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Working Paper

Economic Integration in East Asia and Europe: A Comparison

Duisburger Arbeitspapiere zur Ostasienwirtschaft, No. 68

Provided in cooperation with:
Universität Duisburg-Essen (UDE)

DUISBURGER ARBEITSPAPIERE ZUR OSTASIENWIRTSCHAFT

DUISBURG WORKING PAPERS ON EAST ASIAN ECONOMIC STUDIES

No. 68 / 2004

Economic Integration in East Asia and Europe - A Comparison -

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herausgegeben von / edited by

Carsten Herrmann-Pillath/Werner Pascha/Markus Taube

für / on behalf of

forthcoming in: Karl-Peter Schönfisch and Bernhard Seliger (eds..)
ASEAN plus three (China, Japan, Korea)
towards an economic union in East Asia?,
Seoul: Hanns Seidel Stiftung.

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Abstract

Different starting conditions and decision-making mechanisms of European and East Asian economic integration are identified. They have led to different paths of integration. The EU process had a major impact on political stability in Europe; it has increased economic stability, at the expense of dynamism and possible over-extension, though. East Asia still has rather liquid mechanisms. This allowed it to exploit its economic potentials flexibly, relying on open world markets. With new problems on the multilateral level, East Asia reacts with various moves, increasing intransparency. Both regions have in the past played out their respective advantages well. Both face limits now. The former paths cannot simply be extended, and doubts remain whether convincing regional strategies have already been found.

Unterschiedliche Startbedingungen und Entscheidungsmechanismen regionaler Integration in Europa und Ostasien werden identifiziert. Sie hatten unterschiedliche Pfade wirtschaftlicher Integration zur Folge. Der Prozess der europäischen Einigung hat maßgeblich die politische Stabilität gestärkt; auch die ökonomische Stabilität wurde befördert, auf Kosten allerdings von Dynamik und mit der Gefahr einer Überexpansion. Ostasien besitzt noch liquidere Mechanismen. Damit konnte es sein ökonomisches Potenzial unter der Rahmenbedingung offener Weltmärkte hervorragend entfalten. Angesichts neuer Probleme auf multilateraler Ebene reagiert Ostasien auf verschiedene Weise, erhöht aber die Intransparenz. Beide Regionen haben bisher ihre potenziellen Stärken gut nutzen können. Sie können ihre früheren Pfade aber nicht einfach verlängern. Es bleiben Zweifel, ob überzeugende regionale Strategien bereits gefunden sind.

Keywords

Regional economic integration, regional monitoring, East Asia, Europe

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The paper was presented in Seoul in November/December 2003 on several occasions. Stimulating remarks from commentators, support from the Hanns-Seidel-Foundation and editorial assistance from Roman Bartnik are gratefully acknowledged.

East Asia and Europe – comparing "apples and pears"?

There are two good reasons why to compare East Asian and European economic integration, despite their remarkable differences in starting conditions, historical paths, and present challenges. The first is that multilateral integration and regional integration in various world regions are intricately interrelated. To understand why East Asia has recently shown a great deal of interest in introducing free trade areas (FTAs) or even closer forms of regional integration, it is necessary to understand recent trends in the multilateral field, the progress of WTO negotiations in particular, and in other regions like the Americas and, indeed, Europe. (From this perspective, we should not be too concerned about which countries to include when we speak of "Europe" and "East Asia". We are interested in rather dense networks of economic, business and political interaction, so "East Asia" encompasses North East and Southeast Asia, for instance).

A second point is that East Asia may be able to learn something from European economic integration – both in a positive and in a negative sense. Either East Asian countries may find suitable solutions and approaches, or they may realise what to avoid. In this context, it is important not to superficially hypothesize that "more" integration is necessarily "better". There may actually be too much integration, a wrong type, or a dangerous trajectory, implying significant opportunity costs. We should therefore first have a look at the economics of integration.

2. Some theoretical considerations

It is easy enough to draw a multitude of distinctions between integration processes in East Asia and Europe – or in other regions. However, which differences are meaningful, which consequences do they have, and what does this imply for the future?

As for the forces behind integration, it can

- either happen spontaneously as *market integration*,
- take the form of *functional integration*, i.e. the tearing down of barriers making possible further market integration (Sannwald and Stohler 1961),

- or consist of an *institutional integration*, involving the set-up of mechanisms and organisations to support and take care of different kinds of integration.

