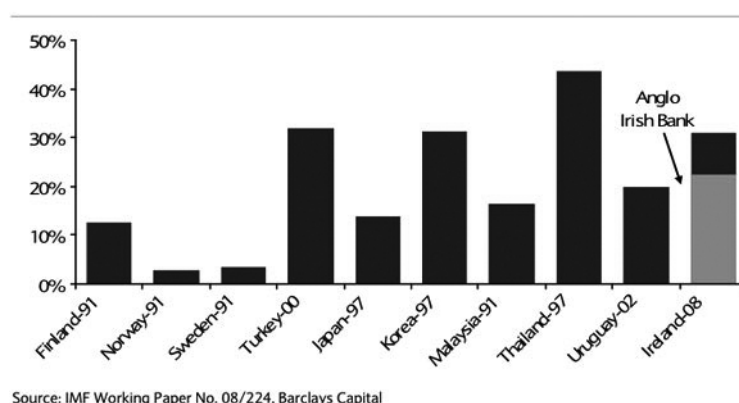
In spite of it being an economic crisis, encompassing both the financial and real economies, the corrective measures have *disproportionately* dealt with the banking sector, in Ireland and elsewhere in crisis-hit countries.

The management of the banks' non-performing-loans (NPL) problem, estimated in early 2009 at euro 90bn (or more than 50 per cent of Irish yearly GDP) led to a number of reactive policies inspired by fear. Cognizant of the deep inter-linkages existing between EU (euro-area) banks, the ECB and EU Commission feared contagion from Ireland if the main NPL-laden bank, Anglo Irish Bank, had been let go à la Lehman Brothers. At the time, the Irish Government was gradually becoming locked out

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<sup>4</sup> Such as Ireland as discussed here, but also and to a certain extent, such as Spain.

of the bond markets, given its unprecedented banking problem. The conjunction of these two events justified, in the eyes of the EU Commission, the forced euro 85bn bailout package from the ECB/Commission/IMF in November 2010. In the course of time, some of these NPLs were eventually written down, with some losses inflicted to bondholders, and the rest was transferred to a 'bad bank' (NAMA)<sup>5</sup>; also, other banks were either partially (Bank of Ireland) or nearly fully (AIB) nationalized allowing restructuring in the industry to take place. The cost of these measures aimed at rescuing the failing Irish banking industry has been estimated at euros 64bn, or the equivalent of more than 40 per cent of yearly GDP. This is substantially more than earlier estimates (figure 1), estimates which had already placed the Irish banking industry in the spotlight of the most costly banking systems to rescue in modern times. With new available data, the Irish banks stand out as the most inefficient of all.



**Figure 1 Estimated costs of the banks' bail out (% of GDP – comparative terms)**

According to ECB/EU Commission/IMF orthodoxy, the rescue of the banking sector was necessary and sufficient to boost confidence and stimulate growth in the real economy. Unfortunately, the macroeconomic indicators displayed in table 1 clearly show that four years after the beginning of the recession in Ireland, confidence has still not yet returned, investment has slumped, unemployment has reached new record highs, private consumption expenditure growth is still negative and real GDP growth is forecast to oscillate around 0 per cent in 2012. The commendable rise in exports since 2010 has not been sufficient to propel GDP into comfortable growth figures. Internal devaluation (*i.e.* declining wage rates) as well as external devaluation, of the euro against major international currencies, explain together the positive performance of exports.

In addition, the attempt of the ECB and EU Commission to contain the disequilibria within the confines of the Irish economy, at a huge economic and social cost, failed: in the Autumn of 2010, the crisis spread to other euro-area countries turning it into a euro-crisis, due to the intertwined nature of the euro-area banking system.

<sup>5</sup> National Asset Management Agency. In a comparative perspective, the South Korean AMC 'bad bank' operated efficiently and was able to resolve 2/3 of its non-performing assets within four years after the 1997 crisis. Econometric evidence shows that 'higher recovery rates are associated with the use of asset management companies only in the case of *efficient governments*' (CEC, 2009: 141). NAMA is characterised by a lack of transparency, an issue that inevitably lends questions in terms of government efficiency.

**Table 1 Macroeconomic Indicators - Ireland (annual % change or share in %, respectively)**

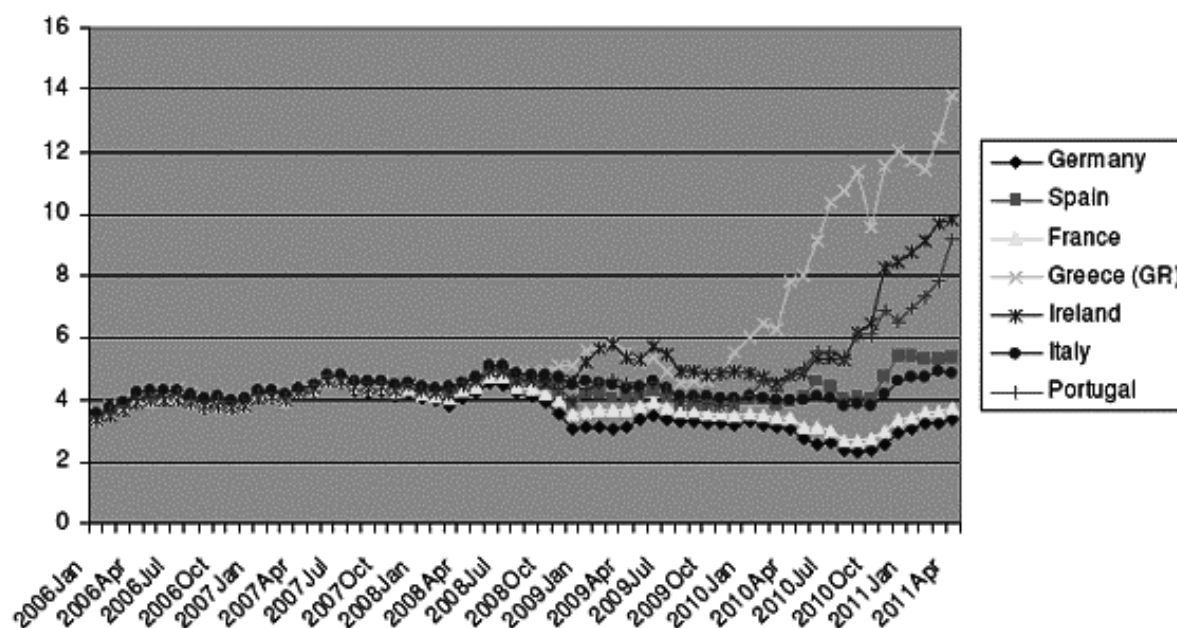
	2006	2007	2008	2009	2010	2011	2012(e)
(1) Real GDP (annual % change)	5.3	5.6	-3.5	-7.5	-0.2	0.8	0.5(EU) 0.4(IMF)
(3) CPI (annual % change)	2.7	2.9	3.1	-1.7	-1.6	1.0	0.7
(3) General government debt (% of GDP)	24.7	25.0	44.4	65.6	94.2	110 (e)	116
(4) Unemployment rate	4.4	4.5	6.4	11.8	13.6	14.5 (#)	14.8
(5) Investment (GFCF) (annual % change)	4.6	2.8	-14.3	-31	-25	-12.5	6.1(1st quarter)
(6) Private consumption expenditure (annual % change)	6.7	6.4	-1.5	-7.0	na	Na	-1.7
(7) Exports (annual % change)	4.8	8.2	-0.8	-4.1	9.4	5.1	-
(8) Current account(per cent of GDP)	-3.5	-5.3	-5.2	-3.0	-2.7	-1.1	

Sources: Central Statistics Office, Dublin; Department of Finance, Dublin.

Inevitably, the rescue of the Irish banking sector through recapitalization measures fueled record high budgetary deficits (14.4 per cent of GDP in 2009 and 31.3 per cent in 2010 according to Eurostat figures; see the appendix) with an ensuing detrimental impact on the sovereign debt level. Ten year bond yields increased steadily and to record high levels between August 2010 and August 2011 (Figure 2). As the data in table 1 show, the Irish economy had extremely low debt/GDP levels before the onset of the crisis, and indeed these were lower than Germany's, making the country an example of fiscal discipline among euro-area countries. The weak foundations upon which EMU had been sitting since its inception implied that the high probability of crisis contagion to other relatively weak euro-area members (Greece, Spain and Portugal) led many investors to see in bond markets new opportunities for short-term or medium-term profit. Indeed, according to the EU Commission, speculation favors the increase of sovereign debt, through short selling and Credit Default Swaps.<sup>6</sup>

<sup>6</sup> Short selling refers to a transaction where a seller who sells a bond (share) does not own the bond (share). The seller sells the bond in time period  $t$ , with the intent of buying it back in  $t+1$ , anticipating a drop in the price in  $t+1$  so as to make a profit.. The March 2012 Regulation on short selling is aimed at controlling this financial instrument; this Regulation is due to enter into force on the 1<sup>st</sup> of November 2012 (OJEU 2012).





Source: ECB, Frankfurt.

Figure 2 Euro area sovereign 10 year bond yields

The austerity measures imposed upon Ireland by its membership to a flawed EMU led to a harsh conflict between fiscal adjustment policies and other (structural) policies. Apart from their negative impact in terms of social progress and social cohesion, these measures are a serious threat to Ireland's sustainable economic growth. Indeed, as we have argued elsewhere, these measures have plunged the young Irish innovation policy into a deep crisis (Andreosso-O'Callaghan, forthcoming). The fact that new funding for R&D has dried out has jeopardized the remarkable efforts of the Irish Governments to pull Ireland, in the space of 10 years or so, in the league of 'innovation followers', comprising also the UK. This has been seriously compromised, and this shows the inappropriateness of 'muddling through' measures put forward by the ECB/Commission/IMF to resolving the crisis. The move away from reactive to proactive measures is analyzed in the ensuing section.

### 3. From the reactive muddling through measures to vision: a *renaissance* of the EU project

The first years of the crisis (2008-2011) are marked by reactive, piecemeal, delayed and timid measures in the financial sphere only from the part of both the EU Commission and the ECB.

First of all, the creation of the European Financial Stability Facility (EFSF) in May 2010, - replaced by the more permanent European Stability Mechanism (ESM)<sup>7</sup>-, is a clear acknowledgement that EMU had, from the start, been amputated from its third component, that is a permanent mechanism of finan-

<sup>7</sup> The ESM can be put in place now that the Karlsruhe Constitutional Court gave its green light for its establishment on Sept. 2012 the 12th. Note that the ESM would be an embryo of the (much awaited) European Monetary Fund (trans-European social solidarity tools are to emerge by 2014, which would replace the numerous traditional EU structural funds).

cial transfers in case of major disequilibria or asymmetric shocks. It is useful to reiterate the fact at this juncture that the 1979 European Monetary System (EMS) had three components, of which a financial solidarity mechanism, allowing the countries unable to contain their currency within the permitted margins of fluctuation in the exchange rate mechanism (ERM) to use a support mechanism comprising a very short-term finance mechanism, short-term support and-medium term loans (6 months to several years). A great deal of economic and financial convergence had been materializing between 1979 and 1999, but this was not enough to allow the candidates for EMU to be labeled as an optimum currency area.<sup>8</sup> In particular, shock asymmetry has continued to characterize the euro-area, pre and post EMU.

However, the EFSF financial envelope of euro 750bn is deemed insufficient to adequately respond to the current crisis. Second, the Treaty on Stability, Coordination and Governance (TSCG) signed in March 2012 and which should enter into force on the 1st of January 2013, needs to be introduced with an array of other structural measures that are of utmost urgency.<sup>9</sup>

Introducing these other measures at the same time as the TSCG would allow the EU project to be seen as both credible, in the eyes of foreign investors, and sustainable. Perhaps this visionary stance is more likely to happen now, given a number of positive developments at both the national and EU levels since January 2011.

The first such positive move was the ECB intervention in the sovereign debt markets for the first time in January 2011, when it bought bonds from EU countries up to euro 5bn, through the EFSF; this was followed by a second intervention of the ECB in the sovereign debt markets of EU countries (unlimited this time), on September 2012 the 6<sup>th</sup>. These bonds are not yet eurobonds as they are still guaranteed by the different Member-States, but this pro-active strategy of the Central Bank signalled a departure from its previous lethargy.

Second, the renaissance of the EU project is more likely to happen in an EU post 2011, given the political change that has occurred in a number of countries, in particular in Italy and France. More specifically, political change in France in May 2012 might signal the country's constructive return to the EU scene, after an absence of 17 years, building on the visionary Jacques Delors line. The return of France to the EU project implies, perhaps paradoxically, more devolution of power from the national level to the EU level, and therefore increased powers to the euro-area. It can therefore be seen that the sine qua non conditions are increasingly met for deeper integration, which needs nevertheless to transcend the boundaries of fiscal adjustment policies. The renaissance of the EU project encompasses therefore the following :

- (i) new rules for a common budget (with the Fiscal Compact, as a very first step);
- (ii) euro-area solidarity policies to face asymmetric shocks, with social cohesion as the main objective;

<sup>8</sup> Since the pioneering work of Mundell (1961) and McKinnon (1963), the Optimum Currency Area theory has evolved to imply, in a modern version, an area of irrevocably fixed exchange rates where: labor and other factors of production are mobile; prices and wages are flexible but there is similarity in inflation rates; production and consumption patterns are diversified; there is financial integration, fiscal integration, similarity of shocks, and political integration (for more on this see Mongelli, 2002).

<sup>9</sup> This is also known as the "Fiscal Compact". Note that this is an international treaty and not an EU treaty, because the UK is not a signatory party, given its concern about the impact of the Treaty on its financial services industry.

- (iii) fiscal and economic governance (progress towards fiscal harmonization, financial transactions tax, reinforced financial regulation, a European credit rating agency...);
- (iv) repatriation of the Euro financial markets to the Euro-area, so as to better channel euro-area savings into euro-area investment needs;
- (v) introduction of a maximum limit of exposure of government debt to non-euro-area financial markets; the creation of eurobonds;
- (vi) common programs of public investment (common infrastructures in the fields of transport, education and training, health; renewed funding in science and technology,...).

It is only with these all-encompassing measures that the EU project can be revived in the near future and that the euro-area and the EU can be seen as credible economic (and political) actors in the international scene.

## Conclusions

From what precedes, it is clear that Ireland, which played the unfortunate role of gateway of the US sub-prime crisis into the euro-area, was used by the ECB and EU Commission as the laboratory test case for EU reactive measures to the euro-area crisis. Harsh fiscal adjustment measures were imposed upon the country, which show for example through a continuing rise in the sovereign 10-year bond yields up to August 2011. The country was clearly too small to face adequately the narrow-minded EU stringent stance. What Ireland would have ideally needed, from the beginning of the crisis, was a set of corrective fiscal policies augmented with financial transfers (from an EU fund alone) enabling it to continue to fund investment projects and innovation. That would have been an appropriate and visionary response to the crisis. But instead, the ‘muddling-through’ strategy of the ECB and EU Commission, until the first positive signals in January 2011, has dealt with one problem only, - the banking crisis -, ignoring thereby the labor market crisis as well as the innovation crisis and the social crisis in the country.

Political change since 2011, combined with the tacit acknowledgement of previous failed strategies, implies a new phase of integration in Europe, with more powers to euro-area members, and a constructive and visionary approach seems to be now feasible. Perhaps a drawback of this future visionary approach is that it favors integration by and among a selected number of EU countries, those belonging to the euro-area, leaving aside others such as the UK. However, some of the proposed new measures such as the financial transaction tax and greater fiscal harmonization addressing ‘fiscal dumping’, would be difficult to accept by euro-area countries as well, such as Ireland.

Finally, the repatriation of the euro financial markets to the euro-area implies a re-regionalization of finance, with noteworthy consequences for third countries such as those in Asia. In some ways, this echoes the call by the ADB at the beginning of the crisis when it proposed that regional savings be channeled back into the regional banking system, so as to eventually be further decoupled and cushioned against shocks arising in other regions of the world (ADB, 2009). Re-regionalization of finance does not nevertheless imply a retrenchment of various regions in geographically confined trade and investment enclaves.

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**APPENDIX: TABLE A1 – Sovereign debt and public deficit of euro-area members (2010-2013)**

Country or area	Public debt in 2011 <sup>76</sup>	Evolution (2010-2011) <sup>77</sup>	Public deficit in 2010 <sup>76</sup>	Public deficit in 2011 <sup>76</sup>	2013 Deficit Forecasts by the Commission <sup>78</sup>	Deficit objective by each country
Germany	<b>81,2 %</b>	▼ 1,8	4,3 %	<b>1 %</b>	<b>0,7 %</b>	1 % in 2013 and 0,5 % in 2014 <sup>79</sup>
Austria	72,2 %	▲ 0,3	4,5 %	<b>2,6 %</b>	<b>1,9 %</b>	—
Belgium	<b>98,0 %</b>	▲ 2,0	4,1 %	3,7 %	3,3 %	2,8 % in 2012 and 0 % in 2015
Cyprus	71,6 %	▲ 10,1	5,3 %	<b>6,3 %</b>	<b>2,5 %</b>	—
Spain	68,5 %	▲ 7,3	9,3 %	<b>8,9 %</b>	<b>6,3 %</b>	4,5 % in 2013 and 2,8 % in 2014 <sup>80</sup>
Estonia	<b>6,0 %</b>	▼ 0,8	<b>-0,2 %</b> <sup>Note 1</sup>	<b>- 1 %</b> <sup>Note 1</sup>	<b>1,3 %</b>	—
Finland	<b>49,1 %</b>	▲ 0,2	<b>2,5 %</b>	<b>0,5 %</b>	<b>0,4 %</b>	—
France	<b>85,4 %</b>	▲ 3,5	<b>7,1 %</b> <sup>Note 2</sup>	<b>5,2 %</b>	<b>4,2 %</b>	3 % in 2013 <sup>81</sup> and 0 % in 2017 <sup>82</sup>
Greece	<b>165,3 %</b>	▲ 20,3	<b>10,5 %</b>	<b>9,1 %</b>	<b>8,4 %</b>	5,4 % in 2012 <sup>83</sup>
Ireland	<b>108,2 %</b>	▲ 15,7	<b>31,3 %</b>	<b>8,6 %</b>	<b>7,5 %</b>	3 % in 2014 <sup>84</sup>
Italy	<b>120,1 %</b>	▲ 1,5	4,6 %	<b>3,9 %</b>	<b>1,1 %</b>	0,2 % in 2014 <sup>85</sup>
Luxembourg	<b>18,2 %</b>	▼ 0,9	<b>0,9 %</b>	<b>0,6 %</b>	<b>2,2 %</b>	—
Malta	72,0 %	▲ 2,6	3,6 %	2,7 %	2,9 %	—
Netherlands	65,2 %	▲ 2,3	5,1 %	4,7 %	4,6 %	—
Portugal	<b>107,8 %</b>	▲ 14,5	9,8 % <sup>86</sup>	4,2 %	3,1 %	3 % in 2013 <sup>87</sup> and 0,5 % in 2016
Slovakia	<b>43,3 %</b>	▲ 2,2	7,7 %	4,8 %	4,9 %	3 % in 2013 <sup>89</sup>
Slovenia	<b>47,6 %</b>	▲ 8,8	5,8 %	6,4 %	3,8 %	—
Euro area	<b>87,2 %</b>	▲ 1,9	6,2 %	4,1 %	3,2 %	3 % (Maastricht Criterion)

Source : Eurostat; Luxembourg

## Comment

Mei KUDO

Dr. Bernadette's paper was about how 'crisis' spread to the Ireland which stands between the United States and Europe, nature of the problem, and rescue by the European Union.

According to Dr. Bernadette although the Ireland received financial assistance from Troika provided that the Ireland would do every effort to reduce public spending, spending cut might lead recession and would be obstacle to public investment in the country.

Dr. Bernadette critically saw EU's reaction that the EU's dealt the Irish problem just as a banking crisis, disregarding the fact that the Irish problem was not just a banking crisis, but more complicated problem of the combination of financial crisis and labour market problem.

The point presented was important, however, unfortunately, we could not see what the Ireland learnt from this 'crisis', how Ireland would reconstruct the relations with the United States or the EU in the future, which consequently would affect domestic relation between market and society in Ireland. Trying to give some lessons for the Ireland would help to make Dr. Bernadette's thoughts on what was the essence of the 'crisis', structural problem of Irish economy, dependence of Irish economy to the United States more clearer.

Dr. Bernadette hopefully saw political situation in the EU in which new political parties, especially, new French government lead by the President François Holland and Italian government lead by the Prime Minister Mario Monti would do every effort to solve financial crisis in the EU, overcoming nationalistic perspective established in 2012. However, I wonder would the establishment of pro-European governments simply solve the 'crisis' in the EU. Although, by uniting Europe, it would become easier to overcome the 'market crisis' with united action on austerity measures. more integration lead to more problem of democratic deficit. If European level solution disregards its impact on society, that way of integration would not sustainable in the long run.

The Establishments of pro-European governments did not suffice to tackle the problem. Real question is what future vision of Europe they could have.

Dr. Bernadette herself pointed out inadequacy of EU's stance to the 'crisis', and insisted the necessity to solve the problem not just a 'banking crisis', but more broad framework including both financial aspect and social aspects in the paper. However, when it comes to the question of future vision of Europe, I received impression that her emphasis was laid more on the necessity of austerity and social aspect became more or less obscure.

## Response

Bernadette Andreosso-O'Callaghan

The comments proffered by Ms. Mei Kudo are refreshing in that they allow to throw a different light on the problems of Ireland, the euro crisis and the future of integration in the EU.