Market integration is the most uncontroversial type to deal with, because the positive welfare effects are usually quite straightforward. As all parties engage in free exchange (to the extent they are allowed to), they will do so as long as they hope to gain. All actors involved can play out their competitive advantages.

One issue is how to measure the degree of market "integration. " Just pointing to an increase in trade volume may not be very meaningful, because the export and import propensities of trading parties may change as well as their sizes and because world trade in general may rise (or fall) due to a shift in transaction cost or other changes. Frequently, measuring the size of absolute interaction is distinguished from relative and even double-relative indices of integration, the latter relating actual trade figures to all trends mentioned above.

Looking at such figures (e.g. Pascha 1995), it is interesting to note that compared to Europe, Pacific-Asia's double-relative trade intensity was very low in early post-war years. Pre-war connections had been cut, and the development up to the 1990s can be read as a catching-up process to reach an economic exchange commensurate with geographic proximity. In this regard, intensifying relations in East Asia were not miraculous, but just a return to normality (Pascha 1995).

Of course, it is difficult to interpret these developments separately from functional integration through multilateral trade rounds (GATT) and unilateral trade policy shifts (reorientation from inward-looking or import-substituting policy regimes).

We therefore turn to functional and institutional integration now. Both can be bedevilled by two critical points in particular:

- Is the *level* adequate? Do schemes make sense on the level of unilateral action, bilateralism, pluralism/regionalism, or multilateralism?
- Are the economic benefits of an enhanced integration (over-) compensated by *government failure*?

Functional integration is usually considered less problematic for two reasons pertaining to government failure. First, it does not involve continuous government action, which reduces the possibility of repeated government failure through vested interests, misuse of policy discretion for temporary gains, etc. Second, it does not prescribe a certain action, but leaves choices within certain boundaries; this should increase the possibility of mutually beneficial interchange. Still, functional integration has a serious “level” issue, namely the well-known problem of trade creation vs. trade diversion.

Conversely, institutional integration involves the strong possibility of government failure, and one also has to make sure to find the adequate level: Does action make sense on a regional level, or would the global, multilateral level be more appropriate?

To give answers to such questions, we must consider why government action, i.e. supplying a public or collective good, is sensible in the first place. There are four major legitimising arguments (Vaubel 1986 on the former three):

- International/regional economies of scale for providing a (public) good,
- International/regional externalities,
- International/regional cooperation failures,
- Non-economic goals like external security.

While this may sound rather abstract, we can exemplify it with respect to trade liberalisation. For two given countries, it may offer either of them few advantages, possibly even disadvantages, to liberalise unilaterally, while the other country stays protectionist. If both remain protectionist because of this “game” structure, they will both face significant disadvantages and forego important benefits from liberalisation. This is a prisoners´ dilemma situation (Krugman and Obstfeld 2003, pp. 235-237) that can be overcome through cooperation. A binding agreement would be preferable to keep either party from cheating, i.e. profiting from the other’s opening while keeping its own economy somewhat protected through intransparent non-tariff barriers or else.

3. Historical foundations of economic integration in East Asia and Europe

Looking at the history of integration schemes – beyond market integration – in East Asia and Europe, a striking and well-described difference emerges. A core of six European countries has come together in the so-called “European Economic Community” (EEC) already in the

1950s (Treaty of Rome 1957), later referred to as the European Community (EC), finally leading to the EU of the 15 as of today, the 25 as of 2004, or the 27, probably including Bulgaria and Romania, of 2007. It developed from functional integration, a customs union with some important aspects of institutional integration, as in agriculture, to a deeper and wider integration scheme. An important step was the Common Market project of 1992, and combining the real economy EU with a monetary union in the form of the common currency Euro (not to forget the somewhat ill-fated earlier European Monetary System (EMS)). The “institutionalisation of integration” has meanwhile reached the level of drafting a constitution contract that might, if passed, state the supremacy of EU over national law.

There were other moves towards regional club building attempts in Europe. Examples are the now defunct Comecon group of Central and Eastern European communist countries, the earlier EFTA European Free Trade Association of independent, smaller European countries, or the more recent European Economic Area (EEA) of smaller EFTA countries with the EU. Still, they all more or less reflected and reacted to the EEC-EC-EU process and can be treated in passing here (see, for instance, Pelkmans 1997, chapter 18).

In East Asia by contrast, it has taken much longer to develop noteworthy beyond-market integration (for a helpful survey of issues, see Fischer 2003 or, more encompassing, Kwon 2002). The 1967 ASEAN (Association of Southeast Asian Nations), later enlarged, tried an institutional integration despite some inner conflicts, and an attempt at functional integration, the Asian Free Trade Area (AFTA), is still not fully realised, particularly with respect to the more painful obligations. Attempts such as the PBEC (Pacific Basin Economic Council) were rather loose, and the 1989 APEC (Asia-Pacific Economic Cooperation) is inter-regional, covering almost the whole Pacific Basin including the US. Its liberalisation attempts under the slogan of “open regionalism” and “concerted unilateralism” have remained a partial success at best, its organisational structure weak, mainly consisting of committee work (Pascha and Goydke 2000). There are few binding agreements; the decision-making style is consensual.

Different types of integration (market-based in East Asia, functional and institutional in Europe) and dominant decision-making mechanisms have led to other differences as well, for instance concerning the prime movers of integration (table 1).

Table 1: East Asian and European integration

	East Asia	Europe
Integration Type	Market integration dominant	Functional and institutional integration
Rules	Flexible, consensus	Binding agreements
Moves	MNEs	National politicians, EU bureaucrats
Government role	Facilitator	Leader
Members	DCs, NICs, LDCs, LLDCs	DCs as core, NICs and LDCs recently
Trade	World market, intra-trade growing	Intra-regional
Investment	Production network growing	Dense links
Monetary Integration	Still weak	Tight (Euro)

Why do we find such striking differences? In Western Europe, the established countries with a long tradition of inter-state treaty systems at least going back to the Westphalian Peace of 1648 hoped to avoid a reoccurrence of war and fascism by all means, leading to a dense treaty network with strong obligations. The content was economic, but the spirit political. This aim could not be achieved without binding commitments.

In Asia, on the other hand, all countries in the early post-war period were more tied to the US than among each other. Deep mutual mistrust let to rather weak interaction. This is in line with expectations from the realist school of international relations (Chan 2001): It expects that states mistrusting each other will prefer non-binding agreements, not putting all “eggs in one basket”. This also helps to explain the multitude of such weak, overlapping cooperation schemes in East Asia.

Moreover, the heterogeneity of states is more pronounced in East Asia than in Europe. While the 2004 EU enlargement somewhat changes matters, earlier EU members are closer together in terms of GDP per capita level than East Asia, the latter ranging from rich Japan to LLDCs like Burma and Papua New Guinea. In addition, at least the leading European countries – Germany, France, Great Britain, and Italy - are rather similar in economic strength, thus neutralizing each other somewhat. Again, from the perspective of the realist school (Chan 2001) one might expect that the more asymmetric the distribution of assets and power (East Asia), the less inclined such countries would be to commit themselves with little leeway to defend their sovereign rights.

Another, more economic factor is that intra-regional trade in Western Europe was – and still is – bigger than in East Asia (table 2). This raised the prospect for trade creation effects in a regional scheme for Europe, while East Asia with its high exposure to the world market naturally expected much more from multilateral liberalisation.

Table 2: Exports of EU and East Asia to major economic regions

Export shares of East Asia in %	**1980**	**2000**
East Asia (Intra-regional)	33.4	42.4
US	21.1	23.7
EU	13.4	15.2
Rest of the World	32.1	18.6

Export shares of EU in %	**1960**	**1980**	**2000**
EU (Intra-regional)	47.4	61.0	62.1
US	7.5	5.4	9.3
Asia	6.5	4.0	7.3
Rest of the World	38.6	29.6	21.3

Source: Barrell and Choy (2003), p.5, p.12, based on Direction of Trade Statistics, IMF.

In table 3, the realist regime of East Asia is juxtaposed with the "liberalist" European integration path based on binding commitments. Given the explanatory power of the mentioned factors, it seems unnecessary to refer to an "Asian way" to explain the different origin and contract style in European and East Asian integration schemes. Such references rather resemble aspects of "symbolic politics" to defend the fairly weak mechanisms in place to overcome possible prisoners´ dilemma situations.