First, the question of Ireland's relationships with both the USA and the EU is an important one. The global financial crisis has, perhaps paradoxically, strengthened such relationships. In the case of the USA, this was obvious from the beginning of the crisis when, on Sept. 30, 2008, a blanket guarantee of about €400bn covering deposits up to €100,000 in six Irish banks was issued by the then government. This exorbitant guarantee (amounting to more than twice annual Irish GDP) was issued less to protect small (Irish) depositors than to send a signal to US investors that the Irish financial sector was, in spite of the crisis, immensely respectful of property rights. The courting by the Irish government of US investors could thus safely resume and, in spite of President Obama's pledge to attract US investment back into the USA, Ireland has nevertheless continued to receive US investment projects although these have been insufficient to reverse the negative trends on the labor market. The Irish Government bank guarantee prevented the restructuring (eventually closure) of insolvent banking institutions and led to a very high level of public indebtedness. It is clear that in the Ireland-USA relationship since the crisis, what has mattered foremost has been the interest of putative US investors, rather than that of domestic taxpayers. The EU-Ireland relationship shows also a relationship of subordination, which in the specific case of the management of this crisis led to further costs for the Irish taxpayers. The incomplete nature of EMU as discussed in the paper and the refusal by the ECB/IMF/EU Commission to allow losses onto senior bondholders led the ECB and its acolytes to force a bailout onto Ireland in November 2010. Consequently, Ireland found itself doubly trapped; its relationship with both the USA and the EU can thus be summarized as a 'vassal-suzerain' relationship, but in this case and despite all appearances, a relationship which makes Ireland a subordinate more to the USA than to the EU.

The second interesting point made by Dr Kudo is the question relating to the revival of the EU project by more pro-EU governments. Although the task of EU governments (even that of large EU countries such as France) is made difficult today by the diminished role of the nation-state in favor of other actors such as the multinational corporations (MNCs) and financial institutions (including hedge funds, etc.), a new path towards a more United Europe is only possible with a number of pro-EU leaders who have a vision and who are able to rebalance power away from MNCs and financial institutions and towards democratically elected institutions. A third and related important comment touches on the critical link between integration and democratic deficit. It is not true that economic integration necessarily leads to democratic deficit; it is rather the chosen type of integration that matters. The article tries to argue that the chosen path of integration since the Maastricht Treaty (a project very much rushed and pushed through by the Mitterand clique) was a non-adequate path of integration. A new path of integration and a new EMU must emerge, with a restructured euro, good governance, participative democracy and shared increased economic welfare as core principles.

A fourth comment relates to the perception by Dr Kudo that I laid too much emphasis on the ne-

cessity of austerity measures to the expense of social cohesion. Actually, the article provides a critical account of 'troika' inspired measures that disregarded the labor market, as well as technological and social policies. These austerity measures have succeeded in preventing the exit of Irish banks from the international banking scene, but they have failed, as discussed here, in boosting confidence, domestic demand, job creation, innovation and growth. Yet again, the IMF/ECB/EU Commission bailout mirrors the naivety of these institutions and the 'one-size-fits-all' policy of the IMF. It is clear that redressing the public accounts (which were in perfect health before the crisis but which deteriorated sharply and quickly because of the banking problem, of the collapse of the property sector and of the withdrawal of US investment from the country) had to be done together with stimulus measures aimed at creating jobs and nurturing innovative output.

Finally the question of the lessons learned by Ireland will remain very much an open question, I am afraid. The economic history of the world is filled with financial crises, and it seems that in many cases policy makers fall into a trap of blind euphoria and deep amnesia.



# **The Eurozone Debt Crisis and the Future of the European Integration Project**

**Henk Overbeek**

## **Introduction**

The Eurozone debt crisis is increasingly threatening the very existence of the monetary union and perhaps even the existence of the European Union as such. This paper looks at the causes of the crisis, at the strategies being pursued in response to the crisis, and finally considers the conditions for a successful rescue of the European integration project.

The current Eurozone debt crisis does not stand alone, nor is it the result of European factors alone. In fact, the European debt crisis represents the manifestation at this specific time and place of a deep global economic crisis, which is similar in terms of its structural character and depth to the crisis of the 1930s. If the historical experience of the 1930s provides any guidance, we know that an eventual solution of the crisis is still far off. Global capitalism, especially in the heartland of the system (the 'old' OECD core) will experience a sustained phase of devalorization of capital (massive closures, e.g. in the global car industry, high unemployment, lower wages, erosion of welfare provisions) before conditions emerge in which a new upswing may become possible. In such conditions, Europe ultimately has two ways of approaching the crisis. It can go the route of national strategies, much as it has in the 1930s. We know what that will lead to at the end of the day: beggar-thy-neighbour policies, nationalism and xenophobia, and worse. Europe has been down that road before. Alternatively, Europe can choose to go the European way, to approach the crisis jointly. This paper will explore where Europe is right now, and what it would take for the European approach to have any chance of success. This will be done in three sections. The next section examines the causes that have led to the sovereign debt crisis in Europe. Then, we will briefly review how the member states of the EMU have so far dealt with the crisis, and how this has brought the monetary union to the brink of collapse. Finally, the last section will discuss the conditions that would need to be fulfilled in order for the project of European integration to (have a chance to) be salvaged.

## **The genesis of the European sovereign debt crisis**

Capitalist crises can take various forms: underconsumption or overproduction when commodities are produced but cannot be sold on the market, or overaccumulation when capitalists face a lack of profitable investment outlets for their surplus capital. In the longer run, all these cases amount to "a situation in which capital accumulates at a higher rate than what can prevent the average rate of profit across the capitalist system from falling" (Hung 2008, 152). What matters is that the logic of the accu-

mulation process itself produces a variety of crisis tendencies, together leading to (the anticipation of) a fall in the rate of profit that capital can realize: this is what is generally referred to in Marxist theory as overaccumulation (cf. Harvey 2003; Hung 2008).

The current crisis, much like the Great Depression of the years 1929-1945, arguably marks the end of a period of slow capital accumulation since the recession of the 1970s. Global capitalism experienced several decades of unprecedented growth during the post-war years, roughly from the late 1940s to the early 1970s. The nature of capitalism in this period, especially the predominance of Keynesian demand management, the relative closure of national economies and the 'controlled' restoration of international trade (cf. the concept of 'embedded liberalism' in Ruggie 1982), was very much shaped by the experiences of the Great Depression. In a similar vein, the recession of the 1970s has determined the character of the subsequent period of neoliberal globalization. The main response of capital to the crisis of the seventies was a mix of temporal and spatial fixes, to use Harvey's terminology (Harvey 1990; 2003; cf. also Duménil and Lévy 2011: 19-22).

Spatial fixes involve the displacement of capital into foreign activities, whether through the relocation of production and the establishment of foreign subsidiaries, through cross-border mergers and acquisitions, or at a more general level through the incorporation of new zones into the capitalist world market (as emphasized in World Systems Theory, e.g. Wallerstein 1974; 1983) in order to find new markets and to raise profitability through cheaper inputs. This often involves what Harvey has called 'accumulation by dispossession', or the subordination to the pursuit of private profit of economic assets and activities previously not (fully) commodified (Harvey 2003, 145 ff.). The key spatial fix of the past decades of course was the incorporation of the People's Republic of China into the capitalist world market after 1978, followed after 1989 by the incorporation of the former Soviet Union and Eastern Europe.

Temporal fixes for the problem of overaccumulation all function to maintain profitability in the present by impairing profitability and stability in the future through debt financing (cf. Harvey 2003). Looking at how capital has responded to the problem of overaccumulation since the 1970s, we see that the temporal fix in this era has taken the form of an unprecedented financial expansion. As Robert Cox already commented in 1992, "finance has become decoupled from production to become an independent power, an autocrat over the real economy" (Cox 1992: 29). The financial sector has expanded far beyond any reasonable need to facilitate production, distribution and consumption, which are after all the basic functions that an economy needs to perform for society in any epoch and under any system. These financial expansions (not new in the history of capitalism) are called financializations, defined as patterns of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production (Krippner 2005:174). This trend manifests itself, firstly, in differential profit rates between financial and non-financial companies, but also takes place *within* non-financial firms, expressed in the increasing proportion of total profits deriving from purely financial transactions as opposed to profits deriving from productive activities (Ashman, Fine and Newman 2010: 175).

## Overaccumulation and spatio-temporal fixes in Europe

In the recession of the late 1960s and early 1970s, overaccumulation of capital was as much a problem in Europe as it was in the United States. The initial reaction on the part of productive capital in much of continental Europe was a combination of rationalization and automation at home, and relocation especially of labour-intensive production processes to low wage countries: the 'new international division of labour' as it was dubbed in the classic study of the time (Fröbel, Heinrichs and Kreye: 1980). The great German and French industrial conglomerates in particular have consistently advocated and pursued an accumulation strategy based on spatial fixes. In response to the crisis of the late 1970s and early 1980s, this first took the form of the integration of Southern Europe, especially of the Iberian Peninsula, into the orbit of Northern European capital, and the relocation of a great part of the production of parts and of assembly activity to Spain and Portugal (cf. Holman 1996). Subsequently, the transformation of the Deutsche Mark-zone into the Economic and Monetary Union (EMU) was the second cornerstone of this strategy: originally agreed to for political reasons during the Maastricht Summit, the creation of EMU and the introduction of the Euro rapidly became key ingredients of the accumulation strategy of Franco-German industrial capital, as they set a brake on the appreciation of the D-Mark and gave German (and French) industrial groups an important additional competitive edge, reinforced by a consistent policy of wage restraint and suppression of domestic consumption (actually pioneered by the Dutch since the early 1980s). The double (political and economic) transformation in Central and Eastern Europe after 1989 (Holman 1998) provided this strategy with new momentum: the low-paid, highly skilled, labour forces in Central Europe provided West European business with the ideal platform from which to deepen its internal division of labour and to open a new offensive on the global markets (see Bohle 2009).

Nevertheless, although spatial fixes have been central to the strategies of the big European industrial conglomerates in the past decades, they have at the same time engaged heavily in pursuing other shortcuts to increased profitability, such as hoarding cash, currency and real estate speculation, and consumer credit financing. Financialization developed quite unevenly in different European countries. In the UK, the Thatcher revolution with its liberalization, privatization and deregulation offensives unleashed an internal, unmediated and forceful wave of accumulation by dispossession from the early 1980s onwards (cf. Overbeek 1990). In Germany it developed latest (really only from the mid-1990s) and slowest (Konings 2008; Dünhaupt 2010). By the end of the 20th century, however, finance-led accumulation had become the predominant growth model throughout the entire EU.

## Financialization and crisis

In the run-up to the global financial crisis in 2008, the grip of finance on the European political economy was strengthened enormously, most spectacularly in those European economies where financialization constituted the core of the response to the lingering problem of overaccumulation. Spurred by the concentration of the global financial sector in the City of London, financial expansion was most pronounced in the UK, Ireland and Iceland – which according to a senior official of the International Monetary Fund could no longer be considered a country but instead had to be understood as a hedge fund (quoted in Palma 2009: 834). In the years up to 2007, the ratio of financial assets to GDP increased sharply, to nearly 600% in the EU, to nearly 700% in France and the UK, and to 900% in

Ireland (Palma 2009). The integration of financial markets in the EU, and the creation of a European market for corporate control (Van Apeldoorn and Horn 2007; Horn 2012), facilitated and indeed stimulated the penetration of the practices of financialization also in those continental European economies that had been relatively insulated from this development before (Germany in particular). Another temporal fix pursued by money capital in a number of European countries was overinvestment in real estate in Ireland, the UK and Spain where house prices increased about threefold in the period 1997-2007 (*The Economist* 2007). Finally, European banks were differentially exposed to and affected by the spread of securitized subprime mortgages from the US. UK banks initially accounted for the bulk of securitization, but after 2007 continental banks (France, Netherlands, Germany) overtook the UK on this score (Nesvetailova and Palan 2008, 175).

### **From banking crisis to sovereign debt crisis**

Since early 2010, the crisis in Europe mutated from a banking crisis into a sovereign debt crisis threatening the credibility of the world's second most important reserve currency, the Euro. Four factors explain the conversion of the banking crisis into a crisis of public deficits and debts.

The first factor to mention is the immediate impact of the banking crisis in two ways. In Ireland, but to a less dramatic extent also in countries such as the Netherlands, Belgium and the UK, governments rapidly built up huge debts when they stepped in to bail out (or nationalize) their banks when the credit crisis started to hit them late in 2008. In addition, nearly all European governments introduced sizeable stimulus programmes in the years 2009-2010 to counteract the effects of a lack of credit on the international capital markets. Government deficits rose rapidly, and the bail outs added dozens of billions to the sovereign debt of the countries involved.

The second factor involves the delayed detrimental impact of the EMU on the Southern member states. At the time of the introduction of the single currency on January 1<sup>st</sup>, 1999, the exchange rate at which the currencies of Portugal, Spain and Italy were locked was unsustainably high (Bellofiore et al. 2010: 130). Furthermore, the EMU eliminated the traditional instrument that enabled these countries to maintain their competitiveness: currency devaluation. To compensate their continued loss of competitiveness, governments ran up large budget deficits, which for a time seemed a viable strategy because Southern EMU governments could borrow money on the European capital markets at very low rates (Cafruny and Talani 2011: 16). Local banks, but also international private banks, built up very high exposure to government debt: by 2010, Eurozone banks were exposed to the tune of \$1.4 trillion (German and French banks each for roughly \$500 billions), with US and UK banks each exposed for about \$400 billion (EuroMemoGroup 2010: 8).

Thirdly, the mercantilism of the members of the former informal DM-zone (Germany, Netherlands, Austria, Scandinavia, Belgium) – continued to be based on the relative suppression of domestic demand through wage restraint and balanced budgets in order to maximize surpluses on the external accounts. The effects of this policy aggravated the position of the Southern EMU members as it structurally limited access to their most important export markets (Young and Semmler 2011: 10).

By 2010, general government gross debt stood at 85% of GDP for the Eurozone as a whole. This is high compared to the years just before the global credit crisis erupted in 2008. Nevertheless, it is not unprecedentedly high, and for several member states debt is even (considerably) lower than during the

second half of the 1990s (Belgium, Finland, Italy, Netherlands, Spain). This suggests that, especially given the prevailing (extremely low) interest rates, Eurozone debt could in principle be comfortably financed if the Eurozone were one integrated bond market. However, the reality of seventeen separate bond markets in the EMU has given financial markets unprecedented leeway to demand an exorbitant premium when lending to peripheral Eurozone governments. Financial institutions have thus played a key role in the European sovereign debt crisis, not just in the past two years driving up the interest premium that targeted governments are made to pay, but all along. All the big international banks (next to Goldman Sachs, also JP Morgan Chase, BNP Paribas, Credit Suisse, UBS, Société Générale, Deutsche Bank) have for instance been involved in the trade in credit-default swaps (CDS): “These contracts ... effectively let banks and hedge funds wager on the financial equivalent of a four-alarm fire: a default by a company or, in the case of Greece, an entire country. If Greece reneges on its debts, traders who own these swaps stand to profit.” (Schwartz and Dash 2010).

## Ways out of the Eurozone debt crisis

Since its outbreak in 2009, the search for solutions for the Eurozone crisis has dominated EU politics. Four directions towards an approach (solution may be too big a word) have surfaced: I call them ‘muddling through’, ‘externalisation’, ‘nationalisation’ and finally ‘Europeanisation’.

### Muddling through

Muddling through seems to be the natural first choice of the EU when confronted with a problem. It consists of filling one whole in the bucket with another in the hope that the problem will go away of its own accord. Normally speaking, such an approach will work for a while, but it never solves the underlying problem. In fact, the approach taken has largely followed this scenario. It consisted of a succession of bail-out packages (Ireland, Portugal, Greece), the creation of various new instruments, marginal institutional innovations, and surreptitious interventions by the European Central Bank (ECB) that have kept the Eurozone afloat at critical moments. By the end of 2011, however, recognition dawned throughout the Eurozone that muddling through would not work this time. The explosive social consequences of the austerity measures particularly in Greece have convinced all but the most hard-headed ‘austericists’ that this line of action becomes socially and politically unsustainable. New avenues need to be explored.

### Externalisation

It has sometimes been suggested that external help might provide a solution to the Eurozone’s financial problems. In particular, the help of the International Monetary Fund (IMF) has been enlisted in the successive bail-out packages for Greece, Ireland and Portugal, and subsequently, Eurozone governments and the IMF leadership under Christine Lagarde have been engaged in discussions about the modalities of possible IMF contributions to the ESM. In the same line of thinking, many in Europe have cast a hungry eye to the large currency reserves built up over the past 15 years by many emerging countries, in particular the BRICs and more in particular China, which alone has accumulated reserves reaching a total value of approximately \$ 3.2 trillion.

There are good reasons to be sceptical regarding this option however. First of all, taking a closer look at the IMF involvement in the early bailout operations reveals that the IMF contributed no more than approximately one quarter of total bailouts in purely financial terms. Its involvement was in fact primarily sought for political reasons. In the cases of Ireland, Portugal and particularly Greece, the IMF's contribution indeed existed not only of cash but primarily of advice to governments on the design and implementation of structural adjustment programmes involving sharp reduction of government expenditures, reforms of welfare and pension systems, labour market restructuring, as well as large scale privatisation of state assets. In addition, the IMF plays a prominent role in the monitoring operations. In fact, the governments of the Northern Eurozone members and the top management of the ECB have found it very convenient that the IMF – given its reputation – would attract much of the flack in the target countries, while themselves staying in the background where possible. But in financial terms, the IMF's involvement remained modest.

Secondly, all of the BRICs, but certainly China that would be expected to contribute by far the most, are developing countries with a large proportion of the population still living in dire poverty, just about to embark on the demanding challenge of constructing domestic welfare and pension systems. In addition, the Chinese balance of trade surplus has been rapidly dwindling in the past few months (Financial Times, 2012 b; c; d; e). If, as seems likely, this represents a structural transformation in the Chinese external position, then the Chinese government will be even less likely to look favourably to such a direct intervention in support of Eurozone governments. From the perspective of the Chinese and other BRIC governments, the more attractive option would be for them to increase their capital contributions to the IMF, even if these funds would ultimately be used (wholly or partly) to support the European Stability Mechanism (ESM). Their explicit aim would then be to obtain increased power and influence, and extended voting weight, in the IMF (Financial Times 2012d).

In fact, there is only one way in which Chinese capital may be expected to enter Europe directly on a significant scale under current conditions, and that is as buyers of European assets being put on the market at fire sale prices under pressure of the privatisation programmes that are part of the bailout terms (Financial Times 2012a). Recent Chinese investments are still rather limited, they are mostly directed towards infrastructure and public utilities, and they are made under harsh conditions. Nevertheless, Chinese investment in Europe is growing rapidly and it is expected to soar to US \$ 500 bn. annually by 2020 (Hanemann and Rosen 2012). Although perhaps welcome, Chinese investments in Europe are no solution to the crisis: that will have to be produced by the Europeans themselves.

### **Nationalisation**

The third scenario considered here would be the political acceptance of the inability of the Eurozone to deal with the debt crisis now facing its peripheral members, and a managed exit of one or more of its troubled members. Such a break-up of the Eurozone would by no means be impossible. The exit of Greece, maybe also of Ireland and Portugal, and possibly even of Spain and Italy, would leave a core Eurozone looking suspiciously like the informal D-Mark zone that preceded it. In a more radical departure, the complete dissolution of the Eurozone could come about if Germany would decide to leave the Euro. So far, no European authority is yet willing to accept the possibility of a break-up of the Eurozone. All dominant sections of the European ruling classes seem committed to save the Euro against

any price. Of course, this determination does not guarantee that in the end the rescue of the Eurozone will be successful. On the contrary, failure to uphold the Euro is becoming more likely almost by the day. And, should it indeed come to a break-up, this would almost certainly set in motion a chain of events that would bring the destructive economic nationalism of the 1930s back to Europe, with all the consequences involved.

## Europeanisation

The final option would be to seize the opportunity that the crisis presents, and intensify the European framework. Increasingly this is what is currently being pursued.

In the first place, this trajectory involves stronger coordination of budget policies and macro-economic management, essentially building on the older Stability and Growth Pact and strengthening this by further institutional innovations, such as enhanced powers for the European Commission and the eventual creation of a Eurozone Finance Minister.

The second element is the strengthening of EFSF and ESM, possibly eventually followed by the creation of Eurobonds. The size of the financial firewalls (the EFSF and ESM in combination with the recently created IMF crisis facility) is considered in principle sufficient to serve their purpose under 'normal' conditions. Joint guarantees of new government bonds in the Eurozone have been advocated by many as necessary to make the public debt of the Southern member states manageable. In addition, the mandate of the European Central Bank has de facto been enlarged with the announcement in September 2012 of the unlimited bond-buying programme by the ECB President, Mario Draghi.

## Conclusion

These measures contain certain elements that are indeed indispensable for an effective handling of the crisis, but a truly European solution must go far beyond what has so far been agreed. The following elements are indispensable for a European approach that will be both effective and legitimate, i.e. based on popular support in all parts of the Eurozone.

Coordination of budget policies and macro-economic management is necessary, but not under the aegis of the extremely pro-cyclical Fiscal Compact. On the contrary, governments whose economies are basically healthy, and where government debt is high but not out of control (and balanced by real assets) should be actively encouraged to stimulate consumption and investment in order to provide a stimulus to the Eurozone economy.

The levels of debt currently borne by Greece, but perhaps also by Ireland, Portugal, and maybe (depending very much on the prevailing interest rates) also Spain and Italy, are such that repayment will have to be rescheduled over a much longer period or that debt needs to be cancelled altogether. In addition, an impartial debt audit should be conducted to establish responsibility for the size of national debt in the Eurozone countries in trouble.