Table 3: Liberal and Realist Positions on Regional Integration

Liberalism	**Realism**
Pursue Binding, Long-term Agreements	Seek Flexible, Short-term Agreements
Focus on a Few Homogeneous Partners	Diversify among Many Heterogeneous Partners
Foster Cross-Linkages among Issues	Avoid Cross-Linkages among Issues
Maximize Absolute Gain	Attend to Relative Gain

Source: Chan (2001), p. 15.

Is there something to learn for East Asia, despite the different regimes both regions have been operating in? If countries truly want deeper integration, binding commitments can hardly be avoided. Large groups of countries will find it very difficult to make such a choice, though. The European experience suggests that it is more promising to start with a small number of countries and that an early success story is needed to motivate reluctant partner to move on.

4. Recent developments in the trade arena

In recent years, the stumbling new WTO trade round has put Asia in an awkward situation. North East Asia was, peculiar among the developed world, not endowed with traditional regional trading schemes such as free trade areas or customs unions. Yet, another disturbing factor is the tendency of the US to substitute multilateral trade liberalisation by bilateral agreements. From the US point of view, this practice allows it to avoid the, to some extent, unwelcome WTO rules and mechanisms of conflict settlement; furthermore it gives the US a chance to bargain for additional rights in agreements with much weaker partners of the Southern Hemisphere.

In order not to be left out in the cold, North East Asia has also started work on bilateral free trade agreements (for the more encompassing context: Park 2002, Seliger 2002). This process is complicated by at least three factors. First, a detectable competition between Japan and upcoming China to consolidate their spheres of influence has led to hasty moves, possibly well beyond what economic logic would suggest. Second, the question of how to treat lagging, weak sectors that may suffer from across-the-board free trade has not been solved. Consequently, the FTAs considered frequently encompass many exceptions, making them a dubious instrument to achieve significant trade creation (while also putting their WTO conformity in question). Third, as customs unions seem out of question for the time being, because they would involve even more painful decisions, free trade agreements need to involve complicated rules-of-origin, raising fears of a "spaghetti bowl" of intransparent, cross-cutting FTAs that might lead to noticeable efficiency losses.

What does this imply for the old question of whether regional integration is a stumbling block or a building block for multilateral integration? Recent developments in East Asia suggest that the faults of the regional arrangements – particularly the lack of binding rules – may lead to very unwelcome paths once the multilateral process stumbles. A patchwork of bilateral agreements may be evolving that is at best third best, but may also lead to troublesome instabilities.

In Europe, the situation was rather different, regional integration always centred on the EU. Even for countries not wishing to join the union for whatever reasons, the European Economic Area gave an opportunity to realise most benefits of economic sphere membership. The Common Market Project did not turn Europe into a "Fortress", as many observers had feared. Arguably, some interested parties cultivated that fear as a bargain chip in the GATT Uruguay round and to make the EU a more sought-after partner in market-based activities. During the early 1990s, there is indeed a noticeable peak of incoming foreign, extra-regional investment in many member countries, including Germany.

In more recent years, the upcoming enlargement towards the East has taken up much of the EU´s energy. What characterised Germany with its emphasis on reunification may now, to some extent, happen to the EU as a whole. With their much more "Southern-type" comparative advantages, the East European economies will become an important "workbench" for the richer part of Europe, and trade diversion may be an issue not to be dealt with lightly. With

this regional consolidation progressing, it is difficult for the EU to keep up the same interest in multilateral progress, as there would be without the prospects of the European East.
Summing up, Europe is in a more comfortable situation than East Asia, as its high degree of intraregional trade isolates the EU from the rougher world trade climate. It is understandable that East Asia tries to follow European precedence under these circumstances. However, it should not be carried away to prepare an over-cooked "spaghetti bowl" of efficiency-impeding, criss-crossing regional trade agreements.

5. Deepened economic integration beyond trade

Both regions, in due time, took greater interest in issues beyond trade policy, for instance in terms of lowering the transaction costs of trade (trade facilitation) or making it easier to undertake FDI (direct investment liberalisation and facilitation). That might involve not only goods markets but also important factor markets for labour, capital, energy and else.

The tariff rates are already quite small due to several successful multilateral trade rounds. Tariffs are not the most important trade impediment any more. If further progress in exploiting comparative advantage is to be achieved, more daunting issues affecting national sovereignty, have to be tackled.