The banking sector in Europe is in bad shape, and will have problems meeting the capital reserve requirements of the Basle III accord. Consolidation in the financial sector is likely, but in many cases governments will not be able to resist the call to save banks that are considered too big or too systemic to fail. State aid, however, should come with strict conditions for future bank policies, or states may

have to nationalise banks as the only way to restore the financial sector to its original function of facilitating the operation of the 'real' economy.

The ECB needs to be liberated from its monetarist charter in which its only remit is price stability. Like other central banks it should also be required to take into account such issues as exchange rate movements, economic growth, labour productivity and (un-)employment.

Strict regulation of financial markets and credit rating agencies including a ban on risky forms of derivatives trading is consistently kept off the agenda in a remarkable demonstration of the structural power of global finance. Yet, there is no reason why legislation (e.g. the Glass-Steagall Act) cannot be brought back that has existed since the 1930s, that stabilised financial markets very effectively for five decades, and that was only reversed in the neoliberal heyday of the 1990s.

This crisis is the perfect time to invest heavily at the European level in infrastructural projects that will enhance cohesion and strengthen the competitive base of the Eurozone, such as expanding the production of sustainable and renewable energy, or extending a Euro-wide high speed rail network strengthening the cohesion between centre and periphery in the European economy. Such a public investment programme should see a decisively enhanced role for the European Investment Bank (which may issue project-specific bonds to attract external funding, for instance from the world's biggest sovereign wealth funds).

Finally, none of these proposals will have any longer term chance of success unless decisive and radical democratisation of the EU polity is undertaken. Legitimacy of the European project has fallen to nearly zero, and this state of affairs is a mortal threat not just to the European project in a narrow sense, but to European democracy as such. The real problem of the Eurozone is not technical, or financial, but it is deeply and fundamentally political.

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## Comments

Hitoshi Suzuki

Overbeek's analysis starts from his point that the current crisis resembles the structures of the crisis of 1929. This leads to Overbeek raising two possible solutions in confronting the crisis. One solution is to tackle the crisis as Europeans did in the 1930s by depending solely on national policies. He down-grades this solution because it would merely drive the crisis from bad to worse, like in the 1930s. He also denies the solution of breaking up the Euro, as well as German growth methods which concentrate in export but lack structural adjustments. Overbeek proposes that a solution of Europeanisation. This is to write off the current debts, create Euro bonds, launch a fiscal and economic union, and expansion of mandates of the ECB and the European Commission.

Four points could be argued towards Overbeek's analysis. The first point is a comparison between Euro countries and non-Euro countries, typically the UK. The failure of the Euro, as the British would claim, is due to failure of enforcement of binding rules. Why bother with binding rules? Is it merely a question of right rules or wrong? The second point is a support for Overbeek's analysis on financialisation, especially Europe's growth depending too much on financial sectors. It should be pointed out that the majority of EU citizens do not work in banks but rather in "traditional" sectors: manufacturing, non-financial service sectors, agriculture, etc. Improvement in the financial sector brings little merit to such people. The third point is a question, whether proposed solutions such as "unemployed Greeks should go to work in Germany" would actually work or not. While capital flows across national borders, labour mobility is far less than one would expect. The final point is a question whether Europeans are aware or not of how Japan, China and other Asian-Pacific countries have financially supported Euro countries during the crisis. Perhaps lack of knowledge about such cooperation is ending up in both European and Asians failing to find joint cooperation and solution for the crisis.

## Part II

### **The Impact of the Euro Crisis and the Asia-Pacific Area**

# The impact of euro crisis on regionalism in East Asia

Yeo Lay Hwee

## Introduction

The European Union (EU) has until recently been seen by some analysts and policy makers as one of the most successful example of regional integration. Some scholars said the EU is *suis generis* and hence its model of integration would be difficult to replicate in other parts of the world. And yet, there are also scholars who believe that lessons drawn from the EU experience can be adopted by other regions in their regional construct.

However, recent events in the European Union, particularly in the way that member states have responded to the Eurozone debt crisis has put a huge dent on the image of the European model of integration. While still acknowledging the remarkable achievements of the European project, cautionary voices have become even louder in Asia as East Asians continue to feel their way towards a regional model that could help manage the increasingly interdependence of their economies on the one hand, and the continued distrust and rising nationalism on the other.

This paper will begin with an overview of the trajectory of European integration and discuss the development of regionalism in East Asia, and how it could be impacted by the euro-crisis.

## The Trajectory of integration in the EU—How Wide and How Deep?

The European integration project started in 1950s and has since gone through five major changes of the treaties to adjust to new circumstances. With each treaty changes, integration has deepened. The nature of European integration has also changed over time – from being seen essentially as a peace project bringing about the reconciliation of France and Germany, to an instrument for economic cooperation and now an entity that is designed not only to manage economic interdependence and the challenges of globalisation but a regional actor trying to shape the external conditions through a web of regional governance structures. As noted by Bjorn Hettne (2008), the need for regional agency comes from the challenges of globalisation as most states are too weak to manage these problems on their own.

New areas of policies are taken up at the European level on the assumption that common efforts will be more effective than individual national efforts. The EU has even implemented a large number of common policies under the broad remit of human security, ranging from immigration, counter-terrorism and police cooperation, which was beyond the purview of the EU two decades ago. However, at the same time, in its endeavours to revitalise the European economies, member-states were not willing to abandon national efforts with regards to policies on research, innovation and technology, seen as

crucial drivers to turn the EU into the most competitive economic region.

The attempt to draft a Constitution in 2002-4 in response to the enlargement and the subsequent rejection of this Constitution by key founding members (France and Netherlands) of the EU brought about heated debates on where the EU should go from here? How far and how deep?

The Reform Treaty (Lisbon Treaty) taking off from where the Constitution failed, contains a number of provisions marking how far the integration should go and conveys the message that there is a need for a pause of some length to ponder the necessity and desirability of further integration. The fact of the matter is that integration in whatever form will work if it proves itself by adding value to what the nation states can do alone. This fundamental fact need to be borne in mind as the EU debates its future. What kind of structural reforms are needed so that the EU can be of added value to its member states in solving the problems the latter face and cannot solve alone? And how can the EU get the citizens to look upon the EU institutions as theirs in the same way as they look upon their national systems – with the requisite legitimacy, transparency and accountability.

The Lisbon Treaty introduced various changes in an attempt to address precisely these issues of legitimacy, transparency and accountability.

On the official website of the European Union, the Lisbon Treaty (Reform Treaty) is being described as providing the Union with “the legal framework and tools necessary to meet future challenges and to respond to citizens demands”. The changes contained in the Lisbon Treaty such as enhancing the legislative power of the European parliament, a greater role for the national parliaments and the citizens’ rights to initiate policy reforms are supposed to make the Union more democratic and transparent. Other changes such as providing the Union a legal personality, creation of the two new positions – that of an appointed President of the European Council for a fixed period of time, and the double-hatted High Representative for the Union in Foreign Affairs and Security Policy supported by a new European External Action Service – are supposed to provide the frameworks and tools necessary to make EU a coherent actor on world stage, and to protect and promote the Union’s values.

While the Treaty does not fundamentally change the EU’s institutional set-up, it contains new elements such as provision for clearer division of power and competences, new voting methods, and the extension of qualified majority voting to more policy areas, all these which are supposed to make the Union more efficient and effective. At the same time, it also contains numerous safeguard mechanisms to limit a further erosion of the member states control over what is decided in terms of new European legislation or budgetary commitments. The QMV while extended to many more areas is also provided with mutual blocking mechanisms and “emergency breaks” and national parliaments are given the possibility to object to new legislation in order to prevent a further erosion of national competences to the EU level. The principles of subsidiarity and proportionality were also reaffirmed in the Lisbon Treaty.

The Lisbon Treaty reflects the desire to balance demands for democratic control and legitimacy versus efficiency and effectiveness. The governance of the EU hence reflects both characteristics of hierarchical, top-down control exercise by supranational institutions, and at the same time, it is increasingly open to “political competition with member states trying to regain initiatives on policies” (Borsel, 2010:191). The Union has to balance the powers and clarify the competence of its institutions and at the same time accommodate the increasing range of national interests as membership expands.

This competition is one of the dilemmas of European governance, and has begun to take its toll on

decision-making during crisis as reflected in the EU handling of the debt crisis that began with the debacle in Greece at the end of 2009. The Eurozone crisis raises awkward questions about the design of the system of governance for the EU as a whole and specifically for the Eurozone. The crisis may be seen to have relegated the European Parliament and European Commission, the two main supranational institutions of the EU to a secondary role, while reinforcing the role of the European Council, the main inter-governmental entity. However, while the economic crisis may have seem to give more power to the EU member states, the close involvement of the European Central Bank and the decisions taken by ECB which is supposed to be independent also demonstrated that supranational institutions cannot be excluded from the decision-making process (Pardo, 2012:86).

However, beyond the institutional wrangling and decision-making process, the seemingly inability of the EU to come to grips with its problem to address the financial crisis in a decisive manner has put a dent on the European integration process long seen as a relatively successful model of region-building. How would this in turn impact the development of East Asian regionalism? What lessons would East Asians take away from the Eurozone crisis?

## An Overview of Emerging East Asian Regionalism<sup>1</sup>

Until recently, East Asian regional integration consisted of burgeoning intraregional trade, based on the increasingly complementary production and trade components of the different countries manufacturing sectors. Intra-regional trade among the ASEAN countries, China, Japan and South Korea, plus Hong Kong and Taiwan has grown from 34.1 per cent in 1980 to 55.6 per cent in 2005. As market-led integration gathered pace, East Asian countries began to explore inter-governmental institutional frameworks to further promote economic integration in the region. Efforts began cautiously in the late 1980s into the early 1990s, in part also in response to regionalism in Europe with the completion of the Single Market by the end of 1992, and the emergence of the North American Free Trade Area. However, earlier efforts occurred at sub-regional level in the form of the ASEAN Free Trade Area (AFTA) and at a broader Asia-Pacific level in the form of the Asia-Pacific Economic Cooperation (APEC). Attempts to promote an East Asian entity in the form of an East Asian Economic Grouping as proposed by then Malaysian Prime Minister, Dr Mahathir Mohamad, were not well-received, in part because of the ambivalence East Asian countries have towards each other, and in part because of opposition from the United States.

Some scholars (such as Gilson & Yeo, 2004) have also attributed the launch of the Asia-Europe Meeting (ASEM) in 1996, a process bringing together leaders and officials from the European Union and the ASEAN member states plus China, Japan and Korea, as a catalyst for intra-regional meeting between Southeast Asians and Northeast Asians leading to an evolving sense of an East Asian community.

However, it was really the 1997–1998 Asian financial crisis that had the effect of stimulating new thinking on the part of East Asian policymakers with regard to regionalism in East Asia. The crisis clearly demonstrated the interdependencies within the region, particularly between Southeast Asia

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<sup>1</sup> This section is drawn partly from an earlier article by the author on “Institutional Regionalism versus Networked Regionalism: Europe and Asia Compared” published in *International Politics*, Vol 47, 3–4, 2010.

and Northeast Asia. It also led to the realization of the region's vulnerability to external forces and the recognition among government and business interests that existing regional cooperation arrangements, such as AFTA and APEC, had been unable to make an effective contribution to solving the problem. The lack of institutionalized frameworks and mechanisms was also a key weakness that hampered the ability of East Asians to respond to the crisis. Deep disappointment with the reluctance of the United States to provide financial assistance to some of the Southeast Asian countries hard hit by the crisis, and the acute sense of interdependence aroused by the contagion effect of the crisis, both convinced ASEAN countries and their Northeast Asian partners (China, Japan and South Korea) of the need for a regional forum for economic cooperation. Hence, the birth of the ASEAN Plus Three (APT) process.

The APT framework which began in 1997 was the first forum that 'formally' linked the 10 countries of Southeast Asia (ASEAN) to these three key Northeast Asian economies. The Asian crisis led to intensified efforts by the East Asians to look into more formal economic coordination as opposed to the more loose and informal economic interdependence driven by market forces that has existed for years. It also jolted the East Asians to the reality of the downsides of globalization, and to rethink how regional cooperation should be developed to manage both the opportunities and the challenges arising from the increasing pace of globalization.

The first ASEAN Plus Three (APT) informal summit was held at the end of 1997 at the height of the Asian financial crisis. The moves to closer regional cooperation in East Asia therefore naturally concentrated in the macroeconomic and financial areas, and progress was made in the early years with a number of currency swap agreements. Although the APT process was in the first instance a reaction to the financial crisis, it quickly led to a further series of meetings and prompted more dialogue among the leaders, ministers and senior officials. Cooperation was also extended from financial and monetary cooperation to consideration of many other areas, with the East Asian Vision Group (EAVG) (commissioned by the South Korean Government) mapping out proposals for an East Asian Free Trade Area. All these official rhetoric and various cooperative initiatives generated optimism that East Asia regionalism was on the move and this would eventually lead to the creation of an East Asian community.

An embryonic form of East Asian regionalism has emerged with the regular APT meetings between leaders, ministers and senior officials. This is based on the shared commitment to economic development (based on market driven integration) and a sense of vulnerability associated with the processes of globalization and regionalization. Greater regional cooperation is one of the few available instruments with which East Asian states can meet the challenge of globalization. Operating in a regional context, the East Asian states can 'Asianize' the response to globalization in what they see as a politically viable form. This is in part an insurance policy against another Asian financial crisis. Lacking the capacity to manage the challenge of globalization at the level of the nation-state, governments have turned to regionalism as a response (Kim, 2004:61). In short, regionalism was to offer the promise of Asian solutions for Asian problems.

Even before the Asian financial crisis, an emerging 'East Asianness' was manifested by a new Asian cultural assertiveness in reaction to the triumphalism of the West. The common ground of opposing western arrogance and hegemony, and limiting the role of the West, was encouraging a sort of defensive regionalism. The moves towards affirming a regional identity, based on Asian values, can be seen as repudiating Westernization (Falk, 1995:14). The optimism surrounding East Asian regionalism

at the turn of the twenty first century was, however, tempered by an increasingly acrimonious relationship between China and Japan in 2004–2006. This was partly exacerbated by the personal visits of the Japanese Prime Minister, Junichiro Koizumi, to the Yasukuni Shrine, which commemorates those who died fighting for Japan in wars and includes a number of individuals seen as war criminals. In China, these visits have been seen as glorifying Japan's past military aggression and have led to cancellation of diplomatic visits, such as in October 2005, when the Japanese foreign minister was to visit Beijing. China and Japan remain reconciled, reflecting past historical enmities and differing contemporary interests. As a result, the development of an East Asian community seems a very distant possibility.

The APT process, the cornerstone of East Asian regionalism, also started to fray when discussions began in 2004 to transform this framework into the East Asia Summit (EAS), envisaged in the EAVG report as the first step towards the long-term goal of building an East Asian community. Some ASEAN leaders believed that community-building could best be advanced through the APT framework, and that the APT summit could simply be renamed the East Asia summit to reflect the strong desire to create an East Asian community. However, regional rivalries and differences, particularly between China and Japan, leading to a more competitive rather than cooperative spirit, resulted in two different visions, that of an East Asian community comprising the original 13 APT members (favoured by China) versus one comprising the 13 APT members plus Australia and New Zealand (favoured by Japan). With the two key regional powers unable to agree on the definition of East Asia, it was left to ASEAN countries to decide on the membership for the EAS. It was during the ASEAN Foreign Ministers Meeting in April 2005 that the three criteria for participation in the EAS were set. These were:

- First, participant countries must sign the ASEAN Treaty of Amity and Cooperation.
- Second, they must be a formal dialogue partner of ASEAN.
- Third, they must have substantive cooperative relations with ASEAN.

Australia, New Zealand and India, having fulfilled all the three criteria, were then invited to join the inaugural EAS in December 2005 as full participants. Hence, an EAS comprising APT was born. The discussions over membership of the EAS reflected fundamental differences among East Asian countries with regards to the content, the trajectory and end-goals of regionalism in East Asia. Some Asian leaders claimed that regionalism in East Asia was distinctive and would necessarily take a different trajectory from that of the EU, which has been based on a rules-based model with a multiplicity of institutions. The alternative might be that of a looser form of networked regionalism, based on a different set of national considerations and understandings among the states that make up East Asia. This claim about East Asia's distinctive regional institutional building, as Acharya and Johnston put it, 'deserve careful scrutiny' (Acharya and Johnson, 2007:10–11).

## Contested Regional Architectures in East Asia

Since the first East Asia Summit (EAS) comprising ASEAN Plus 3, plus Australia, New Zealand and India, was launched in 2005, APT and EAS have continued to develop in parallel. The older APT process has waxed and waned depending on the state of relations between China and Japan as



described above. However, there is no denying that some progress has been achieved in the area of monetary and financial cooperation. The Chiang Mai Initiative (CMI) launched in 2000 comprising a network of bilateral currency agreements have now been multilateralised (CMIM) following the global financial crisis of 2008. A pool of funding of US\$120 billion was set up, with the proportion of the amount of contribution between ASEAN and the Plus Three countries kept at 20:80, respectively. In parallel, in order to support the potential option of delinking the access to CMIM funds from conditionalities imposed by IMF, a regional surveillance mechanism, in the form of the ASEAN + 3 Macroeconomic Research Office (AMRO) was set up in 2011 (Hamilton-Hart, 2012, p 242).

Besides the currency cooperation embodied in CMIM and AMRO, APT countries have also since the Asian Financial Crisis strived to develop its own Asian regional bond markets as alternative channels for raising capital. The Asian Bond Market Initiative (ABMI) that was endorsed by the APT Finance ministers at a meeting in 2003. Under this framework, a number of working groups were set up to address the technical issues of developing bond markets. An Asian Bond Fund (ABF) was also set up by East Asian and Pacific Central Banks to invest directly in markets (Lai & Ravenhill, 2012:146). Another concrete step taken after the onslaught of the global financial crisis was the establishment of a \$700 million trust fund in April 2010 with primary contributions from ADB and the Plus Three countries that will guarantee bonds issued in regional currencies (Lai & Ravenhill, 2012:147).

While the APT process seems to have yielded some concrete initiatives, the EAS which is a younger process into its 7th year has remained a much looser framework whose “main achievement” has been its further enlargement to include Russia and the US as members. EAS’ agenda has also been more on non-traditional security issues. While EAS did declare the goal of having a Comprehensive Economic Partnership for East Asia (CEPEA) comprising the original 16 members (ASEAN + 6), most analysts and policy makers realised that the likelihood of this initiative being achieved is still far away. The East Asia Free Trade Area (EAFTA) proposed under the APT framework has a higher probability of being realised. With the entry of the US, seen as the paramount key security player in the Asia-Pacific, several analysts have pushed for a better differentiation of the APT and EAS framework where the former would focus on economic integration projects, and the latter on non-traditional and perhaps even traditional security issues (Rana, 2011; Wanandi, 2012). The inclusion of US and Russia into the EAS framework meant that the region’s major powers- China, India, Japan, Russia and the US are all in the framework which should allow for greater focus on various security issues (Murphy, 2011).

With the EAS, the East Asia region now hosts three overlapping frameworks – the ASEAN Regional Forum (ARF), the APT and the EAS, leading to calls for further streamlining of these frameworks and processes. The ARF launched in 1994 was then the very first Asia-Pacific platform for all major powers to discuss political and security issues.

The existence of all these different frameworks and processes has raised questions on the nature and substance of East Asian regionalism, and if an East Asian community and identity could really evolve from what some coined as messy architecture with no clear geographical definition, with competing interests, overlapping agenda and driven by consensus-based, informal processes. Beyond the current regional realities, would the EU experiences in dealing with the current sovereign debt crisis also have an impact of how regionalism would develop in East Asia?

## The Nature and Future of East Asian Regionalism

Economic linkages, however, much they have grown, have yet to overcome problems that are at their root, non-economic in nature. East Asian regionalism will thus continue to be constrained by the lack of historical reconciliation between the two big powers, China and Japan, and other political and strategic obstacles. Deeply established regional norms against formal institutionalization will make pooled sovereignty or a more structured community difficult in the foreseeable future (Yeo 2005). This will be further compounded by the fact that East Asian economies are not only regionally integrated but many of the key economies are globally integrated. And as globalization continued to gather pace, conventional geographical notions of region are increasingly irrelevant. The fact that India, Russia and the US are members of the East Asia Summit (EAS) attests to this “non-geographical definition” of East Asia.

The emergence of a polycentric, with a multiplicity of actors and the lack of well-defined poles in a multipolar world, the diffusion of power in an increasingly networked world and the proliferation of actors and forums may mean that traditional regionalism in the form of deep integration as undertaken by the EU would be unlikely in East Asia. Soft forms of cooperation, informal networks and non-institutionalised trans-regional frameworks are therefore likely to predominate in East Asia (ESPAS Research Project Report, 2012:126).

We are at a critical juncture of transition from a western-defined and dominated system to a yet unknown system. While the US leading this western-centric order remained predominant, the US can no longer “do it alone” in achieving its goals and objectives. US’ paramount leadership would be increasingly contested. US presence in the Asia-Pacific is necessary but no longer sufficient for the security of the region – and while this insufficiency is recognized by most, there is no consensus as to what should be put in place to supplement or complement the US security guarantee. In East Asia where the rise of China is most felt, is also an arena where the contest for leadership can be most serious. Whether this can be managed peacefully without serious conflicts and threats to regional stability and prosperity remains to be seen and is one of the primary reasons for the emergence of patchworks of alliances and a proliferation of various regional forums and processes.

In a region as diverse as East Asia and in an increasingly unpredictable future, it is unlikely that the countries in East Asia will purvey a grand vision or strategy of an East Asian Community. Instead they will like to maintain a certain flexibility and nimbleness to improvise and integrate in areas as and when desirable.