Another reason for this is the trend of economic globalisation with shrinking communication and transaction costs as well as new, complex inter-organisational structures of multinational enterprises. To make use of these potential gains, one would have to go beyond simple trade liberalisation, and a regional level for some issues did make sense, as geographical proximity offered some advantages (positive externalities) to utilise the new options.

Still, Europe and East Asia took rather different routes. In Europe, the existing policy-making channels took up deeper integration, giving more importance to the central bureaucracy (institutional integration), relying on binding agreements among members, the most important of which was the 1992 Common Market Project. One reason may have been simple path dependence, as the organisational devices such as the European Commission and the Council of

Ministers got more entrenched and structured the agenda as well as the decision-making processes.
Another factor is suggested by the neo-functional approach (Haas 1971): Interdependence among policy issues leads to an increasing demand for further institutional integration, and if such schemes have gained some reputation for reliability, it will be easier to supply new and deeper schemes. Moreover, different issues may offer more chances to strike bargains.

However, this comes at a cost, because the danger of governmental failure also rises. Politicians and bureaucrats realise ever-deeper institutional integration as a means to raise their power and influence. For instance, national politicians may be tempted to delegate "dirty work" such as agricultural subsidies to the European level, while Euro bureaucrats may be happy to take over additional work to increase their budgets and career opportunities (Vaubel 1986).

Such a public choice-view offers a helpful explanation of the frustration of many citizens with the European bureaucracy, creeping into every life sphere and spreading a thick blanket of stiffening regulation over the continent. "Euro sclerosis" (Herbert Giersch) is a well-used catchword of the 1980s.

At hindsight, though, one has to admit that the EU has somewhat improved its image. This holds when looking at recent competition supervision, for example. Moreover, the Commission has been praised by many economists for insisting that Germany and France should stick to the limit of an additional fiscal burden of 3 percent p.a. under the statutes of the European Stability and Growth Pact. One gets the impression that the European level has become an important force to help pushing reluctant member states towards painful structural reform. At the same time, costly, grossly inefficient policies like the Common Agricultural Policy stay in place.

How can this be explained? Pursuing a "self-interested dysfunctionality" on the European level comes at a certain cost for policy-makers, as the efficiency losses become ever more obvious to the citizens, finally undermining this mechanism. During the 1990s, the EU was shaken by a number of scandals, most prominently during the years of the Santer-led Commission. To repair their shaken image, it was a sensible approach for the EU authorities to

visibly follow at least some policies that could muster public approval, at the same time weakening national governments that try to keep the regional authorities at bay.
In East Asia, deepened integration was kept within the mechanisms of a “soft regionalism” (Robert Scalapino). Due to the eventual development of regional production networks, the necessity of such integration became ever more obvious, so we need some additional explanation of why mechanism similar to the neo-functional approach would not work in Asia to overcome possible prisoners´ dilemma situations.

Employing a realist perspective once again, it is understandable why countries living in rather asymmetric power structures would be hesitant to give up sovereign decision-making power in such sensitive issues. Deeper integration almost by definition covers policy fields with significant domestic sensibility, such as competition, exploitation of the sea given certain territorial claims, communication standards, media access through satellite systems, etc.

Moreover, it was always feared that deepened production networks, e.g. by Japanese enterprises, would be used to gain monopoly power in weaker factor and goods markets, supported by superior finance, ODA or else.

It is not surprising that there has been a vast number of projects and mechanisms in the area, for instance under the umbrella of APEC, but there is little effort to objectively measure what progress has actually been achieved already (Pascha 2003).

6. Coverage of countries

With respect to the economies covered by regional arrangements, there are noticeable differences between Europe and East Asia. European institutional integration has grown in almost concentric circles, with few setbacks so far.

In East Asia, there is a multitude of groupings, their respective boundaries criss-crossing the region. The most important arguably are the South-East Asian ASEAN and the trans-pacific APEC. Since the 1990s, there have been discussions of a Pacific-Asian grouping (encompassing both North East and South East Asia). While earlier calls for an East Asian Economic Caucus (or even Group; EAEC, EAEG) by Malaysia's Mahathir did not lead to concrete results, the Financial Crisis of 1997/98 led to new attempts. We understand ASEAN+3 as an outcome of these discussions.