As noted by some scholars, free trade agreements (FTAs) have proliferated in the region over the last decade as a method for achieving economic integration. “Up until the end of the 1990s, the ASEAN Free Trade Area (AFTA) was the only notable development. By the end of 2010, however, about 50 (mainly bilateral) FTAs involving East Asian countries have come into effect ... and around 15 FTAs are being studied for feasibility. Regional integration / cooperation mechanisms have become increasingly flexible and dynamic so as to serve the range of diverse policy preferences of East Asian countries” (Okamoto, 2011).

East Asian countries’ commitment to regional integration is thus rooted in a desire to achieve a wide range of diverse goals through a series of nominally narrow processes and mechanisms and the

ability to involve extra-regional allies as counter balances within the region. East Asian countries co-operation and compete with each other to achieve multiple goals and the flexible, multi-layered and inclusive nature of East Asian regional integration processes reflects and accommodates these policy preferences and goals closely. In short, East Asian integration is more likely to involve the continuing agglomeration of many frameworks and agreements rather than the creation of a common “grand design” for the future ...” (Okamoto, 2011).

Victor Cha (2010) concurs somewhat with the above observation in his article “The New Geometry of Asian Architecture: What works and what does not” in which he put forth three assumptions about how major players in Asia, China, Japan and the US could address the security dilemmas in the region. The first assumption is that no single institution can define the region. Unlike in Europe, there will be no region-wide Asian equivalent of NATO. His second assumption is that ad hoc institutions work better than formal ones and the third assumption is that bilateral and multilateral institutions can be mutually reinforcing. Based on these assumptions, he posits that the emerging architecture in Asia will consist of a series of bilateral or plurilateral groupings organized on a functional basis to solve a problem. He added that this model of “regional community” is not civilizational where a particular “Asian-ness” defines the group, “nor is it postwar Western Europe”. “Instead it is akin to a business model – where coalitions form among entities with the most direct interests to solve a problem. ... Membership in these coalitions, moreover, is not defined by political ideology but by functional need. And they are more often than not overlapping and interlinked in terms of the membership”.

Summing up, East Asian regionalism will remain open, inclusive and non-geographically defined by virtue of its deep integration with the global economy. It is built on the primacy of the nation-state and its national interests and hence fundamentally inter-governmental in approach, emphasizing confidence building and re-assurances of protecting national interests. It is not led by big powers or one dominant player, and instead managed by a grouping of small and middle size Southeast Asian countries, the Association of Southeast Asian Nations (ASEAN) which has taken on a more formal institutional structure, but whose *modus operandi* is primarily pragmatic and flexible, and serves to mediate relations between ASEAN and the major powers. Membership in various forums and frameworks would be overlapping and based on interests and issues and not on ideology or civilizational ground. Functional cooperation through fluid networks comprising a complex patchwork of forums, frameworks and institutions of variable geometry rather than formal institutions would be the realistic way to deepen cooperation.

Given the underlying historical animosities and lack of reconciliation between key powers such as Japan and China, the diversities in socioeconomic and political models, different levels of economic development, and the shifting balance of power, complexity is a critical component of architecture for Asia. East Asian regionalism will have to develop its own pathway finding a synergy and greater complementation among the different frameworks and processes as building blocks towards deeper regional cooperation. This is not likely to take the form of formal integration like the European Union (EU).

## Impact of the Euro-crisis on East Asian Regionalism

As the EU falters with the integration project as citizens increasingly questioned the legitimacy, transparency and accountability of the policy makers and their decisions, and as the EU struggles to contain the euro-zone debt crisis, the East Asians would become even more cautious of formal integration. The debt crisis in the Eurozone has dented the EU's image and its regional integration model. While the East Asians have constantly reminded their European partners that the EU model cannot be copied and East Asian regionalism is unlikely to evolve in the same way as regionalism in Europe, many East Asians have nevertheless looked at EU with much admiration for the historical reconciliation and the peace that the European project has brought to the region for more than half a century. This historical lesson would not be lost to the East Asians when they confront their own inability to overcome history and nationalism.

However, the euro crisis would confirm the East Asians' penchant against "over-institutionalisation". The lessons that East Asian would learn is that Formal institutionalisation of cooperation is not the only way forward, as institutional politics (seen in the EU) can be just as "paralyzing". Indeed it is more important to ensure the right balance of politics and policy for regional cooperation to succeed.

Having said that, in a different way, the euro crisis may also act as a catalyst for further regional integration in East Asia just as the Asian Financial crisis in 1997 / 98 lead to the launch of the ASEAN Plus Three (APT) process as Southeast Asians and Northeast Asians realize their growing economic interdependence.

The economic interdependence between Southeast Asia and Northeast Asia has grown and deepened over the years. However, because of the export-oriented nature of many of the East Asian economies, the EU has remained as a key market for East Asian exports. The EU is China's biggest trading partner. It is ASEAN's second largest trade partners, and ranked 3<sup>rd</sup> and 4<sup>th</sup> in its trade partnership with Japan and South Korea respectively. The EU is also an important investor in several of the East Asian economies, and FDI flows with these various economic partners have been considerably affected. For example, in 2010 EU outward flows decreased for the third consecutive year, down 62% compared with 2009<sup>2</sup>.

The general dependence of East Asian economies on external markets has made most East Asian economies more vulnerable to the deterioration of the economic situation in the EU. To mitigate the impact of the slow growth and weak recovery in the EU and US, East Asia would need to work on further economic integration in the region. The work towards ASEAN Economic Community and the launch of discussions on a possible trilateral free trade agreement among China, Japan and South Korea are important steps towards East Asian economic integration. Progress has also been achieved in the area of monetary and financial cooperation amongst the East Asian economies.

All these of course appeared to have stalled in the last few months with the increasing tensions in South China Sea between China and the various ASEAN claimants in particular Vietnam and Philippines, and the worsening ties amongst Japan and its East Asian neighbours over the Senkaku / Diaoyu

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<sup>2</sup> Eurostat, Foreign Direct Investment Statistics, May 2011,  
[http://epp.eurostat.ec.europa.eu/statistics\\_explained/index.php/Foreign\\_direct\\_investment\\_statistics](http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Foreign_direct_investment_statistics)

and the Dokdo / Takeshima islands. Yet the broader trend is towards a certain rebalancing from the over-reliance on western markets to more intra-regional trade and investments.

The crisis in the Euro zone does not lend itself to easy solutions, and even with the most optimistic scenario it would take some years for the EU to get back to sustainable growth and regain its “shine” in the global economy. East Asian economies would therefore have to look for new source of growth. A rebalancing is taking place, and is indeed needed and necessary as East Asia look into greater intra-regional economic activities to sustain the growth necessary for political and socioeconomic stability. South-South trade would also become more important.

## Conclusion

From the above discussion, one could see that the development of East Asian regionalism has its own dynamics and constraints. The success of the EU in creating a single market of 500 million rich consumers, and more importantly the historical reconciliation between Germany and France and also its other smaller neighbours, and the enlargement of the EU to include the former Communist countries in Central and Eastern Europe is seen as a remarkable achievement and envied by some in East Asia. However, it is also commonly acknowledged that the trajectory of East Asian regionalism will be different and the EU model of integration while inspirational can never be copied here.

The further deepening of the EU in the 1990s may have act as one of the drivers (amongst many other factors) for the East Asians to further regional cooperation. However, the current euro crisis has also provided pause for the East Asians to scrutinise the EU integration model further. The sovereign debt crisis and the crisis responses from the Eurozone countries have cast doubts on the EU model of integration. However, paradoxically, this long-drawn crisis with all the implications for EU's trade and investment with its East Asian partners may also led indirectly to East Asian looking more into their own regional markets for growth and in the process engendered even greater economic integration.

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## Comment

Hiro Katsumata

This paper covers a number of important issues concerning European integration and East Asian regional cooperation. It first focuses on the development of European regional integration since the 1950s. It underlines the significance of the Lisbon Treaty in terms of the governance structure of European cooperation, and also points out that the Euro crisis effectively undermined the relevance of this structure. The paper then focuses on the development of regional cooperation in East Asia since the late 1990s. Before dealing with the two regional frameworks – namely, the ASEAN Plus Three and the East Asian summit – it reminds us that the Asian financial crisis in 1997 stimulated new thinking about East Asian regional cooperation. Next, the paper examines the characteristics of East Asian regional cooperation, and states that it is open, inclusive and deeply integrated into the global economy. The paper points out that, due to the existence of a number of factors which complicate their diplomatic relations – such as Sino-Japanese rivalries and socio-economic diversity – the East Asian countries will have to find their own way of promoting regional integration, which is distinct from that of the European countries. Finally, the paper goes on to address its central issue – namely, the impact of the Euro crisis on the development of regional cooperation in East Asia. It argues that the crisis made the East Asian countries question the utility of formal integration. More specifically, the crisis reminded these countries that an excessive level of institutionalization can be detrimental to the sustainability of regional integration. Yet, importantly, the paper also argues that the crisis may actually have accelerated the process of East Asian regional integration. Given the reliance of most of the East Asian countries on the European market and investment, these countries probably had to facilitate their economic integration, so as to mitigate the negative impact of the Euro crisis on their national economies.

I would like to build on these extremely important insights by highlighting three issues for conference participants and/or the readers of conference proceedings to consider. First, was the Euro crisis about the problem of over-institutionalization or of the over-expansion of the membership? In a sense, over-institutionalization seems to constitute the core of the problem which the EU members have confronted. In this respect, the paper reminds us that supranational institutions could not be excluded from the decision-making process of the EU. In another sense, the over-expansion of the EU membership also seems to be an issue. The framework for European cooperation has continuously expanded over the last few decades, and the EU now has 27 member states. Yet some of them seem to have weak socio-economic structures, and such structures probably have exacerbated the region-wide crisis in Europe. Simply put, some of the EU members may not have been ready to join the EU when they were invited to do so by the existing members.

Second, has the impact of the Euro crisis on East Asia been economic or ideational? There is little doubt that the crisis has had a major economic impact across the world, including East Asia. As the paper correctly points out, in the long run, it will probably facilitate the process of economic integration among the East Asian countries, most of which depend heavily on external/European powers in terms of trade and investment. Yet one can also argue that the crisis has had a negative impact on the

identity of the EU as an appropriate and legitimate model of regional integration. Indeed the paper points out that the crisis has put a “huge dent” on the image of the European model of regional integration.

The implications of the weakening of the European ideational power are serious. It may mean that the rest of the world – including the East Asian countries – will no longer emulate the EU, and will find their own way of promoting regional integration. This may have a detrimental impact on the promotion of liberalism across the globe. In the case of Southeast Asia today, one of the major reasons why the ASEAN countries are addressing liberal issues such as human rights and democracy is that they see the EU as a legitimate model. With the intention of securing their identities as legitimate members of today’s global society, these countries are emulating the European countries and addressing the liberal issues (Katsumata 2009b). This kind of positive development will halt if the European ideational power weakens. In this respect, the impact of the Euro crisis in the long run may be more serious than one would normally assume.

Finally, is East Asia modeling itself on the EU or becoming a model to be emulated by others? The paper suggests that, especially before the outbreak of the crisis, the East Asian countries looked to the experience of the European countries, although they repeatedly said that the European model could not be implemented in their own region. One may go as far as to argue that the East Asian countries – including the ASEAN members – have been constantly modeling themselves on the EU, thereby adopting new agenda items, such as free trade, environmental cooperation, preventive diplomacy, domestic conflict resolution, human rights and democracy. It is fair to say that many of these agenda items have been pioneered by the Western powers, including the European countries.

Yet the institutional experience in East Asia may constitute a model to be emulated by others in the global society. What is notable in this respect is the fact that the association of minor powers in Southeast Asia has successfully socialized China into its norm of cooperative security relations, mainly within the framework of the ASEAN Regional Forum (ARF) (Katsumata 2009a). When Beijing attended the first meeting of the ARF in 1994, it was cautious about promoting multilateral security cooperation. However, after attending several ARF meetings, it began to modify its cautious attitude. Today China is one of the most active players in the ARF, proposing a number of ideas for cooperative security. This is a result of ASEAN’s effort to share its cooperative security norm with Beijing. This kind of achievement is notable, and can perhaps be emulated by others. It is probably too simplistic to say that the Southeast Asians always copy external powers. Today they can also be copied by others in the global society.



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# Australia-EU cooperation in the context of Asian engagement

Jiro Okamoto

## Abstract

As the rise of Asia continues, Australia and the EU are increasingly seeking to engage with the region. Because Australia's prosperity and security depend heavily on Asia, it needs to utilize every opportunity to advance its interests in Asia, and the policy cooperation and coordination with the EU regarding Asian engagement is one of these opportunities. Australia and the EU share a wide range of common interests in the region and they already have started policy cooperation in some specific policy areas. This paper argues that there is more room for policy cooperation/coordination between the two in the context of their Asian engagement but it also points out that there are some points that Australia should be careful when dealing with the EU.

## Introduction

Developing and maintaining close political and economic relations with Asia has been one of the major foreign policy objectives for Australia for a long time. As China, India, Indonesia and others continue to rise as emerging countries, how to engage with the region will be more and more important for Australia over the next several decades. The recently published 'Australia in the Asian Century' white paper (Commonwealth of Australia 2012) reiterates Australia's determination for deeper and more comprehensive engagement with the region.

This paper discusses the possibility of policy cooperation and coordination between Australia and the EU in the context of Australia's Asian engagement. First, it identifies the reasons why the focus should be placed on the EU. Second, it reviews the development of Australia-Asia, EU-Asia and Australia-EU relations respectively. Third, it explores the common interests between Australia and the EU in Asia and argues that there are some areas in which policy cooperation/coordination can be beneficial for both parties. It also discusses how these interests can be achieved. The paper concludes with a summary of the discussion and indication of two points that Australia should be careful when dealing with policy cooperation/coordination with the EU.

## Why Focus on the EU?

There are several reasons why the focus should be placed on the EU. First, it is an undeniable fact the EU is one of the world's leading powers. The EU currently has 27 members and its total population is more than 500 million in 2010. In the same year, the amount of the EU's GDP was €12,268 billion, which was bigger than the United States' and accounted for a quarter of the world's total. The EU's trade with the rest of the world occupies around 20 per cent of global trade and it is the world's biggest

exporter and the second biggest importer. Thus, in the era of globalization, the health of the EU economy as a whole has considerable influence on the world's economic circumstances. The EU, at the same time, has been gradually consolidating its institutions to emerge as an organization with a single voice on international relations. The EU first started to integrate its members' external policies in the area of international trade. The European Commission now has exclusive power to decide policies for the EU in this area, including international investment, trade-related intellectual property rights and transportation. In addition, the Treaty of Lisbon (came into effect in December 2009) has created the posts of President of the European Council and High Representative of the Union for Foreign Affairs and Security Policy, which serve as external 'faces' of the Union. The members agreed to seek the EU's common positions, joint actions and common strategies in the areas of foreign and security policy, which define the direction and concrete activities of the EU once members provide their consent.

Second, the EU is not only streamlining its organization to act as a single actor in international relations but also willing to exert its power and influence on international affairs. Its relations with Asia are not exception. In economic relations, while it has its own serious financial problems within the region, the EU has concluded negotiations for a comprehensive free trade agreement (FTA) with Korea and signed in October 2010. The EU is currently negotiating FTA with Singapore, Malaysia and Vietnam and another one with Japan look set to start in the near future. In political relations, for example, the EU's stance against Myanmar's military regime was very tough. It strongly denounced the regime's authoritarianism, human right abuses and lack of democratization and, along with the United States, in isolating Myanmar politically and economically.

Third, as the EU's involvement in and engagement with Asian affairs would have important impact on the region, Australia needs to be fully aware of the EU's policy intentions and goals. Australia wants to utilise every opportunity to realize its national interest in the region. Thus, cooperation with the EU would be desirable. Australia could find common interests with the EU and policy cooperation/coordination is deemed to advance Australia's interests. Conversely, Australia might need to distance itself from the EU's position if their regional policy intentions and goals cannot really conform.

## **The Australia-Asia Relations**

Asia, particularly East Asia, has long been a very important region for Australia. As the main theatre in the Pacific War and source of uncertainty after the War, its importance was based essentially on political/security considerations rather than economic relations until the 1970s.

After the global economic slump in the early 1980s, East Asian economies recovered strongly affecting in the process significant structural change. Importantly, to sustain economic growth propelled by FDI inflows and export expansion, most countries in East Asia began gradually to liberalise their trade and economic regimes as well as to promote multilateral liberalisation within the framework of the GATT. Australia also needed to maintain and promote free and open international trade and investment to underpin structural reform of its domestic economy which had begun in the first half of the 1980s. The Australian government set a foreign economic policy objective to promote global freer trade via cooperation with Asia Pacific economies, as seen in its initiative to establish APEC in 1989.

The growing importance of East Asian economies for Australia was reflected in the significant

increase in their share in Australia's exports and imports. In 1948, Japan's share in total Australian exports and imports was negligible but it had increased to almost 30 per cent in exports and 25 per cent in imports in the mid 1980s. The growth in the share of Newly Industrializing Economies (NIEs: Korea, Hong Kong, Singapore and Taiwan) and ASEAN members was also considerable. Collectively, they accounted for only three per cent of Australia's total exports and just a little more than one per cent of imports in 1948. In 1995, their shares reached 32 per cent and 17 per cent respectively.

Australia's active engagement policy with Asia began in the late 1980s and accelerated through the 1990s. There was, however, a significant shift in how to achieve the policy goal. Before the turn of the century, Australia's foreign policy in general had a distinctive multilateralist characteristic. Because the government's liberalisation and deregulation measures were introduced unilaterally, it needed to underpin these domestic efforts by attention to strengthening international economic regimes, especially the GATT/WTO. Australia's efforts in establishing and developing the Cairns Group as the third force in multilateral trade liberalization in agricultural products, as well as its initiative in APEC in concluding the GATT Uruguay Round stood out as examples. On top of its aspiration for closer economic relations with East Asia, Australia's Asian engagement policy at this time was based on the recognition that Australia should be integrated politically and socially with the region.

Nevertheless, Australia's intention to engage with Asia comprehensively met with Asia's mixed responses. For example, the East Asian Economic Group (EAEG) proposal by Malaysian Prime Minister Mahathir bin Mohamad in 1990 assumed as potential members only East Asian states, excluding Australia. Australia was as outspoken as the United States in opposing the proposal. The ASEAN Free Trade Area (AFTA) initiative was also potentially problematic for Australia. As AFTA aimed for liberalisation of intra-regional trade, it could diversify trade flows away from Australia. In sum, Australia's intention of comprehensive engagement was not fully accepted in East Asia, especially by ASEAN members.

Australia decided to take the first step towards bilateral approach in November 2000. Prime Minister Howard made a joint announcement with the Singaporean Prime Minister Goh Chok Tong that the two governments would start negotiations for a bilateral FTA. By the end of the year, the government began considering negotiating an FTA with the incoming George W. Bush administration in the United States.

Since embarking on the shift in foreign policy orientation, Australia's approach towards East Asia has again brought mixed results. Australia's active involvement in East Timor's independence process in 1999, particularly the central role it played in the UN peacekeeping operation, was praised domestically and by the UN, but it provoked resentment in Indonesia. Since the September 11 terrorist attacks in the United States in 2001, the government worked closely with ASEAN members in an effort to contain terrorism in the region. However, after the Bali bombings on 12 October 2002, which killed or injured more than 200 people including 88 Australians, Prime Minister Howard's statement about the possibility that Australia could launch "pre-emptive military strikes" against terrorists operating in neighbouring countries caused yet another wave of resentment in the region. In the area of economic relations, Australia had completed bilateral FTAs with Singapore, Thailand and Malaysia, and had commenced negotiations with China, Japan and Korea.

It has been notable that, through driving its bilateral approaches, Australia not only secured bilateral

FTAs with East Asian states but also achieved unexpected results of promoting multilateral economic relations with East Asia as a whole. For example, Australia, along with India and New Zealand, was invited to attend the inaugural East Asia Summit to discuss the development of regional cooperation with ASEAN+3 leaders in December 2005.

Over the last decade, the political and economic rise of China has been posing significant opportunities and challenges to Australia's engagement policy with Asia. On the one hand, China has become the largest trade partner in the mid 2000s, taking over Japan that stayed in the position for 40 years. The Australian economy recovered from the recent Global Financial Crisis quickly thanks mainly to the ever growing demand of China (and India) for Australia's minerals and energy exports. On the other hand, its economy's dependence on China would put Australia in an awkward position. For the first time in history, Australia's largest trading partner and growing investor is neither a security guarantor nor a country with which there was any deep sense of shared culture, values or institutions (Wesley 2011).

Australia's China policy under the previous government (1996–2007) was based on realism and pragmatism: respecting differences and cooperating in the areas of common interests. In other words, Australia did not attempt to work out differences with China in core political and social values and institutions but sought mutual economic gains during the period (Wesley 2007). The current government has been trying to engage China through global and regional multilateral institutions such as the UN, WTO, APEC, ARF and East Asian Summit in the hope of encouraging China to become a responsible global stakeholder in a rule-based international system. Nonetheless, this 'socialization' approach has not changed the Chinese government's stance on political and social institutions very much. Therefore, while continuing its efforts to bring China into accord with a liberal international system, Australia has turned to the United States as a way to balance China's growing influence in the region. Accepting a US marine base in Darwin (November 2011) is an example for Australia's seeking engagement of, and closer security relations with the United States.

## **The EU-Asia Relations**

The EU (including its predecessors the European Economic Community [EEC] and the European Community [EC]) has fostered bilateral relations with Asian countries since the 1960s. The EEC became one of the first dialogue partners of ASEAN in 1977 and the ASEM process, a cooperation dialogue between the EU and most East Asian countries, started in 1996. Despite continuing financial problems of member countries in recent years, the EU has been active in their attempt to engage with Asia. The EU's intentions and goals have been expressed in a series of policy papers prepared by the European Commission (European Commission 1994, 2001, 2007). This section reviews the development of EU's bilateral relations with some key Asian countries as well as its inter-regional relations with ASEAN and East Asia. It also explores the policy goals of EU's engagement with Asia stated in the policy papers.

The EU has concluded a number of bilateral agreements with Asian countries, which focus on specific issues that are not covered by the multilateral agreements. By now there are Cooperation Agreements with almost all Asian countries. Partnership and Cooperation Agreements (PCAs) are in force

with Japan (1991), Korea (2001) and India (2004) and the EU is negotiating PCAs with Brunei, China, Indonesia, the Philippines, Thailand and Vietnam. In addition, a comprehensive FTA with Korea came into effect in 2011 and negotiations for similar agreements are underway with India, Malaysia, Singapore and Vietnam. The EU has also established Strategic Partnership with Japan (2001), India (2004), China and Korea (2010).

The EU established relations with China in 1975, which are now governed by the 1985 EU-China Trade and Cooperation Agreement. As the bilateral relations have grown and diversified since then, the EU and China decided to upgrade the relations to cover not only bilateral economic issues but also foreign affairs, security and global economy. As Strategic Partners, they now hold annual summits and regular dialogues on wide range of issues. Both parties have also signed a series of more specific agreements on issues such as industrial policy, education and culture. Human rights issues are discussed as part of regular political dialogue as well as by-annual Human Rights dialogue since 1995.

The formal EU-Japan relationship with Japan started with trade-related agreements in the 1970s. It has grown considerably over the decades and the leaders of the EU and Japan now meets annually for dialogue covering foreign policy, trade, investment and regional/global political and economic challenges. They are engaged in a number of sectoral dialogues as well, including science and technology, financial services and environment.

The EU and India started their relationship in the 1960s. Their relations are based on the Cooperation Agreement in 1994, which provides opportunities for annual summits and ministerial- and expert-level meetings. In trade issues, technical aspects such as technical barriers to trade, sanitary and phytosanitary measures, agricultural policy and industry policy are discussed by senior officials and working groups. These ongoing efforts culminated in the start of FTA negotiations in 2007. In 2004, India has become a Strategic Partner of the EU.

Following the 2001 EU-Korea Framework Agreement on Trade and Cooperation, the EU's relations with Korea gained importance to the extent that negotiations started to update the agreement in 2007. This culminated in an updated Framework Agreement and the agreement to start FTA negotiations in 2010. The former addresses a wide range of international concerns including non-proliferation of weapons of mass destruction, human rights, counter-terrorism, energy security and climate change. The EU-Korea FTA signed in 2011 is a comprehensive agreement that covers not only far-reaching liberalization of bilateral trade in goods and services, but also trade facilitation measures, investment, behind-the-border issues, intellectual property rights and others.

The EU's relations with Indonesia intensified since 2000 with the establishment of political and economic dialogue. The EU considers Indonesia as a priority country in Southeast Asia because of its size, geopolitical importance and standing in the Muslim world. The EU-Indonesia relations have grown over the past decade to the extent that both parties conduct annual ministerial meetings since 2008, backed by regular senior officials' meetings. Negotiations for PCA started in 2010.

The formal dialogue relations between the EU (EEC) and ASEAN started in 1977. The relations have since rapidly grown and expanded to cover a wide range of areas including political and security, economic and trade, social and cultural and development cooperation.

In the political and security area, summits and ministerial meetings are held annually. The recent ministerial meeting in April 2012 adopted an 'Action Plan to Strengthen the ASEAN-EU Enhanced

Partnership (2013–2017)’ that aimed to give a more strategic focus to political, economic and social cooperation.

In order to promote trade and investment flows between the two regions, the EU and ASEAN agreed on the ‘Trans-Regional ASEAN-EU Trade Initiatives’ which is a policy dialogue mechanism in economic and trade related issues. The Initiative is hoped to pave the way for the development of an EU-ASEAN FTA whose negotiations have been stalled since 2009. The EU continues to be ASEAN’s second largest trading partner (after China) and the biggest source of investment inflow with a share of almost 20 per cent of the total in 2011. The total trade between the EU and ASEAN was US\$ 235 billion accounting for about 10 per cent of total ASEAN trade with Dialogue Partners (Australia, Canada, China, the EU, India, Japan, Korea, New Zealand, Russia and the United States).

The EU and ASEAN agreed on the ‘Regional EU-ASEAN Dialogue Instrument’ as a policy dialogue process for promoting relations in non-trade areas. Following the introduction of the Instrument, both parties organised a number of sectoral consultations on issues such as trafficking in persons, information and communication technologies, labour and employment, air transport, climate change and science and technology. The EU also financially supports ASEAN’s efforts towards, among others, disaster management, higher education, regional integration and creating ASEAN Community.

ASEM started in 1996 on the initiative of Singapore and France as an effort to reinforce region-to-region relations and dialogue between Asia and Europe. It was seen at the time as a missing link in relations between the continents of America, Europe and Asia. With Australia, New Zealand and Russia formally joining ASEM in 2010, its membership has grown from 25 to 48. Its activities are defined in the 1998 Asia-Europe Cooperation Framework, which identified ASEM as an informal process of dialogue on a range of area. Dialogue in ASEM is not just driven by meetings and agreements at the leaders’ and/or ministerial levels, but can occur in public policy areas on the initiative of a broad range of parties, including government officials, technicians, academics and civil society.

ASEM is not a forum for negotiation and formal agreement, but rather one for meetings and discussions that are of a consultative and consensus building nature. Therefore, it complements other international organizations where Europe-Asia dialogue takes place, as well as the bilateral relations between the EU and Asian countries. As such, ASEM offers itself as one of a number of fora that enhance discussions about how to foster stable and mutual beneficial international relations in multi-polar settings.

The EU is engaging with Asia through bilateral and region-to-region measures. Then, what are the policy intentions and goals? They have been expressed in a series of policy papers published by the European Commission. In 1994, the Commission set out an overall framework for the EU’s relations with Asian countries in its Communication *Towards a New Asia Strategy* (European Commission 1994). This was followed in 2001 by *Europe and Asia: A Strategic Framework for Enhanced Partnerships* (European Commission 2001) that updated the strategy, taking account of key development in the 1990s and established a comprehensive strategic framework for the EU’s relations with Asia in the coming decades. The strategy was reviewed again by *Regional Programming for Asia Strategy Document 2007–2013* (European Commission 2007), which also set the priority areas for cooperation and decided the allocation of the EU assistance fund.

According to these documents, the goals for the EU’s Asian strategy are:

- (1) to contribute to peace and security in the region and globally, through a broadening of our engagement with the region;
- (2) to further strengthen our mutual trade and investment flows with the region;
- (3) promote the development of the less prosperous countries of the region, addressing the root causes of poverty;
- (4) contribute to the protection of human rights and to the spreading of democracy, good governance and the rule of law;
- (5) build global partnerships and alliances with Asian countries, in appropriate international fora, to help address both the challenges and the opportunities offered by globalisation and to strengthen our joint efforts on global environmental and security issues, and;
- (6) to help strengthen the awareness of Europe in Asia (and vice versa).

Van der Eng (2011) points out that there are two imperatives that underpin these goals: political and economic. The political imperative is to help avoid threats to global security. Considerable security challenges continue to exist in Asia, which could become global problems: between India and Pakistan, between China and several Southeast Asian countries on South China Sea, between China and Japan on East China Sea, between Korea and Japan on the possession of an island in Japan Sea. North Korea has always been and continues to be a major threat in the region as well. While the EU is not in the position to help resolve such issues directly, it can offer support for ways in which Asian countries wish to consider work towards resolving such issues.

The economic imperative is that the EU has become highly dependent on imports from Asia. This economic imperative has been bolstered in recent years as Asia has emerged from the Global Financial Crisis as a stabilizing force and a key engine of global economic growth. This adds to the imperative to keep Asian countries engaged in international institutions that foster global trade and investment. While Asian countries generally acknowledge that their involvement in global trade and investment has fostered economic growth and poverty reduction, it is still possible that they (particularly China and India, as seen in their attitude towards the WTO Doha Development Agenda negotiations) may become tempted to undermine these accomplishments for the purpose of serving national interests. Coordinated efforts may be relevant to help Asian countries resist such tendencies and they are clearly EU's interest.

## The EU-Australia Relations

Australia's relationship with the EU (EEC/EC) has not always been a happy one, particularly in the economic area.

When establishing a post-war international trading regime, Australia insisted to maintain the already existing preferential trade arrangement with the United Kingdom (British Commonwealth Preference System). Its argument was successful and the System was incorporated in the GATT as an exception. The United Kingdom's accession to the EC in 1973, nevertheless, meant that Australia lost the preferential access to the UK market which was still an important destination for Australia's agricultural exports such as wheat, meat, wool, sugar and dairy.



The EC/EU's Common Agricultural Policy (CAP) remained as a significant problem for Australia in the 1980s. It stimulated excess production through a high price support scheme covering a wide range of agricultural products such as sugar, wheat, butter, poultry, cheese, beef, veal and pork. These products were disposed of in international markets with the assistance of subsidies paid directly to exporters. Because of CAP (and the Export Enhancement Program for agricultural products by the United States), Australia decided to form the Cairn Group in 1986 as an international coalition of states that favoured trade liberalization for agricultural products. Australia continued to lead the Cairns Group, as the 'third force' of agricultural negotiations' through to the conclusion of the Uruguay Round. The end results of the Uruguay Round on agriculture, however, turned out to be less than the Cairns Group had hoped for, but the fact that the agreement that extended all the rules and disciplines of the GATT to agricultural trade had been reached for the first time in the GATT's history was significant.

As agricultural trade included fully included in the WTO agenda and the EU finally agreed to the CAP reform in 1992 due mainly to its budgetary pressure, Australia's relations with the EU improved since the mid 1990s. Several helpful initiatives were taken by both parties, including Science and Technology Cooperation agreement and the Mutual Recognition Agreement on product standards. The Australia-EU Partnership Framework in 2008 set out the future direction of bilateral cooperation and agreed that they should focus on: shared foreign policy and global security interests; the multilateral rule-based trading system and the bilateral trade and investment relationship; the Asia Pacific region; energy issues, climate change and fisheries and forestry, and; science, research, technology and innovation, education and culture and facilitating the movement of people.

In October 2011, Australia and the EU started negotiations for a treaty-level bilateral Framework Agreement. The Agreement is expected to be in line with the Partnership Framework but with binding clauses. Both parties are working towards the conclusion of negotiations by the end of 2012.

## Common Interests and Policy Cooperation/Coordination

As explained above, Australia and the EU have been seeking to advance their interests in Asia. It seems that many of their interests overlap with each other and both parties have already started policy cooperation in some areas.

As the economic rise of the Asian region continues and the levels of Australia's and the EU's economic dependence on Asia has become higher, a wider range of shared interests in the international trade and investment policies have emerged between Australia and the EU. It is important for both parties to avoid Asian economies, especially the emerging ones such as China, India and Indonesia, from crushing. It is also important for both of them to ensure that Asian economies act according to liberal international trade and investment institutions.

In development assistance area, the EU is already an important development partner for Australia, particularly in the Pacific region. The EU is a significant donor in the region. Under the tenth European Development Fund, it provides the Pacific with approximately €500 million between 2007 and 2013. In 2011, Australia and the EU agreed to establish delegated cooperation arrangements for aid delivery, the scheme by which one development agency delivers an aid program on behalf of a partner agency. The first two Australia-EU delegated aid projects will be in South Sudan, where the EU will deliver

food-security assistance on Australia's behalf, and in Fiji, where Australia will deliver a component of the EU's assistance.

Australia shares with EU the importance of regional order and stability, as serious political and economic conflicts in the region would certainly pose direct threat to Australia and, maybe indirect but significant influence on the EU in this era of globalization. The EU has made an important contribution to promoting security outcomes for East Timor and for the countries of the Pacific region. The EU is providing support for the Jakarta Centre for Law Enforcement Cooperation, a joint Australian-Indonesian initiative to enhance the expertise of Southeast law enforcement agencies in combating terrorism and transnational crime. It also provides support for the Bali process on enhancing regional cooperation on people smuggling, trafficking in persons and related transnational crime.

To achieve common interests in the region, Australia and the EU should work out policy cooperation and coordination in various levels. Bilateral policy cooperation in specific issues such as development assistance needs to be advanced. Global multilateral frameworks such as the UN and the WTO should also be utilized fully to tackle regional problems that have global impacts.

Yet, arguably, the most potent forum to deal with economic issues for both parties now is the G20. The G20 was established in 1999 in the wake of the Asian financial crisis with the aim of stabilizing global financial markets but its role was highlighted during the recent Global Financial Crisis. The Group was created out of a realization that other existing arrangements for international economic cooperation were not sufficiently representative of the countries that were required to seek solutions to the crisis. The elevation of the G20 to summit status is recognition that global problems could not be resolved without participation of the rising powers. It is also an acknowledgement of the creative contribution that 'middle powers' could potentially make to the global diplomacy. The members of the G20 include Australia and the EU, as well as key countries in Europe and Asia Pacific: China, France, Germany, India, Indonesia, Italy, Japan, Korea, the United Kingdom and the United States. In the Group, Australia looks well positioned to make its 'middle power' initiative, which was successful in the cases of APEC and the Cairns Group, on sustainable economic development, financial stability and an open trade and investment environment. Australia can attempt to create issue specific coalitions with other middle powers within the Group and invite the EU's support if possible.

Another forum that has potential for Australia to seek policy cooperation/coordination with the EU is ASEM, after Australia's inclusion in the ASEM process in 2010. Unlike the G20, ASEM is a policy dialogue process on political, economic, social and cultural areas. It is still early to judge how Australia is using ASEM in terms of policy cooperation with the EU but it offers Australia an opportunity to interact in a single forum with key partners in Asia and Europe.

## **Concluding Remarks**

Australia and the EU share common interests in maintaining the steady economic rise of Asia and developing the region as a stable and prosperous place. For these purposes, both Australia and the EU want Asian countries, particularly the emerging ones, to act according to the established international institutions and play constructive roles in creating a new order. Base on these common interests, Australia and the EU can cooperate to coordinate their policy in the region in various levels: bilateral, re-

gional and multilateral.

In trying to cooperate with the EU, nevertheless, Australia needs to pay attention to two things. First, Australian policy makers should understand how the EU operates in terms of making and implementing its external policy. The EU is consolidating its organization to have a strong single voice not only in the trade policy area but also in the foreign/security policy area. Yet, policy competence of the EU, particularly in the latter, is still far from stable. Each member tends to have its opinions in sensitive foreign/security matters and it is sometimes hard for the Union to formulate a unified stance. Australia needs to be careful whether the EU can act as one in individual issues in the region.

Second, and perhaps more important, Australia should be reminded that European and Asian experiences in regional integration so far are quite different. The European integration has been based on the shared values such as democracy, rule of law and human rights, and binding political and economic commitments through international treaties. Regional integration in Asia has been multiple cooperation processes that focus on mutual, pragmatic economic benefits. The EU must act as a global 'soft power' anywhere in the world and its approach towards Asia has to be based on its rules and values within the Union. This may cause inflexibility in the EU's attitude when dealing with Asia in some sensitive issues. Australia, which faces much more direct influence from Asia than the EU, needs to maintain room for flexibility when coordinating Asian policy with the EU.

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## Comment

Daisuke Hayashi

It is not so easy to define how important Australia is for the EU and vice versa. Of course, we understand both of the parties are major Western powers, sharing common values of democracy and human rights, playing important roles in the international society, and working closely together on a wide range of issues such as environment, climate change, peace and stability, sustainable development, good governance, etc. However, it is still difficult to find a reasonably relative position of EU-Australia relations among other important external relations for each actor.

One of such examples is trade – what we think is the most traditional and important policy area between Europe and Australia. Australia is just the 12th largest trading partner in export from the EU and the 25th biggest source of imports (even behind Algeria, Nigeria or Kazakhstan) in 2011, accounting for only 2.0% and 0.9%, respectively, in the total amount of the EU trade (DG-Trade 2012). For Australia, the EU can be placed as the third largest export market (8.9%), following China and Japan, and the biggest source of imports (18.1%) in 2011. Such honourable positions, however, can be plausible but quite tricky because if we pick up other multilateral economic entities, of course the APEC should be placed as the largest trading partner for Australia (71.0% in the total amount of the Australian trade) and the ASEAN comes next (14.5%). The EU should be placed just as a less important trading partner (13.4%) for Australia than the ASEAN or the APEC, even behind the Australia-China trade (19.9%) (DFAT 2011). In this sense, as Philomena Murray puts it from a famous phrase invented by a distinguished historian Geoffrey Blainey, there still seems to be “the tyranny of distance” geographically between the EU and Australia (Murray 2007).

On the other hand, the EU and Australia have not only frequently direct contacts in bilateral relations, but also far more opportunities together in multilateral, regional and international frameworks. And, the most important clues can be found in the Asia-Pacific to find out a relative position and potential value of EU-Australia relations. In this regard, Dr. Okamoto is quite successful in sketching out EU-Australia relations; particularly he puts the bilateral relations in much broader contexts of the Asia-Pacific region or multilateral frameworks such as the ASEM or G20. He argues that, as both Australia and the EU have drastically developed their engagements with Asia, they should seek for more cooperation and coordination in various kinds of issues such as enhancing free trade, expanding international development aid, and supporting law enforcement in combating terrorism and transnational crimes, etc. Of course, Dr. Okamoto is not too optimistic but also points out some conflicts over the preferential trade system for Australia as well as special protection favourable for European agricultural products by EU's Common Agricultural Policy (CAP). And, he also mentions unstable policy competence of the EU in external policies as well as difference of quality in regional integration between Europe and Asia.

I also agree that the Asia-Pacific can be the centre of gravity where the EU meets Australia and works closely together to widen and deepen EU-Australia relations in a more advanced stage. As de-

defined mainly in Objective III in the EU-Australia Partnership Framework of 2008, the both powers can collaborate for promoting regional stability, supporting sustainable development, and enhancing effective aid practices in that region. Particularly, Australia, identifying themselves also as one of the Asian-Pacific powers, will further promote their own strategies and engagements, clarified in the “Australia in the Asian Century” White Paper of 2012. Now they are gradually switching their mindset that “the tyranny of distance” is being replaced by “the prospects of proximity” (Australian Government 2012). In this sense, the future EU-Australian cooperation clearly depends on how the EU can contribute to the peace and prosperity of the Asian-Pacific region through constructing mutually-beneficial free trade networks based on multiple FTA/EPA/PCAs, promoting political norms of democracy and the rule of law, and supporting sustainable developments in those emerging economies in the Asian-Pacific region. Those European contributions can provide Australia with more incentives for collaboration, and improve the range and the quality of their partnership.

And, the EU should focus more on their cooperation with Australia for some highly advanced areas such as climate change, green projects, environmental protection, research and development, and higher academic education. Both the EU and Australia share a higher sense of climate change and environmental protection because the both powers are at the frontiers of global warming near the North and the South Poles. And, Europe still has great advantages and unique attractiveness of providing wealth of advanced researches and higher education in various academic fields. Since the scientific and technical cooperation agreement signed on 23 February 1994, the EU and Australia have expanded their traditional collaboration for those areas and currently work on some ambitious goals defined in Objectives IV and V in the Partnership Framework. In other words, Europe is not just an alternative of other advanced partners for Australia such as the United States and Japan. But in fact, the EU can be a unique as well as a best partner for Australia to promote greater cooperation for such highly advanced areas of environmental, scientific, technological and academic issues where other major powers cannot find a better position compared with Europe.

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# Part III

## **Special Lectures**

# The recent development of economic integration in Asia-Pacific

Fukunari Kimura

## Abstract

This paper provides an overview of the recent development of *de facto* and *de jure* economic integration in East Asia and Asia-Pacific. The East Asian economy has steadily grown with effectively utilizing the mechanics of production networks or the 2<sup>nd</sup> unbundling backed up by practical and functional *de jure* economic integration. The dominance of East Asia as a factory of the world was substantially intensified in the past decade. The recent competitive formulation of regional free trade agreements (FTAs) including the initiatives for the Trans-Pacific Strategic Economic Partnership Agreement (TPP) and the Regional Comprehensive Partnership Agreement (RCEP) would contribute to the establishment of a new international economic order compatible with the novel international division of labor. Europe may want to participate in the rule making by committing itself more deeply to Japan-EU FTA and other trans-regional integration initiatives.

## 1. Competitive formation of new international economic order

Europe has been no doubt the most advanced region for deep economic integration, and other parts of the world have certainly learned a lot from the European experience. However, East Asia and Asia-Pacific consist of countries at widely different stages of development, and thus realizing a “single market” cannot be an immediate goal. A path for deeper economic integration is not unique.

The trajectory of economic integration in East Asia and Asia-Pacific is perhaps more practical and functional than the European experience. On the real economy side, *de facto* economic integration led by the development of international production networks first started, and the *de jure* economic integration followed for further extending such operations. The recent boom of negotiating over region-wide free trade agreements (FTAs) including the Trans-Pacific Strategic Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP) explicitly pursues the formation of new international economic order that suits a new type of international division of labor called production networks, global value chains, or the 2<sup>nd</sup> unbundling. On the financial economy side, the integration effort began while facing the burst of the Asian currency crisis, and the starting point of financial cooperation was concerted measures for avoiding or mitigating crises rather than financial integration *per se*, unlike in the case of Europe.

This paper places its focus on the real economy side and provides an overview of the recent development of *de facto* and *de jure* economic integration in East Asia and Asia-Pacific.