It is doubtful whether the patchwork of organisations is anywhere close to being efficient. For instance, the membership of the US in APEC and in the Asian Development Bank (ADB) is largely based on its interest to make its influence felt in the region. Is there an economic rationale as well? It would be difficult to argue that an "optimal club" defined by common Asian interests, needs and externalities would have to encompass the USA. Without US membership, though, the question of intellectual and strategic leadership would have to be raised. For international organisations supplying a public good, there is always the issue of members hoping to take a free rider position. Which member would be willing and capable to take over an additional burden? So far, Japan has not made a particularly convincing job of supplying such able leadership in organisations like the ADB, even though it wields a lot of influence (Pascha 2002). Apart, it is an open question whether the rivalry between Japan and China can be a productive force – or whether it will rather be a destructive force – in such processes.

Yet another issue is whether East Asian organisations would want to compete with multilateral or arguably "Western-minded" organisations. When an AMF was proposed, such considerations reached a lot of prominence. While such competition may be considered fruitful as a search process for the best solutions to deliver international public goods, it may still lead to perverse results. If an AMF would compete with the IMF for regional "customers" to accept aid, recipient countries may choose the help with the easier conditions attached and not a "bitter medicine" with better long-term prospects. Reference to regional peer pressure rings somewhat hollow in this context. Such pressure may indeed work, if neighbours are influenced through externalities ("regional contagion") and thus deeply concerned about making their regional mechanism work. However, there may also be cases of regional collusion, in which neighbouring countries try to hide disturbing information.

In the European case, the process of "concentric growth" may seem smoother in retrospect than it indeed was; it actually encompassed some rather unstable periods. There was a dominant logic, however, namely the goal of the advanced member economies in Western Europe to enlarge their sphere of stability, and for the more peripheral newcomers to gain secure access to markets – and to transfer payments, in the case of poorer economies. This came at a price, because the stability hindered the refreshing wind of global challenge to blow though many laggard sectors.

The ultimate challenge has been to steer the enlargement process to include 10 more Central and Eastern European countries, most of them formally communist and more recently so-called transformation economies. The tendency for the EU to grow seems to have reached its apex. Possibly, there are already net diseconomies of scale – for two reasons: First, the necessity to finance structural and regional assistance seems almost beyond the means of even the richest Western EU economies. It is still open to what extent EU help will be enough to raise Eastern European income levels fast enough to avoid a huge outpour of labour to Western Europe once migration will be fully liberalised. Second, the decision-making mechanisms of the EU have to be revised significantly to be workable with 25 – or even more - member countries with vastly diverging interests and resources.

Whenever the EU circle gets larger, new boundaries and sources of potential instability are touched, anyway. In the EU´s case, the major open issues are Russia and Turkey. While Russia is so big and so different that it stretches the imagination to consider it ever joining the EU, it will be very important to find ways not to make it feel an outsider. As for Turkey, it is a poor and rather large neighbour in the Southeast of Europe. In some respect, relations with the EU are already close, for instance in terms of labour migration, but mainly for political reasons the task of integrating Turkey seems formidable. It may be just as dangerous to leave Turkey out of the EU as to let it join.

With respect to the necessity of reforming decision-making mechanisms, the EU has taken up the challenge to prepare a constitutional contract. There is a draft, prepared by an EU Convention under the chair of Valery Giscard d´Estaing. It may be said that the enlargement has made it more difficult to reform the EU, but the enlargement has at the same time proven beyond doubt the necessity of reform and may thus have even hastened the process to deliver a draft.

Currently, it is still too early to tell what its fate may be. While important issues seem to have been agreed upon, such as a considerable extension of majority voting, other key questions are still hotly debated. This holds for how to define "majority" (the "double majority recommended by the convention involves a majority of countries, representing three-fifth of the total population), and for the number of commissioners. The constitution will have to pass an inter-governmental conference, national parliaments, and even referenda in several member countries.

At the time of writing, the European Summit of Brussels of December 2003 has just taken place. It did not lead to the adoption of the draft and is generally considered a painful failure. Some countries (Spain, Poland), whose voting weights would be lower under the double majority rule than under the Treaty of Nice, found it impossible to agree. Other countries, namely the net contributors to the EU budget, have reasoned that the future budgets should be capped at one percent of GDP. This has been understood as a more or less open threat directed at Spain, currently the top beneficiary of EU funds, and at Poland, the largest economy of the new entrants and thus presumably the largest beneficiary in the future. While a lot of political manoeuvring is involved, these developments do show how the enlargement is linked to the critical importance of reforming decision-making processes.