## 2. Production networks and *de facto* economic integration

Baldwin (2011) claims that the 2<sup>nd</sup> unbundling, i.e., the international division of labor in terms of production processes or tasks, has developed since the 1980s, where ICT revolution has dramatically reduced the cost of logistics and coordination among fragmented production blocks. East Asia has been a pioneer of introducing the 2<sup>nd</sup> unbundling, particularly in the manufacturing sector, and has led the world in developing sophisticated international production networks.

The mechanics of the 2<sup>nd</sup> unbundling is formalized by the fragmentation theory (Jones and Kierzkowski (1990)). The essence of this theoretical framework is to explicitly present the characteristics of production networks or the 2<sup>nd</sup> unbundling with the flexibility of cutting out production blocks and the importance of service link to connect them. “Global value chain (GVC)” has recently become a popular word even in a non-academic literature. GVC, however, includes both the 1<sup>st</sup> unbundling (separation between production and consumption across national borders) and the 2<sup>nd</sup> unbundling. Furthermore, production networks, particularly in the manufacturing sector, are typically “regional” rather than “global.” We have to note that production networks or the 2<sup>nd</sup> unbundling is a subset of GVC, requiring a higher level of international policy environment.

Kimura and Ando (2005) expand the framework into the two-dimensional fragmentation: fragmentation in the dimension of geographical distance and fragmentation in the distance of disintegration (intra-firm or arm’s length). In the early stage of industrialization, the former is crucial, particularly in participating in international production networks to start out industrialization. At a higher stage of development, the latter becomes important in the process of forming industrial agglomeration. In contrast to the mechanics of the demand-led formation of agglomeration in Europe, industrial agglomeration in East Asia is primarily based on the economic logic of fragmentation in the disintegration dimension where arm’s length transactions are proliferated in short distance.

The new type of international division of labor has drastically changed development strategies of less developed countries (LDCs). Latecomers can now jump-start industrialization by inviting production blocks, rather than fostering a whole industry. Aggressive participation in production networks accelerates industrialization. After reaching a middle-income level, it becomes crucial for LDCs to utilize positive externalities of industrial agglomeration in order to make local firms come into production networks and proceed industrial upgrading.

The change in the nature of the North-South trade has also altered the strategy of developed countries (DCs) on globalizing corporate activities. De-industrialization is a serious concern of DCs. However, with the 2<sup>nd</sup> unbundling, DCs can stop or at least slow down de-industrialization by developing effective division of labor with LDCs in terms of production processes and tasks.<sup>1</sup> This is the way to introduce dynamism of LDCs into stagnant DCs.

Production networks are sometimes blamed as shock transmission channels when a massive demand/supply shock such as the Global Financial Crisis and East Japan Earthquake occurs somewhere in the world. However, at the same time, production networks present stability and resiliency against

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<sup>1</sup> Ando and Kimura (2012c) analyze the micro data of Japanese manufacturing firms in 1998-2009 and find that firms that increase the number of affiliates in East Asia expand domestic employment and operations relative to firms that do not.



shocks. It is proved that transactions in production networks are less likely to be interrupted and more quickly to resume than other types of transactions.<sup>2</sup>

Due to the slowdown of the US and EU markets as well as aggressive demand boost in East Asia, intra-East Asia trade explosively expanded after the Global Financial Crisis and intensified regional production networks and market links even though it did not yet provide perfect decoupling between regional and external markets.<sup>3</sup>

The past ten years were a rare decade when virtually all LDCs in the world could enjoy rapid economic growth. The basis of economic growth, however, differs across countries and regions. Many LDCs such as Sub-Saharan African countries grew thanks to a resource price hike, which accelerated resource-related investment and the appreciation of local currencies. In the end, wage levels of workers became substantially high in the other parts of the world. In East Asia, on the other hand, the growth was based on the steady development of productive sectors such as manufacturing and related services sectors. The aggravation of the terms of trade between manufactured goods and natural resources and benevolent labor movements from informal to formal sectors substantially mitigated wage hikes. The dependence on East Asian exports of machinery parts and components was substantially enhanced in Eastern Europe and Mexico.<sup>4</sup> Although the wage hike and structural changes in China may alter the situation to some extent, the dominance of East Asia as a factory of the world will surely continue in the coming five to ten years.

Production networks in East Asia, particularly in electronics industry, started in the early 1990s without notable support from *de jure* regional economic integration. Although ASEAN Free Trade Area (AFTA) agreed in 1992 and became effective in 1993, actual tariff cuts for regional trade were slowly implemented. Trade liberalization necessary for international production networks proceeded due to unilateral tariff removal or a “race to the bottom” in competing over attracting foreign direct investment (FDI) and the most-favored-nations (MFN) based tariff removal led by the Information Technology Agreement (ITA) in the latter half of the 1990s. A well-concerted move at the regional level started only after the burst of the Asian currency crisis in 1997-1998 when ASEAN economic integration was accelerated and East Asian integration effort started. Since then, *de jure* economic integration has deliberately removed domestic resistance, for example, in the liberalization of automobiles and iron and steel sectors and has prepared economic environment for latecomers, i.e., Cambodia, Laos, Myanmar, and Vietnam, to come into production networks.

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<sup>2</sup> See Ando and Kimura (2012a) for the detailed empirical study on Japan’s export data during the periods of the Global Financial Crisis and the East Japan Earthquake by using the concept of intensive and extensive margins.

<sup>3</sup> Ando (2012) examines intensive and extensive margins of intra-East Asia trade in details.

<sup>4</sup> Ando and Kimura (2012b) analyze the drastic expansion of parts and components imports from East Asia by the emerging Eastern European countries.

### 3. The recent advancement of *de jure* economic integration in East Asia

In the first decade of this century, East Asian economic integration was led by ASEAN. ASEAN has targeted the completion of ASEAN Economic Community (AEC) by 2015.<sup>5</sup> Because of large gaps in terms of development stages among member countries, it is difficult to immediately achieve “a single market,” but the idea of “integrated production base” helps prioritize necessary policy support for the new type of international division of labor in ASEAN. ASEAN has also concluded five ASEAN+1 FTAs with its FTA partners by 2010 that include China, Japan, Korea Rep., India, Australia, and New Zealand and has tried to keep “ASEAN centrality” in the economic integration initiative.

While ASEAN and East Asia a bit slowed down their moves toward wider economic integration, the expanded negotiation over TPP including the United States started in March 2010. This move stimulated countries not participating in TPP negotiation, notably China, and intensified efforts toward concluding more FTAs in East Asia. The negotiation over the China-Korea FTA started in May 2012, followed by the initiation of negotiations over the China-Japan-Korea FTA in March 2013 and RCEP, i.e., ASEAN+6 FTA, in May 2013. In parallel, Japan started negotiating over Japan-EU Economic Partnership Agreement in April 2013 and plans to join the TPP negotiation from July 2013.

TPP is regarded as a so-called “high-level” FTA that tries to achieve thorough trade liberalization and cover a wide range of policy modes. Although the negotiation seems to be difficult and complicated, it may be fairly influential for setting up a new international economic order once it is concluded. Such expectation generates a domino effect with which some countries are rushing into the negotiation. The countries that think themselves not ready to participate in TPP may have a fear of isolation and possible suffering from trade/investment diversion and thus try to seek their own economic integration moves.

Such competitive formation of wider FTAs can be constructive if it works for accelerating liberalization and upgrading the integration effort. The mission of economic integration in East Asia and Asia-Pacific is to prepare a new international economic order for a new international division of labor, namely production networks or the 2<sup>nd</sup> unbundling. In this regard, TPP would make substantial contribution in tariff removal, services and investment liberalization, intellectual property protection, government procurement, competition policy, and others while a series of development agenda such as logistics and other economic infrastructure development, small and medium enterprises development, and the formation of efficient industrial agglomeration are not directly covered. RCEP can be more flexible for incorporating development agenda by applying a lukewarm but progressive “ASEAN way” rather than over-emphasizing a contrast between binding commitments and non-binding policy suggestion. ASEAN has actually achieved the deepest economic integration in East Asia in terms of the coverage of tariff removal, rules of origin, trade facilitation, and services and investment liberalization and thus has a potential for leading highly disciplined negotiations over RCEP with keeping ASEAN centrality. TPP, RCEP, and other economic integration initiatives may work as competing and complementary efforts toward the ultimate mission.

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<sup>5</sup> ERIA conducted the Mid-term Review of AEC Blueprint. See ERIA (2012) for the details.

## 4. Conclusion

A path to economic integration is not unique. Although the European experience is always referred to as an important predecessor, the trajectory and sequence of economic integration in East Asia have widely differed from those in Europe. They are more practical, functional, flexible, and incremental than the European way, fitting to small but accumulating trouble-shooting for international production networks. “The ASEAN way” used to be a word of criticism over slow and lenient progress of economic integration but is now possibly a word of wisdom that seeks a flexible and progressive path for achieving steady economic integration. East Asia including Northeast and Southeast Asia is not at all a simple region in international politics but shares a robust basis of *de facto* economic integration. FTA partners of ASEAN ask ASEAN to sit on the driving seat of regional integrity and come up with sustained economic growth for decades. ASEAN and East Asian economic integration is still far from achieving a single market but functions pretty well as an integrated production base. Although complete decoupling is difficult, East Asian economy is increasingly dependent on its economy itself.

The dominance of East Asia in manufacturing activities will surely continue in the coming decade. Whatever the resource prices, East Asia will grow steadily and climb up beyond the middle-income level. East Asia will be the venue for constructing a new international economic order that is compatible with the 2<sup>nd</sup> unbundling. Also considering the recently enhancing commitment by the US to East Asia, Europe should get more deeply involved with the East Asian dynamism. The Japan-EU FTA would be a gateway for EU to come into the game of new international rule making.

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# Legal aspects of Korea's FTAs

Deok-Young PARK

## 1. Introduction

The GATT system, which came into being in 1948 with the goal of promoting free and fair trade, relaunched itself as the WTO through the Uruguay Round and continues to act as the world's true multilateral trade system. After the advent of the WTO in 1995 and the subsequent deadlock of the DDA negotiations in 2002, however, the proliferating conclusion of FTAs is increasing rapidly worldwide. This means that the world's major trading countries are no longer depending on the WTO system for support and are seeking for their own means of survival through bilateral or multilateral FTAs.

Korea, whose external dependency rate reached 97.3% in 2011 and therefore is heavily dependent on trade, is no exception to this global trend. Starting from the Korea-Chile FTA negotiations in 1998, the number of FTA negotiations and conclusions soared as Korea adopted a strategy to simultaneously push ahead with FTAs, and as a result trade is expanding through the 8 FTAs concluded with 45 states(as of Nov. 2012). This paper proceeds to review the legal challenges of Korea's FTA hub strategy from the viewpoint of the GATT/WTO, and afterwards look over Korea's current FTA conclusion status, the issue of applying the most-favored-nation(MFN) principle to the service and intellectual property rights(IPRs) fields, and the legal burden Korea holds as a divided nation on the treatment of products from the Gaesung Industrial Complex.

## 2. FTAs under the WTO System

FTAs are preferential trade agreements that facilitate trade between parties by lowering tariff and non-tariff barriers on goods, services, investment and intellectual property. FTAs are a kind of regional trade agreement(RTA), and is the slackest form of economic integration compared to custom unions, common markets and economic unions.

### (1) Background to the proliferation of FTAs

The integral reason for the proliferation of FTAs despite the multilateral WTO system is that trading countries widely acknowledge that trade expansion by trade liberalization above the WTO standard can benefit the economies of both trading countries. Another reason is that easily negotiable and readily agreed upon FTAs are favored as a reaction to the inefficiency of the multilateral trade system. Other reasons like the promotion of domestic economic innovation, leverage for international creditworthiness and negotiation power, reinforcement of the political, diplomatic and sociocultural relationships are mentioned as the motivation behind the proliferation of FTAs.

While the areas covered by FTAs differ significantly depending on who the contracting parties are,

most traditional FTAs and FTAs between developing countries focus on the trade liberalization and tariff reduction of goods. Around the time of the advent of the WTO, however, the coverage of FTAs gradually expanded to include not only the elimination of tariffs on goods, but also the liberalization of services and investment and areas of policy harmonization like IPRs, government procurement, competition and trade remedies. It is likely that since the overall tariff rate was already low through multilateral trade negotiations, FTA negotiations moved forward to other fields of interest.

## **(2) Legal Status of FTAs**

Strictly speaking, the WTO and FTAs are in conflict in some aspects. As the multilateral trade system, the WTO lowers trade barriers overall and aims for trade liberalization and fair trade. On the other hand, FTAs are a kind of preferential trade agreement that liberalize trade between the parties on a different scale. The member states of GATT/WTO, however, are in the opinion that if FTAs are negotiated to the degree that all trade barriers actually are eliminated(GATT Article XXIV:8(b)) and trade liberalization is attained, FTAs can be consistent with the WTO. In other words, if the FTA complies with the standard stipulated in GATT Article XXIV and the FTA is notified to the WTO by the FTA parties, WTO members are not prevented from concluding FTAs with each other. Other than GATT Article XXIV, the intention of the member states to permit FTAs is furthered by GATS Article V and the 'Enabling Clause', which was agreed upon by GATT contracting parties during the 1979 Tokyo Round with the purpose of allowing differential preferential treatment to developing countries. As of August 2012, among the 338 regional agreements notified to the WTO 15 are custom unions under GATT Article XXIV, 35 agreements are under the Enabling Clause, and the remaining 288 agreements are regional trade agreements under GATT Article XXIV and GATS Article V.

## **3. FTAs Concluded by Korea**

### **(1) Background to Korea's FTA Promotion**

As a country which has relied heavily on international trade for its economic development, Korea is actively pushing ahead with FTAs for the following two reasons.

Firstly, the positive effect of FTAs are being demonstrated in real life cases and statistics. Various cases of expanding exports between countries in the same FTA bloc can be found all over the world. For instance, according to a WSJ report, sales of Hyundai cars in France rose 30% , while Peugeot and Renault fell 20% and 17% respectively. This shows the extent of how FTAs can affect exports. Also, a Korea International Trade Association study shows that after the Korea-Peru FTA entered into force in August 2011, the market shares for Korean color TVs in Peru spiked to 3.68% in 2010 to 28.16% in 2011, exceeding that of China(24.76%). This is another example of the benefits of FTAs.

Secondly, the need for FTAs can be found in the way that they innovate the overall state system and strengthen the economy by actively opening markets and liberalization. For example, Korea's automobile industry which incessantly raised issues on all kinds of regulation barriers underwent reform through the Korea-US FTA, enabling Korean consumers to reap the benefits. In order for Korea's economy to become a true advanced economy through qualitative development as well as quantitative development, it should actively use FTAs.

Korea has adopted a strategy to simultaneously push ahead with FTAs since 2003, and is steadily erecting a massive economic bloc by expanding the number of FTAs with Korea strategically centered as the hub. To maximize the influence of the FTAs, Korea is negotiating comprehensive FTAs that cover not only tariff elimination in the goods sector, but service, investment, IPRs, technology standards as well. Also, since the FTAs that Korea negotiated are consistent with the WTO provisions on goods and service, they fulfill the complementary role to multilateralism and both reform and advance Korea's system.

## **(2) The Current Situation of Korea's FTAs**

As of November 2012, the current situation of Korea's FTAs is 8 agreements with 45 countries, and based on the announcement of the Korean Ministry of Foreign Affairs and Trade is as follows: Korea-Chile FTA(entered into force in April 1, 2004), Korea-Singapore FTA(entered into force in March 2, 2006), Korea-EFTA FTA(entered into force in September 1, 2006), Korea-ASEAN FTA(entered into force in June 1, 2007 for Agreement on Goods and January 1, 2009 for Agreement on Services), Korea-India CEPA(entered into force in January 1, 2010), Korea-EU FTA(provisionally applied since July 1, 2011), Korea-Peru FTA(entered into force in August 1, 2011), and Korea-U.S. FTA(entered into force in March 15, 2012). Korea's FTA with India uses the acronym CEPA(Comprehensive Economic Partnership Agreement) because India opposed against the use of the word FTA, but this agreement is in essence still a FTA.

In addition, Korea has settled negotiations with Turkey and Columbia, with the Korea-Columbia FTA initialized on August 31, 2012. The Korea-Turkey FTA is now in proceedings for the approval of the Korean National Assembly. As of now, Korea is in FTA negotiations with 74 countries including China, Canada, Australia, which accounts for about half of the WTO's 157 members. Korea is on track at becoming a true FTA hub.

## **4. Tariff Elimination and Phased Tariff Reduction under FTAs**

Tariff elimination is of essence in FTAs. Usually tariffs are eliminated immediately as the FTA enters into force, but in cases of sensitive items, tariffs are phased out in consideration of impact to the domestic market, and some items like rice are exempted from market liberalization. Deciding on which items' tariffs will be eliminated or be phased out to what extent is an issue to be negotiated with the other negotiating party.

In the instance of the Korea-EU FTA, the number of items which tariff will be immediately eliminated is 8,535 for Korea and 7,201 for the EU. The number of items with a 3 year phase-out period is 478 for Korea and 151 for EU, those with a 5 year period and 7 year period are respectively 346 and 45 for Korea, and 46 and none for the EU.

## &lt;Concession Results for Industrial Products&gt; (Unit: billion \$, % )

Concession Phase	Concession for Korea				Concession for EU			
	No. of items	Ratio	Imports from EU	Ratio	No. of items	Ratio	Imports from Korea	Ratio
Immediate elimination <sup>(A)</sup>	8,535	90.7%	18	69.4%	7,201	97.3%	31.8	76.7%
3 year phase-out <sup>(B)</sup>	478	5.1%	5.8	22.4%	151	2.1%	6.8	16.6%
Early elimination <sup>(A+B)</sup>	9,013	95.8%	23.8	91.8%	7,352	99.4%	38.6	93.3%
5 year phase-out	346	3.7%	1.8	6.9%	46	0.6%	2.8	6.7%
7 year phase-out	45	0.5%	0.3	1.3%	-	-	-	-
Total	9,404	100%	25.9	100%	7,398	100%	41.4	100%

## &lt;Major Items according to Concession Phase&gt;

	Korea	EU
immediately	vehicle parts(8), other fine chemistry materials(1~8), measuring instruments(8), fabrics and apparels(8~13), color TVs(8), refrigerators(8), vessels(5), tires(8), optical instruments(8), chemical instruments(8), light bulbs(8), fabric machinery(5~8), food packaging machinery(8) etc.	vehicle parts(4.5), parts for wireless communication devices(2~5), sweaters(12), fabrics(8), refrigerators(1.9), air-conditioners(2.7), radios(9~12), ski boots(8~17), polyester fabrics(8), vacuum cleaners(2.2), lead-acid batteries(3.7), lithium batteries(4.7) etc.
3 years	middle and large passenger cars(exceeding 1,500cc)(8), other fine chemistry products(5~8), pumps(8), engines and its parts for vessels(8), parts for wireless communication devices(8), glasses(8), pharmaceutical products(6.5), cosmetic products(8), railroad cars(5), parts for railroad cars(5), parts for vessels(8) etc.	middle and large passenger cars(exceeding 1,500cc)(10), bearing(8), tires(2.5~4.5), synthetic resins(6.5), rubber belts(6.5), copying machines(6), microwave ovens(5), ceramic products for the kitchen(12), airplanes(7.5~7.7), other footwear(17), bicycles(15) etc.
5 years	small passenger cars(under 1,500cc)(8), hybrid cars(8), valves(8), bearings(8), cement(8), lubricating oil(7), skin care cosmetics(8), adhesives(6.5), synthetic rubber (8), lumber(5), motors(8), pumps(8), trucks(10), medical electronic equipment(8), other ceramic products(8) etc.	small passenger cars(under 1,500cc)(10), hybrid cars(10), color TVs(14), monitors(14), car stereos(10), parts for optical instruments(6.7), pure woolen fabrics(8), woolen thread(3.8) devices for playing image recordings(14), trucks(22) etc.
7 years	pure woolen fabrics(13), processed goods(8), sodium hydroxide(8), heavy construction equipment(8), printing machine(8), metal cutting procession machine(8), other machinery(16), plywood(8~12), fiberboard(8) etc.	none

## 5. Origin Determination and the Issue of Products from the Gaeseong Industrial Complex

One of the most important challenges Korea faces in becoming a FTA hub is origin determination. Actually this is probably the most important issue in FTAs. This is because the product in question needs to fulfill the requirements of the FTA's rules of origin in order to benefit from the FTA. Therefore the most sensitive part during FTA negotiations between major countries is the rules of origin, and to this Korea was no exception. The following chart summarizes the origin determination criteria of the Korea-EU FTA.

<Origin Determination Criteria of the Korea-EU FTA>

Change of Tariff Heading Criterion
When a product is manufactured from imported materials, the tariff heading(HS code) of the imported materials and that of the product has to be different starting from a certain digit(e.g. HS 2nd digit, 4th digit, 6th digit) in order to determine the state of origin - Example: When producing gasoline(HS2710) from imported petroleum(HS2709), the 4th digit changes three times
Value Added Criterion
When a product is manufactured from imported materials, the use of non-originating materials during the manufacturing process has to fall under a certain limit(e.g. 45% of the ex-works price) in order to determine the state of origin
Specific Operations Criterion
The manufactured product has to be processed through special processes like chemical reactions, purification processes, and blending processes in order to determine the state of origin



## &lt;Specific Examples of the Use of the Origin Criterion&gt;

Item	Origin Criterion
Automobiles	<ul style="list-style-type: none"> <li>- Vehicles: ratio of non-originating materials does not exceed 45%</li> <li>- Vehicle parts: ratio of non-originating materials does not exceed 50% or change of tariff heading(CTH) criterion</li> <li>- Motorcycles, trailers and other vehicles were agreed upon the change of tariff heading criterion or the non-originating material ratio of 50%</li> <li>- Railway trains use the change of tariff heading criterion, bicycles use the non-originating material ratio of 45%</li> </ul>
Machinery, Electrical, Electric	<ul style="list-style-type: none"> <li>- Choice between change of tariff heading(CTH) and non-originating material ratio of 45-50%</li> </ul>
Apparels	<ul style="list-style-type: none"> <li>- Fabric forward</li> <li>- Exception: In the case of yarns and fabrics, viscose rayon yarn and nylon staple yarn, which are completely dependent on imports, use the non-originating material to a certain extent</li> <li>※Fabric Forward : A relaxed criterion compared to Yarn-Forward criterion of the Korea-US FTA. It is also called the double modification criterion because products only need to undergo a two step process</li> </ul>
Chemical products	<ul style="list-style-type: none"> <li>- Almost all items use change of tariff heading(CTH)</li> </ul>
nonferrous metals	<ul style="list-style-type: none"> <li>- All items use change of tariff heading(CTH), with the exception of some copper and aluminum items</li> </ul>
Footwear	<ul style="list-style-type: none"> <li>- Non-originating uppers and inner soles are allowed, but imports of assemblies affixed to inner soles are not.</li> <li>- However, the value added criterion of under 50% can be selected</li> </ul>

Because of high domestic labor costs, many Korean companies moved their product manufacturing process to China or Southeast Asia, and recently are manufacturing products at the Gaeseong Industrial Complex, North Korea. The Korea-US FTA which recently entered into force and the Korea-EU FTA which is being provisionally applied since last July have not yet solved the origin issue of products manufactured at the Gaeseong Industrial Complex.

South and North Korea defined trade between the Koreas as “exchanges within a people” in the 1991 Agreement on Reconciliation, Non-aggression, and Exchanges and Cooperation Between South and North Korea, and the 1995 Special Act on the Implementation of the World Trade Organization Agreement Article 5 also stipulates that “the exchanges between South and North Korea are exchanges within a people and therefore are not exchanges between states subject to the Agreement”. This article, however, possibly contradicts with the general aim of the WTO of granting member status to not only states but to separate customs territory possessing full autonomy and the most-favored-nation(MFN) principle. Because North Korea is not a member of the WTO, products from the Gaeseong Industrial Complex are highly likely susceptible to stiff tariffs.

## &lt;Export Conditions of North Korean Products&gt;

Country	Tariff rate for North Korean Products	Tax rate for major items(%)	Possibility of export in case of decision as outward processing
US	Very high tariff rate (2~10 times higher than MFN rate)	Neckties 7.2(MFN rate) 65(rate for North Korea)	Export not possible Absolute disadvantage in price competition
Japan	Statutory tariff rate (About 30% higher than MFN rate)	cotton T-shirts 7.4-10.9(MFN rate) 11.2-16.8(Statutory rate)	Export possible Disadvantage in price competition but can be overcome by production cost reduction
EU	MFN rate (Slightly higher than GSP and other preferential rates)	Leather apparels 0( preferential rate) 4(MFN rate)	Export possible Slight disadvantage in price competition but can be overcome by production cost reduction
China	MFN rate	Apparels 19.3-25	Export possible
ASEAN	MFN rate	Apparels 5-15	Export possible

The Korean government dealt with this issue in the FTAs with Singapore and EFTA by inserting an outward processing provision, and therefore the Korea-Singapore FTA and Korea-EFTA FTA each have an “outward processing” provision that acknowledges products manufactured in the Gaeseong Industrial Complex and exported to the other FTA state as Korean products benefiting from the preferential tariff rate.

The Korea-US FTA negotiations tackled the outward processing issue as well, but with temporary results. Through negotiations, Korea and the US decided on establishing a “Committee on Outward Processing Zones on the Korean Peninsula” and adopted a separate annex that lets the committee designate outward processing zones(OPZs) under certain conditions. These criteria include ① progress toward the denuclearization of the Korean Peninsula; ② the impact of the outward processing zones on intra-Korean relations; and ③ the environmental standards, labor standards and practices, wage practices and business and management practices prevailing in the outward processing zone.

The Korean government’s explanation is that products manufactured in the OPZ will be applied preferential tariffs identical to those applied to Korean ones under certain conditions, and North Korean areas other than Gaeseong can be selected as OPZs. This issue, however, can be seen as being dependent on the political decisions on the establishment of peace on the Korean Peninsula, and even if peace is established, it is highly unlikely that North Korea will subject itself to the labor and environmental standards of the international community. In this context, it seems that the actual value of this provision depends on the political resolutions of Korea and the US in relation to the situation change in North Korea. It seems that the Gaeseong Industrial Complex issue is one of the crucial issues that need to be solved in relation to Korea’s FTA hub strategy.

## 6. Services and IPR Areas and MFN Exceptions Issue

Unlike the FTAs during the GATT era which focused on the trade of goods, FTAs of today are usually comprehensive FTAs which cover services, IPRs and investment. According to the WTO, however, there is no FTA exception in the IPR regulating TRIPs Agreement like that of GATT Article XXIV or GATS Article V. Therefore, since the special treatment that the other FTA party receives shall be extended to all other WTO members, caution is advised in this part of the negotiations.

In the case of the service regulating GATS, the MFN is a general obligation that extends to all members, but members adopted the positive list method, which means that members include in their concession schedules the sectors that they wish to open and exclude those that they do not. The Korea-US FTA, on the other hand, adopted the negative list method, thus contracting parties include sectors that they do not wish to open in their concession schedules.

Also, unlike the GATT/WTO system, the FTA incorporates the so-called ratchet mechanism, in other words a non-retrogression provision. This means that once a sector is opened, the level of market access cannot be returned to its previous level. The ratchet mechanism was much debated on during the Korea-US FTA negotiations, but the coverage of this mechanism is limited to general service sector of Services Chapter Annex I, and service areas directly linked to the livelihood of citizens like public services are exempt from the mechanism. It seems that the debate on the ratchet mechanism arose in the first place because the above fact was overlooked. In other words, the retrogression of the service sectors listed in Annex I are prevented, while the ones listed in Annex II can be subject to change according to the future policy of the Korean government.

In the area of IPRs, some FTAs follow the TRIPs-Plus standard, indicating a more stringent protection of rights than the WTO. Some of the Korean FTAs include provisions stricter than the WTO. For instance, the Korea-US FTA lengthens the protection period of copyrights, incorporates various obligations to prevent online copyright infringement, and reinforces enforcement and remedies for holder of rights. As a drastic effort, the Korea-EU FTA recognizes geographical indications which have a long history and are regarded as brands. The Bern Convention does have an exception to reciprocity in regard of copyrights, according to WTO TRIPs Article 4's MFN principle, these provisions apply to all WTO members.

## 7. Conclusion

Korea depends on international trade for most of its economic development. Korea has an export dependent economy that can be seen by how the global recession directly influenced the domestic economy and stock market. In this kind of situation, increasing exports was and still is the crucial method of economic development for Korea, and will continue to be so for the time being.

In the situation where trade liberalization through the WTO DDA negotiations are at a standstill and the global trade environment deteriorating, it seems the option left for Korea was the strategy to move forward with FTAs simultaneously. The policy chosen for the lowering of tariffs for Korea's exports, expanding trade of services, and more actively attracting foreign investment in this world of global competition was the conclusion of numerous FTAs. Consequently, Korea's FTA hub strategy

is, by concluding FTAs with the world's major trade countries, evolving into a FTA hub. By entering into FTAs before major competitors like China or Japan, Korea can dominate in advance the effect of FTAs and foster the competition power of Korean products, hence enhancing Korea's economy.

However, one point should be kept in mind. Korea basically has a trade structure of importing materials – processing imported materials – exporting finished product. Therefore, Korea has to pay special care to the issue of determining the state of origin in its future FTA negotiations and in the long run strive for the recognition of products from the Gaseong Industrial Complex as Korean products. If the issue of the recognition of products from the Gaseong Industrial Complex as Korean products is settled, one of the barriers to the economic cooperation of the two Koreas will be eliminated. This will eventually facilitate the interaction or communications between the two Koreas, and in turn play an optimistic role for the future of the Korean peninsula and help complete Korea's FTA hub strategy.

# **Presentation Material**

# **Asian Trans-Regional Cooperation and the Major Power's Power Shift; The US, China, Japan, and the EU**

**Kumiko Haba**

The author analyzes and investigates the Asian Regional Integration and the Major Powers' Power Shift: The US, China, Japan and the EU. Especially she investigates the Power Shift and Asian Regional Economic Development, and how people could organized this area by economy, institutionalization, security, think-tank learning from the European Union.

## **1. What is the problem in the Global Era?**

### **The Turning points of the International Politics**

These decades in the 21<sup>st</sup> century are the important turning points, during 200 years, from the Western Modernization to the new Power Shift era.

First is the 9.11.2001. That showed the terrorism and the Iraq War. (2003) and that brings from the hard security like missile and armament to the soft security: it means that one knife or one gun can threaten a pilot and can attack the center of the Big Power. "Terrorist is in the midst of citizens."

Second is the 9.15. 2008. Lehman Shock and Financial Crisis in the US and the world. That showed the key currency might also be destroyed, and the stagnation of developed countries began.

Third is the Euro Monetary Crisis. That is also the financial instability of the second currency, and it brought the Japanese Yen and Chinese Yuan direct exchange in the long run.

Fourth is the so called "3.11" in 2011, which is the Tohoku Disaster: Earthquake, Tsunami, and Nuclear Power Accident. That showed how small and powerless the human power and science technology, and it brought the reconsideration of nature's power, natural renewal energy and "solidarity" of people.

Fifth is the Emerging Asia: that is Rising China and India.

Those things show the Power Shift and Power Balance exchange.

All show inevitably the importance of reconsideration of "Modernization" during these 200-300 years: That is capital & monetary development, war & peace, problem of proliferation of nuclear power, importance of nature and environment change.

Sixth is, in the effect, the conflict of territorial dispute, like Senkaku (Diaoyu, Chinese) islands problems, Takeshima (Dokuto in Korea) islands problems, and northern islands problem with Russia, proliferation of nuclear power in North Korea, and others. In the North-East Asia, nationalism and antagonism started and are increasing in each month.

Seventh and the last new situation is the start and swift development of the Trans-Regional networks. For example, China and Taiwan FTA started in 2010. The Trans Pacific Partnership, Japan-China-Korea FTA, and the US-EU FTA, all started in 2013, and Japanese Yen and Chinese Yuan direct exchange started in 2012.

All show the emerging Asian Power and BRICs Power and the declining the developed power. And these things need the reconsideration of Western Modern Age; The historical Power Shift is starting from West to East and from the developed power to the developing power, from the military to economy, and to knowledge: intelligence and technology. The developed countries are challenged by the developing power during these one-two decades.

The problem is the new type of the globalization in early 21<sup>st</sup> century. New Globalization attacks developed countries.

Characteristics of Globalization after 21<sup>st</sup> century are following two.

First is the long range instability and soft declining of the Developed countries: like the US, the EU and Japan.

Second are the emerging largest developing countries; like China, India, Brazil, and Russia, so called the BRICs countries.

Why these things occur? That is the “Globalization and Competitiveness”: What is the competitiveness in the 21<sup>st</sup> century?

Those are “1) Cheap labor, 2) cheap goods, and 3) the huge population, that is, the huge market”.

These were, the “symbol of poverty” in the 20<sup>th</sup> century. But they are “competitiveness” in 21<sup>st</sup> century, by using knowledge and technology.

US, EU, Japan are challenged by Emerging Power (BRICs).

They are challenged by “Competitiveness” of New Comers.

## 2. Angus Maddison's World statistics. (From 1 AD to 2030.) (table1)

This table is the Angus Maddison statistics. Angus Maddison is the macro economist, macro statistician, born in the UK, and the Professor of Netherlands. He calculated GDP of each country, from 1 AD to 2030 and showed interesting effects. That is the table of the Angus Maddison.<sup>1</sup>

He showed the historical Power Shift from Europe to Asia. He wrote: until 2030, GDP of Asia will become more than 50 percent. This effect is already showed by IMF and World Bank and other statistics during these days, but he calculated that before 2007 for the first time.

Further-more, he calculated more important thing. Two hundred years ago, that is, in 1820, Asian GDP had accounted more than 50 percent! by Angus Maddison. That is why he started to calculate from middle ages and ancient ages, as well, and he reached the same calculation. The Asia is calculated almost 50% during each age.

200 years ago, the U.S. was only 1.9%, almost nothing! He calculated as well.<sup>2</sup>

That is why he concluded that the Economic development in Asia is not miracle. It is returning to the past!

What happened during these 200 years? That is modernization, war and colonization, and the de-

velopment of the technology. Wealthy Asia was colonized and could not develop well during the Modernization age.

But “the Modernization of Western monopoly era” is slowly ending. After the Post Cold War “Historical Asia” is rising again “by the global competitiveness”. It is not miracle. They are the historical power.

**Table 1. Angus Maddison Statistics of World GDP, 1820-2030**

	(% including the USA (*USA))					
year	1820	1870	1950	1973	2003	2030
Western Europe	23.0	33.1	26.2	25.6	19.2	13.0
Western offshoots*	1.9	10.0	30.7	25.3	23.7	19.8
Asia(incl. Japan) ★	59.4	38.3	18.6	24.1	40.5	53.3
Eastern Europe	3.6	4.5	3.5	3.4	1.9	1.3
Former USSR	5.4	7.5	9.6	9.4	3.8	3.4
Latin America	2.1	2.5	7.8	8.7	7.7	6.3
Africa	4.5	4.1	3.8	3.4	3.2	3.0

### 3. Economic Development in Asia

#### 3-I. Rising China, Rising India, All Asian countries are developing: showing by statistics

In this chapter I would like to show some statistics by the World Bank and Ministry of Economy, Trade and Industry (METI) in Japan, during this decade and near future.

First is the World GDP in 2010-2012 by World Bank (table 2).

It shows the National level GDP and it is well known that 2010 was the turning point. The US is the first, and China became the second. Japan became the third. China surpassed Japan in that year in 2010.

But in the Regional level, it shows another result. The EU is the first, surpassing the USA after 2004 until 2013, it means after enlargement of the EU, from 15 to 25-28 countries until now, the EU is the top of the world, in the regional level.

★ And furthermore, more amazingly, if we calculate the statistics of 2012, ONLY the sum of Japan, China and Korea, three countries, it is almost the same as the US GDP! If we collaborate with antagonized three neighbors, we are the same economic power of the US! And the GDP of ASEAN +3(China, Korea and Japan) is surpassing the USA and the EU already, and the ASEAN+6(Japan, China, Korea, India, Australia, and New Zealand) is the Top of the World!! Need not collaborate all Asia.

No one calculated about that, but not all of Asia, but only North East Asia will be surpassing the USA and the EU!

Of course, the problem is the following: ASIA is not organized under three pole system, that is the US, EU, Asia, and there are strong antagonism each other until now and even strengthening the antagonism.

But, de facto, Asian Regionalism is already working economically.

Inter-regional Trade in Asia is already 60%, calculated by Hitomi Iizaka group. EU Inter-regional



Trade is 65%, almost the same.<sup>3</sup>

**Table 2. World GDP in 2010 IMF in 2012**

	2010	2012	Regional Level
(World Bank)	(billion dollars)		
World	62,909	Sum of Asian Region (by author)	
The EU	16,282	16,584* <ASEAN+6(RCEP)	21,185
1 The US	14,582	15,685* <ASEAN+3(CJK)	17,648
2 China	5,879	8,227* +JCK	15,321, JC14,191*
3 Japan	5,498	5,964* JCKFTA=theUSA	
4 Germany	3,310	3,401*	
5 France	2,560	2,609	
6 The UK	2,246	2,440	
7 Brazil	2,088	2,396	
8 Italy	2,051	Russia	2,022
9 India	1,729	Italy	2,014
10 Canada	1,574	India	1,825
11 Russia	1,480	= ASEAN 10	1,480(2010) 2,327(2012)
15 Korea	1,043	1,130	

### 3-II. Economic Development in Asia—Statistics by METI in Japan in 2014.<sup>4</sup>

Here I would like to show the economic development of Asia by the statistics of METI in Japan.

#### 1) Economic Growth after the Lehman Shock (in 2008-2009)

The Economic growth after the Lehman Shock in 2008-2009, the U.S., Europe, and Japan are negative growth, suffering uniformly and significantly. See table3. But in the same period, •BRICs countries are highly positive growth like 7-10 percent. Emerging Asia is not affected by the financial crisis, rather developing, showing by statistics. I can not show the statistics, because of limitation of words. All are by METI statistics

#### 2) Savings Rate Growth: (table4)

The saving rate in Asia is more amazing ratio. Significant savings rate in China, India and ASEAN countries.

In the household economy, saving ratio is almost 25% in China and India. Japanese saving ratio, which was said that it was very high comparing other countries in the world, only 3.3% in saving ratio, along with the United States in 2010.

The saving rate in the national GDP level, they are more amazing. Chinese and Indian saving rate in national GDP level are 40-50%. In these two countries, almost half of the GDP is saving! And not only in these two big countries, but also in other ASEAN countries, saving rate in the national GDP level is 30-40 %. These are important statistics.

#### 3) Economic Potentiality in Asia: “Middle class” development in Asia

High saving rate shows another side. In 1990, only 100 million “middle class” was there in Asia. But in 2008, almost 880 million “middle class” population is glowing in Asia, and in 2010 1 billion. (Table5)

This means more population of middle class are growing already as “consumers” in Asia, more

than sum total of the US, EU and Japan.

Of course the Middle Class in this statistics is from more than 5001-35000 in the disposal income, so until now they are almost lower level in developed countries, but in Asian Development bank shows during 10 years from this ratio, 10 % becomes high income earner in the world.

It means that Asia is already the “huge consumer market”, not only productive market, until 2020. (Table6)

So, what is the problem in Asia? :Division of Economy and Security

Everyone knows that the Economy and Security is strictly divided in Asia.

In the European Union, the economy and security are almost unified (Euro Atlantic Cooperation EU/NATO) (table 4) After the Cold War, Germany unified and “One Europe” started after in 1990.

But, In Asia, it is said, “the Cold War does not finish yet”, rather strengthening.

First is the Asian Region is not organized, and second is the antagonism is even strengthened in this decade on the territorial questions---Senkaku, Takeshima, and North islands of Russia. Japan has troubles on territorial issue, with all three neighbors like China, Korea, and Russia. It is harmful for economic collaboration and development of the regional cooperation.

Furthermore, East Asia is suffering the instability and proliferation of Nuclear Weapon in North Korea, and militarization in China threatening in borders.

#### **4. “Multi-layered and Trans Regional Cooperation” in Asia (showing the maps, comparing the EU)**

However, even though, multi-layered and trans-regional cooperation’s are already working in Asia. (Table7)

##### **1) Multi-layered organization in Asia**

More than twelve cooperation organizations are working in Asia, like the map. (See the book, Kumiko Haba, *Asian Regional Integration in the Global Era, The Relation among Japan, the USA, and China and the TPP*,) — Iwanami, 2012.<sup>5</sup>

BUT, it is very important character in Asia. Asian “proper” organizations are only three! ASEAN, ASEAN +3(China, Japan and Korea), and SAARC (South Asian Association for Regional Cooperation).

The US already joined to five Asian organizations /6, with TPP. Those are; APEC, ARF, 6 Party Talks, ASEAN+10, ASEAN +8 /and TPP. Most of them are done in the 21<sup>st</sup> century.

The EU joined in three: ASEM, ARF, ASEAN +10.

Various important organizations like Six Party Talks (Security for North Korean Nuclear weapon), and huge Mega- Region: Shanghai Cooperative Organization (SCO) (Military), and SAARC are working.

So enormously diverse and soft Regional Cooperation are working in Asia, more than 12 organizations, US joins 6, EU joins 3, and Russia joins 8! (MAP 1) They are “Multi-layered and Trans regional cooperation

European Regional Integration is so much institutionalized and rigid organization. (See Map 2)

It is well organized, an functional institutionalization is working toward inside of Europe, like Free Trade Agreement, Schengen zone, Euro zone others. (Map 3)

But Asian Regional Cooperation is beyond Asia; Trans-Regional Cooperation working there; East Asian Summit (EAS), APEC, ASEM.(Map 4).

## 2) Asian Regional Cooperation makes “Donutization”

So it can be said that Asian Regional Cooperation makes “Donutization”, which Kumiko Haba termed. Inside is hole or weak, only three organizations are working but weak, and antagonism inside, and rather widening toward outside like APEC, TPP and EAS. American initiative is so much strong, and the EU and Russia also wish to join and make many world wide –regional organization.

It is understandable, because Asian economy is so strong, that all Great Powers wish to join, because they are declining in the long run.

On the other hand, Asian core must have strengthened, because it doesn't work without Asian proper organization; strong core and collaboration with the USA and the EU will be needed.

## 5. Conclusion and Proposal: How we could reorganize Asia under the crisis?

### (1)Economic core

So how could we reorganize Asia under the crisis?

First is that we need to strengthen the Economic core.

Strengthening the economic core in Asia will be very important.

Obama Government Policy is “We are the member of Asia-Pacific”. The USA is not against Asian Regionalism, but it wishes to join and wish to solve the US difficult situation for Employment of two million people, export doubling plan.

For the United States, the US-EU FTA: Strengthening the Western alliance is also very important.

The Power Balance is changing, and reorganization of new power balance will be needed by peace, prosperity and development.