There has been a debate on whether there should be clear clauses when to leave the EU. Intuitively, one would expect a better performance of a "club" if there were an exit clause. However, this raises moral hazard issues and can significantly strengthen the blackmailing power of individual countries (topical discussions of issues such as voting rights and exit clauses by German institutional economists can be found in Cassel and Welfens (eds.) 2003).

As for another point of recent interest, France and Germany have signalled ever-closer cooperation, possibly in order to pressure smaller countries not to overplay their bargaining position. This echoes tendencies that if an enlarged EU becomes inflexible, smaller clubs within the EU may move ahead. From an economic point of view, this seems sensible as long as it is not discriminatory to other EU members and as long as other members are allowed to join if they obey the rules of the sub-club. In an extreme case, a move towards various, possibly criss-crossing sub-clubs may undermine the stability of the EU. However, it may also develop into a flexible mechanism experimenting with innovative organisational schemes (after all, each individual country can be understood as a sub-club anyway that came into existence due to historical idiosyncrasies).

7. Monetary integration

Another topic that can only be shortly covered here is monetary integration. Europe is obviously much further down this road than East Asia.

Even in Europe with its background of real sector integration since the 1950s, it is still discussed whether it was ripe for a common currency in the late 1990s – and whether it is at the time of writing. In terms of the theoretical basis for an "optimum currency area", it is quite clear that the current EU (with Denmark and the UK not participating in the Euro scheme) is not such an area (Jochimsen 1998). Giving up the exchange rate adjustment mechanism only makes sense as long as there are enough other channels to react to asymmetric shocks and divergent conditions in various parts of the union (labour mobility, possibility of fiscal transfers, etc.). After several years of experience, it is still doubtful whether the EU has reached such conditions.

For instance, given sluggish German growth, the EU interest rate is too high to make Germany grow stronger. It cannot be lowered, though, because there is stronger growth and inflationary pressure in other, more dynamic European economies. Low German growth has led to significant unemployment, as the labour is not flexible enough to clear the labour market through real wage adjustment or labour mobility.

Another well-recognised problem is the Stability and Growth Pact. It is indeed an important addition to the Maastricht Treaty rules on monetary union, because without the pact, member countries could avoid the stringency of a tight monetary policy by ever more pronounced deficit spending. From a market-based point of view, even without a pact each government should be controlled by the financial markets: If it engages in too much deficit-spending, the interest rates on its bonds should rise and debt financing should become ever more costly. According to Maastricht, the European Central Bank (ECB) is not allowed to bail out a national government, so this market mechanism should be able to put strings on national politicians. However, one cannot but observe that the interest rates on the national debt of the different Euro economies show only minor differences. It can be inferred that financial markets do not expect the EU or the ECB to let a member country of the Euro scheme go bust. Hence, finan-

cial markets actually do not penalise irresponsible fiscal spending, and some mechanism like a stability pact is indeed necessary. Recent experience shows, though,
that it is very hard to make powerful member countries like Germany and France comply by the decided rules of the pact in times of economic trouble.

(It should be noted in passing, that without a monetary union, national governments are indeed forced by financial markets to consider their steps carefully. Irresponsible fiscal spending should soon have an impact on the interest rate and on the exchange rate, forcing the government to stop such an irresponsible policy).

Given the enlargement of the EU, more problems can be expected in the future, as all new members have a right (and an obligation) to join the Euro scheme once they meet the agreed conditions.

It was hoped that the pressure of the common currency would force member countries to make their (other) markets more flexible. However, this has not happened so far, and national governments have found it a convenient strategy to simply blame others (e.g.: the European Central Bank) for the emerging imbalances.

In Asia, attempts at monetary integration are significantly more limited so far. The financial crisis of 1997/98 was arguably a sea change for such ideas. Contingency effects of currency devaluation spread through the region. While Korea's exchange position was weak in 1996/97, one might venture to argue that its situation was not critical enough to have necessarily led to a full blown crisis – if not for the contagion effect from other devaluation crises (Indonesia, Thailand) in mid and autumn 1997.

Steps towards further integration have been rather slow – but noticeable -, after the ill-timed proposal to set up an AMF. The Cheng Mai Agreement to establish an enlarged swap agreement was a step in the direction of further integration, and so was the recent move towards a stronger East Asian bond market.

Stronger currency cooperation could at some stage take a similar course as the EMS, namely trying to stabilise currencies within certain corridors. Given the different trade, capital, asset and liability structures of East Asian countries, it will not be easy to find a suitable position between the US Dollar, the Japanese Yen, and – possibly – the Chinese Yuan. Moreover, it will be an issue whether with highly liquid international financial markets, such a scheme would truly be trustworthy in times of asymmetric shocks in one member currency.

The idea of a common currency is distant, as the characteristics of heterogeneous East Asia are even more removed from an optimal currency area than the EU. Apart, experiences of the EU are not necessarily only positive.

8. Towards regional peer monitoring mechanisms (ReMMs)?

There is another possible interpretation of recent (financial and monetary) developments in East Asia, though: namely, that it points towards the ultimate goal of a well-developed regional peer monitoring mechanism (ReMM). There has recently been a lot of interest in ReMMs in various world regions (e. g.: Williamson 2003). One reason is that the possibility of regional contagion seems to have increased. A further reason is that global monitoring seems clumsy, intransparent and faces concerns of legitimacy. Another factor are similarities in regional circumstances, giving regional partners more competence to evaluate neighbours than distant peers.

However, there are also problems to take into account. Firstly, given the concerns of our theoretical reasoning in chapter 2, is there really an additional role for ReMMs sandwiched between multilateral surveillance and the monitoring by free markets? Secondly, the possibility of contagion does not only offer an incentive for mutual monitoring, but also to behave collusively by legitimising each other’s policies. Drawing convincing institutional rules for such ReMMs is thus both critically important and far from easy.

The European Growth and Stability Pact can be understood as an early example of a ReMM. As happened so frequently, the EU is an early mover with respect to global trends, and other regions have ample reason to watch European developments carefully. As has been pointed out above, the rules governing the Pact are far from satisfactory. Firstly, one cannot trust them to work in times of stress, as has been recently proven with respect to France’s and Germany's fiscal deficits. They depend on the states actually enforcing them, and the very fact of regional interdependence – or dependence on the major EU powers of Germany and France, in this case – lowers the possibility of doing so. Rules that are more automatic may be well worth considering to improve the Pact. Secondly, rules and trigger points seem to be arbitrary to some extent. This holds for the famous "three-percent-rule" in particular. Such arbitrariness makes it more difficult to publicly legitimise tough reactions in times of stress. Thirdly, even the economics of the rules seem somewhat dubious. For instance, an unconditional three-percent-rule, irrespective of the situation in a business cycle and of the shares of cyclical and structural fiscal deficit, is difficult to defend with basic economic reasoning.

ReMMs in East Asia, based on ASEAN, ASEAN+3 or else, are still in a nuclear stage. We would hope that careful consideration is given to the question whether rules which seem workable in fair weather conditions, can also be expected to function in times of stress and crisis.

9. Some tentative conclusions

As could hardly be expected otherwise, differences between European and East Asian economic integration are manifold. It is interesting to note that the divergent starting conditions and decision-making mechanisms have led to rather different "landscapes" of integration mechanisms. On the background of NATO and the Helsinki Process, the EU integration has brought forward a deep trust in political stability. Another war among the former European archrivals, France, and Germany, drawing the rest of Europe yet once again into a nightmare of destruction, has become unthinkable. The EU has also developed considerable economic stability along its path, offering a high degree of intra-regional economic activity, at the expense of dynamism and possibly an eventual overreach of its capabilities.

East Asia still has rather liquid mechanisms. In an age of progress on a multilateral level, this offered the chance to exploit the options of cooperation flexibly, going hand in hand with relying on world markets. With progress of a new WTO round still dubious and the US turning unilateral and bilateral, East Asia reacts with an increasing intransparency of smaller moves on several levels.

Both regions have in the past successfully played out the respective advantages of their peculiar regional integration patterns. Both have now reached an end on this road. What might be the next step, overcoming the limits of the earlier paths and noting how difficult it has become to achieve progress on the multilateral stage?

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