### (2)Security

- 1) Trans Regional Security Organization will be needed, like Six Party Talks, and ARF, like OSCE in Europe.
- 2) Soft Collaboration of North-East Asian alliance will be very important.  
Introduce the EU experience to Asia: like FTA of countries and regions, Peace-making, Regional Cooperation knowledge might be helpful.
- 3) Nontraditional security in Asia----- against disaster, non-proliferation of nuclear radiation, energy efficiency: they can perform by learning from the EU.
- 4) Democratization in China need not hurry: democracy brings instability in heterogeneous society, as Michael Mann wrote (2004)<sup>6</sup>, so it needs to introduce softly and slowly. The democratization of nations will be decided inside nations, not outside.
- 5) Mutual respect, confidence building in ASIA is very much needed.

### (3) Soft Power, and Think Tank

Strengthening of Think tanks, Soft Power, and the Young Students Exchanges are urgent demand in Asia.

The US and the EU have powerful think tanks. We took lessons from the US and the EU think tanks. Learn from the EU/ EC, European Parliament, Council, and European University Institute, making up such worldwide elites groups is very important and urgent task. Because in 21<sup>st</sup> century, expertise will be needed, seeing from the Nuclear power accidents, environment policy and other issues.

### (4) Reconciliation with enemy

Learning from Franco-German Reconciliation, Japan-China-Korean Reconciliation will be urgent task. Young Students exchange and making co-university collaboration brings the “Asian Identity” in the future.

The 21<sup>st</sup> century is the Three Pole age and Emerging Asian age.

Asia will be the Top of the world in near future.

We have to change the “Donut” situation. Strengthening the Asian Regional Collaboration, Reconciliation and Mutual Respect leaning from the EU will be very much needed.

Win-Win policy guarantees the stability and prosperity.

Asia can save the world crisis! It is not my words, but the title of Asian Financial Journal. I think that Asia really can save the world if we collaborate together economically, and making bridge to the US and the EU, and to develop the think-tank networks learning from the EU and the US.

### Notes

<sup>1</sup> Angus Maddison, *Contours of the World Economy 1-2030 AD: Essays in Macro-Economic History* (Dec 5, 2007)

<sup>2</sup> See table: Western offshoots is the United States. It is almost 1, 9% in 1820.

<sup>3</sup> Iizaka Hitomi, K.C. Fung, Alan Sui, “FDI and Intra-East Asian Trade: Are there source country differences?” Hong Kong-Taipei-Tokyo Trade Conference, City University of Hong Kong, 2011 May.

<sup>4</sup> METI statistics, in 2010.

<sup>5</sup> Kumiko Haba, *Asian Regional Cooperation in the Global Era, Relation among Japan, the USA and China and the TPP*, Iwanami Publisher, Tokyo, 2012.

<sup>6</sup> Michael Mann, *The Dark side of Democracy Explaining Ethnic Cleansing*, Cambridge University Press, 2004.

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## EURO Crisis and Asia Pacific

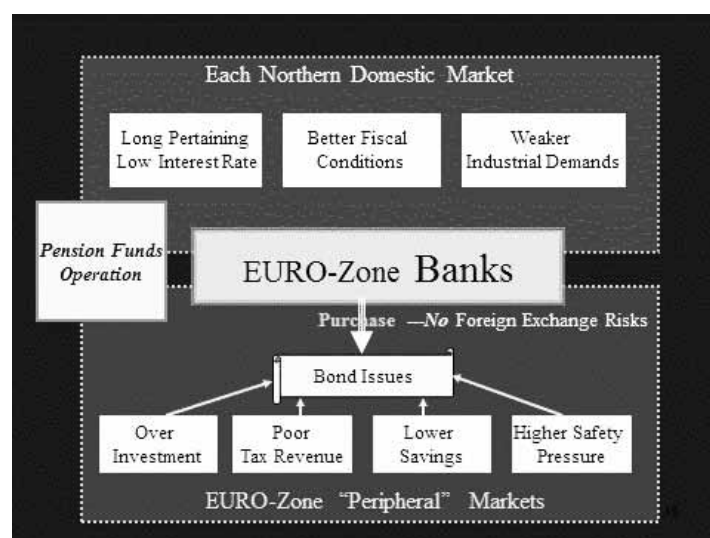
Hiroshi Watanabe

### Assessment

Almost every ten years, global financial markets experienced the so-called “shock” in any sense. There are “Black Monday”, “Asian and LTCM Crisis” and Sub-prime issues and following Lehman Brothers’ collapse and Greek incident. The duration and damage of each incident becomes longer and larger respectively.

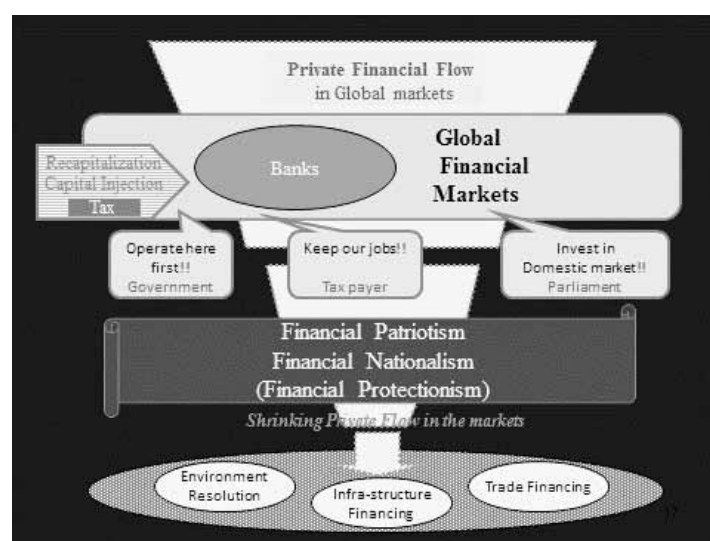
Past Financial Crises		Length (Quarters)	Size (Quarter Equivalents)
Black Monday	(1987)	1	4
Junk Bond	(1989-90)	6	6.5
Mexico	(1994-95)	4	5
Asia, LTCM, Russia	(1997-99)	2	1
Dotcom, Enron	(2000-01)	7	4
Sub-prime	(2007- )	10?	10?
(Economist 2008)			
Greek=EURO Incident	(2010- )	16?	20?

Especially, current difficulty starting in 2006 continues and deepens. Recovery from Lehman shock seemed to be well carried, and the end of 2009 the markets players already believed that an aftermath of shock was nearly over. But at the beginning of 2010, the world found that there was a gigantic concealment of Greek fiscal deficit figures. This would lead to shake entire European market since Greece and other 16 countries in EU shared one single currency, EURO.



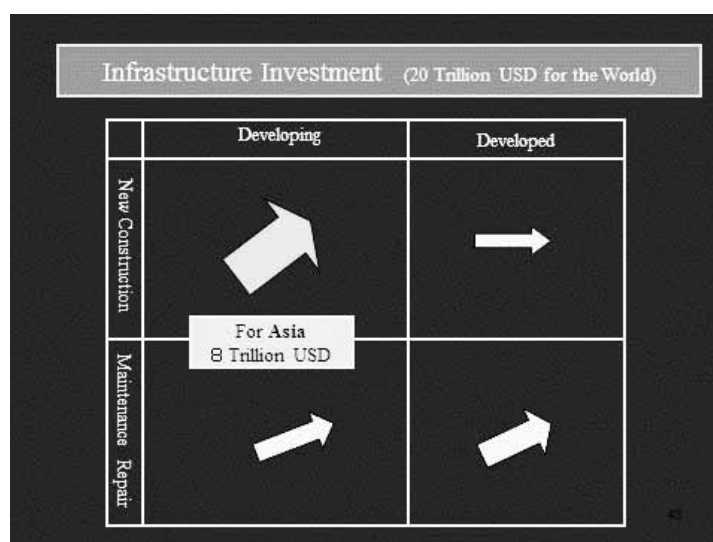
Even though European countries have made every effort to solve the Greek difficulty, the fear for contagion was firmly held among the market players and indices in the market have been significantly deteriorated. Luckily there was an agreement upon a package for rescuing Greece and some domestic policy actions in Portugal and Ireland have sustained two economies in 2012. Still there remain questions for Spain and Italy, but there is no urgent fear for the second dip in a near future. European Union and International Monetary Fund have prepared enough liquidity to cope with incidents, with the significant liquidity supports from non-European countries like Japan and China.

But such a fragile situation in European market brought a massive shrinking of European Banking system including their international businesses. As the confidence on the government bonds issued by peripheral countries was eroded a restructuring of debts and weakening of bond prices have put a heavy burden to the banks which have purchased huge amount of these government bonds. Right after Lehman shock, each government has an enough power to save these banks by capital injection. Even at that time, government, congress and taxpayers demanded that banks should work first in the domestic market since they were supported by tax revenue of each country. There was so-called "Financial Patriotism" sentiment which constrained the international or foreign businesses of these banks.



Now the situation is getting worse. As many governments have faced the severe fiscal tightness, they lost power to save the banking system. The joint effort with neighbors or counterparty on the other side of ocean is inevitable. Still an anxiety held by banking institutions got deepened, and they rushed to get cash and tried to avoid the long-term financing necessary to maintain the adequate level of investments for the production and infra-structure, not only in Europe but throughout the entire global markets. Especially this cautious attitude of European banking institutions resulted in the big shortage of financing to projects in the emerging and developing economies, including Asia.

During the good days like 2005 and 2006, around 15% or 20% of the financing need for Asian projects were carried by European banks (mainly, continental European banks). But since 2010, the presence of European banking institutions in the international finance syndication has drastically dropped down. Then it has led to the slow pace of implementation of these projects in Asia as well as those in other corners of the globe. For example, US\$ 8billion is expected to sustain the infra-structure projects in Asia in a coming decade. Even Asia itself has a big amount of saving in general, but a long-term lending is not fully supplied within the region. They must utilize the expertise of the global operating banks. Thus, shrinking of the European banks' operation in Asia gave the negative impact on the healthy development of this emerging region.



In addition to the financial negative impact, there is a sharp decline of the import demands for the goods which Asian countries have sold to Europe for the last two decades. This causes the slowdown of world trade and curves the pace of industrial activities in Asia. (In this paper, I will discuss mainly on the financial aspects and will not touch upon industrial and production field.)

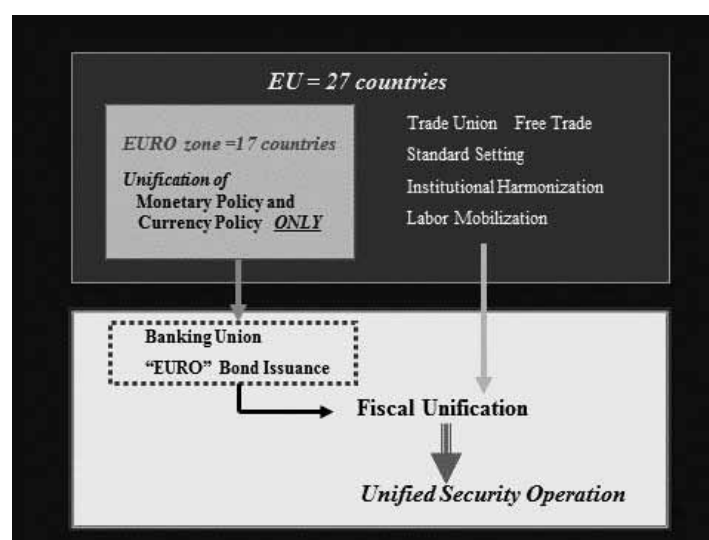
## [Prescriptions and Measures]

### \* EURO Maintenance

With the good understanding of “Austerity”, European countries have launched the joint operation for restoring the sovereign fiscal soundness and sustain the adequate level of financial operation in the region. As the peripheral countries have faced the difficulties, the Core member countries' support led by Franco-German ally is critical. Due to the cautious action toward the decision in democratic process, rescue actions were rather delayed and slow. But so far we appreciated the firm commitment and

implementation by EURO currency member countries to sustain the current regime. But in the long-run, member countries should seriously discuss the future plan of EURO. Up to now, there were only the unifications of monetary policy and foreign exchange policy. Final decision of the fiscal side and resource allocation is now carried by each sovereign decision. This discrepancy puts constraints on the path to the real integration of member countries' economies.

They have already started the discussion on the possibility of fiscal unification. As the first step, they discussed two important issues: Forming of Banking Union and Issues of "EURO bonds". Standardization of supervision and monitoring system of financial service agency is necessary to obtain the confidence of the players in the financial and monetary markets. Also joint debt management operation gives some relief to the purchaser of sovereign bonds markets. The differences based upon the historical background are never easy to modify and questions of the fare burden sharing require the good rationale and convincing persuasion.



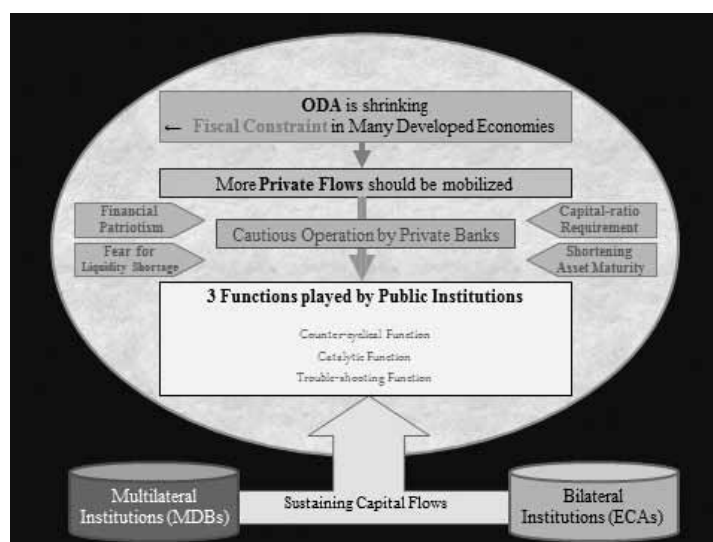
When they discussed on the fiscal unification, they also consider the impact on the future strategy of joint actions for regional security. In this course of discussion of the fiscal unification and the regional security, United Kingdom should join the process.

Non-regional countries shall make a significant support to these efforts by European countries to keep the EURO currency system. But the big share of the wealth in the world is still held by the European people and they are still richest in the world. They have to solve their problems with their own assets. However ironically the people are rich but government is poor. In order to solve the fiscal deficit of each country, there will be a big shift of wealth from private sector to public sector by increasing taxes, commission and premiums. Under the democratic regime it must take long time even though payment obligation comes on the prefixed schedule. They have always to keep appropriate amount of liquidity. In this regard, some non-regional countries which have enough size of liquidity would extend the lending-offer. With a catalytic function of IMF, Japan, China and oil-exporting countries have agreed to provide the short-term liquidity to prepare the payments in Europe.



### \* Funding for Asia

How to keep the magnitude of financing channeled into developing and emerging economies are critical in order to mitigate the negative impact of shrinking in European banking operation in the international field. As far as private financing institutions have constraint for the time being, public institutions, whichever multilateral and bilateral, should play compensating roles. In Asia, Asian Development Bank, JBIC and other national public institutions have expanded their size of operation since 2008 by fully mobilizing their credit outstanding. This is a real counter-cyclical function.



Also we have to take measures to invite new regional players to participate the syndication to keep the size of fund provision. In the case of Australia and Japan, local banks which have less experience in international business would be invited and the public institutions would give some assurance measures like guarantees to secure their lending. In addition, many banks in ASEAN countries have a sound status, adequate capital ratio and big savings. They are not accustomed to the cross-border businesses, but they are now willing to expand their operation field and enter these area. We thus encourage these ASEAN banks to provide enough funding to regional projects. This is a catalytic function of public institutions.

When we promote a sound development in Asia, we must pay the attention to the liquidity condition in the region. Since the money is easy to fly between markets, excess liquidity in the other markets, especially in the markets in developed economies, may flood into Asian markets. It may result in pushing inflation or bringing asset bubble. International and interregional coordination are strongly urged.

(End)

## **Concluding Remarks**

**Ryosuke Amiya-Nakada (Tsuda College, EUSI)**

In place of conclusion in a formal sense, please allow me to state my personal impression of the conference. Frankly speaking, as the chair have used the word 'comprehensive' three or four times, the points discussed in this conference have been so wide-ranging that I cannot neatly summarise them.

I have been impressed by insightful presentations and comments by the participants. Throughout the conference, the common thread may be the fact that regional integration is a quite complex phenomenon, which requires a wider view and a deeper insight. For example, Professors Overbeek and Andreosso-O'Callaghan have shown that the so-called Euro 'Crisis' cannot be considered in isolation. Rather, It should be scrutinised in global and societal contexts. Professor Hwee, Dr. Okamoto and Professor Haba have illuminated the multifaceted nature of regional integration. Reflecting on the nature of this complex beast is our task as academics. It is a difficult endeavour, but also a quite challenging and stimulating research agenda.

The investigation on the EU and regional integration is of enormous importance in practical terms, too. As Professor Haba and Dr. Katsumata have suggested, ideational or discursive aspects of regional integration are important as a kind of infrastructure. In this regard, this conference is a testimony to the importance of establishing a meeting ground for participants from different countries with diverse perspectives. Complex phenomenon has to be shed lights from different angles.

We, the EUSI Tokyo, are finishing the first period of activities and applying for the next funding round. This conference has shown that we should continue to explore and exchange ideas for possible scenarios for regional integration, and for a better future of the world. On behalf of the EUSI Tokyo and the Tsuda College, I thank all the participants, especially speakers and chairs, for your engagement with this conference. I hope we can push this endeavour of academic exchange further, and we can meet and discuss on different occasions.

# **EUSI Tokyo International Conference**

EU Asia Japan Day

*“The EU at a Crossroads: The Eurozone Crisis under Globalisation”*

## **Day One (Guest Lecturers Limited)**

Date: Friday, 12th October, 2012

Venue: #T101,102, Tsuda Hall 1F

Sendagaya Campus, Tsuda College

## **Day Two (Plenary Session)**

Date: Saturday, 13th October, 2012

Venue: Tsuda Hall

Sendagaya Campus, Tsuda College

Hosted by EUSI in Tokyo

Day One (Guest Lecturers Limited)

Preconference Seminar

Special Lectures and Academic Meeting

Moderator: Chris Burgess, Tsuda College

Welcome Speech

Masako Iino, President, Tsuda College

Opening Remarks

Takamoto Sugisaki, EUSI in Tokyo / Tsuda College

Session 1:

*“Dynamics of Asia-Pacific Area”*

Chair: Chris Burgess, Tsuda College

Special Lectures

*“Recent Development of Economic Integration in Asia-Pacific”*

Fukunari Kimura

President, The Japan Society of International Economics / Keio University

*“Some Legal Issues in Korean Responses to Global FTA Trends”*

Park Deok-Young

Yonsei-SERI EU Centre, Yonsei University

Q & A

Session 2:

Academic Meeting *“EU Studies in Japan”*

Chair: Takamoto Sugisaki, EUSI in Tokyo / Tsuda College

*“EU Studies in Japan”*

Toshiro Tanaka

Governor, EUSI in Tokyo / Jean Monet Chair /

Emeritus Professor, Keio University

*“EUSI in Tokyo Activities”*

Hideki Hayashi

Secretary General, EUSI in Tokyo / Specially Appointed Fellow,  
Japan Center for Economic Research

Meeting for the Conference and Publication

by Takamoto Sugisaki, EUSI in Tokyo / Tsuda College

Day Two (Plenary Session)

*“The EU at a Crossroads: The Eurozone Crisis under Globalisation”*

Moderator: Takamoto Sugisaki, EUSI in Tokyo / Tsuda College

Welcome Speech

Masayuki Ike-uchi, Governor, EUSI in Tokyo / Tsuda College

Opening Address

Rudie Filon, Counsellor, Head of Press, Public and Cultural Affairs, Delegation of the European Union to Japan

Keynote Speech

Takamoto Sugisaki, EUSI in Tokyo / Tsuda College

Session 1:

*“Regional Integration under Stress”*

Chair: Marie-Bernadette Andreosso-O’Callaghan, University of Limerick

*“Australia-EU policy cooperation in the context of Asian engagement”*

Jiro Okamoto

Visiting Fellow, Centre for European Studies, Research School of Humanities & the Arts, College of Arts and Social Sciences, Australian National University

Q & A

Discussant: Daisuke Hayashi, Ph.D. candidate, Keio University

*“The Impact of the Euro-crisis on Regionalism in East Asia”*

Yeo Lay Hwee

Director, EU Centre in Singapore

Q & A

Discussant: Hiro Katsumata, Research Fellow, Waseda University Institute of Asia-Pacific Studies

<Lunch Time>

Session 2:

*“Financial and Social Dimension of the EU Today”*

Chair: Yeo Lay Hwee, Director, EU Centre in Singapore

*“The Eurozone Debt Crisis: Origins and Implications for the Future of the European Integration Project”*

Henk W. Overbeek

Professor of International Relations, Head of Department, Department of Political Science, VU University, Amsterdam

Q & A

Discussant: Hitoshi Suzuki, University of Niigata Prefecture

*“Asian Regional Integration and the Major Powers: The US, China, Japan and the EU”*

Kumiko Haba

Jean Monnet Chair / Aoyama Gakuin University

Q & A

Discussant: Ryosuke Amiya-Nakada, Tsuda College

<Break>

*“Euro Crisis Management and the Future of Regional Integration - The Case of Ireland”*

Marie-Bernadette Andreosso-O’Callaghan

Jean Monnet Professor of Economics / Euro-Asia Centre, Department of Economics, Kemmy Business School, University of Limerick

Q & A

Discussant: Mei Kudo, Researcher, EUSI in Tokyo / Research Fellow, Tsuda College Institute of International & Cultural Studies

Session 3:

Special Lecture

Chair: Park Deok-Young, Yonsei-SERI EU Centre, Yonsei University

*“Euro Crisis and Asia-Pacific”*

Hiroshi Watanabe

CEO, Japan Bank for International Cooperation (JBIC)

Closing Remarks

Ryosuke Amiya-Nakada, Tsuda College



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