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From Trade Led to Monetary-Led Regionalism

Why Asia in the 21st Century will be Different to Europe in the 20th Century

Richard Higgott*

* Director of the Centre for the Study of Globalisation and Regionalisation (CSGR) and Professor of International Politics, University of Warwick.

CSGR is a national thematic priority research centre of the UK Economic and Social Research Council (ESRC). He is the editor, *The Pacific Review*. His latest works are *Towards a Global Polity?* (co-ed) Routledge, 2002 and *Globalisation and the Middle East: Economy, Polity and Society,* (co-ed) The Royal Institute of International Affairs and Brookings, 2002. This paper arises out of a joint project with Dr Heribert Deiter of the SWP, Berlin. Thanks are offered for permission to use some of our joint work. The support of the ESRC in this research is also acknowledged.

Abstract

The financial crises of the late 1990s marked an intellectual watershed for the global economy, and also for regionalism as the Janus face of globalisation. At the beginning of the 21st century, the theory and practice of regional cooperation and integration may evolve along different lines to how it was understood for most of the second half of the 20th century. In East Asia, in particular, this will mean that the relationship between multilateralism and regionalism will change. The 'East Asian' region will become an increasingly important domain within which to explore enhanced protection against financial crises. What we might call 'monetary regionalism', sceptical western voices notwithstanding, is now firmly on the regional agenda in East Asia.

Within conventional political economy, the theory and practice of monetary regionalism is not as easy to understand as traditional, trade driven, regional integration. Thus one aim of this paper is to outline a theory of monetary regionalism and demonstrate the degree to which it represents not only a break with the interpretation of the regional project in East Asia prior to the late 1990s but also with that of Europe in the second half of the 20th century.

From its start in 1989, APEC claimed to be a new type of regionalism. The promise was that APEC would promote open regionalism. APEC did not achieve this goal. Nor did it provide support to its Asian members during the financial crises of the late

1990s. At the same time, more traditional (what we might call Balassian) trade driven regional integration of the kind used to explain development of the European Community, are showing signs of decreasing importance. In Asia, there is a growing interest in trade co-operation, but notably reflected in bilateral preferential trading arrangements. This leads to a complex picture of competing regional initiatives across the economic policy spectrum in the wider context of the growing politico-economic dialogue between Southeast and Northeast Asia that has developed via the ASEAN+3 process since 1997.

Introduction

The study of regions, regionalism and regionalisation has once again come to prominence. Not since the 1970s has the analysis of regional integration been so conspicuous. This has much to do with the emergence and in some cases resurgence of regional projects in the 1980s and 1990s. Scholarly attention in the United States was given a shot in the arm by the much-discussed creation of the North American Free Trade Agreement. In South America, MERCUSOR was created in 1991. ASEAN (the Association of South East Asian Nations) became more assertive in Asia during the 1990s, and 1989 saw the birth of Asia Pacific Economic Co-operation (APEC). Meanwhile the Southern African Development Community (SADC) became a focal point for stabilisation and regeneration following the end of apartheid. Most prominently, the European Union's single market programme intensified economic and political integration in Western Europe from the mid-1980s, a process, which continued with the remarkable achievement of monetary integration among a majority of the EU member states by the end of the century.

This paper is in part designed as a stocktaking exercise of various conceptual and theoretical approaches to regionalism from the broad sub-field of international political economy. It takes as its immediate reference point the prospects for regionalism and its study in the wake of the financial crises that began in Asia in the second half of 1997. This directs attention not only to the extent to which regionalism remains a viable policy option for states in an increasingly globalised economy, but more particularly to the issue of whether there are specific templates to which the growth of formal regional integration necessarily corresponds. The assumption is that there is a change in thinking and practice, and that different regions will experience the desire for different paths to enhanced regional cooperation. In keeping with the title of the paper, I wish to argue that Asia's future is not Europe's past. The focus is on developments in Asia, while drawing out the differences with the European historical experience.

East Asia is a region of economic experimentation. The financial crises of the late 1990s forced regional scholars and policy makers alike to examine not only their national economic policies, but also their very understanding of regionalism. Frustration with a prevailing trade driven orthodoxy had developed throughout East Asia. Conventional approaches did not address the major regional concern, namely *financial volatility*. The crises of the late 1990s exposed the weaknesses of existing regional institutional economic arrangements. But a by-product of the crisis has been a willingness to see the longer-term importance of enhanced economic policy co-ordination. This, however, is developing not at the level of ASEAN, nor the Pacific-wide APEC. Rather, interest now focuses on an understanding of region combining ASEAN with the states of Northeast Asia, China, Japan and South Korea.

Moreover, before the crisis, trade led regionalism in the Asia-Pacific had been driven by the Anglo-Saxon members of APEC. This approach now seems less salient. APEC had lost its attractiveness for many Asian players. It offered little towards reducing financial instability, and expected too much with regard to US demands for 'open sectoralism' in trade relations.

Asian policy communities have learned that globalisation and regionalisation are not mutually exclusive activities but rather they exist in a dialectical relationship. Regionalism is not an alternative to globalisation. Rather, it is an ineluctable part of it. Less a challenge to multilateralism, the new regionalism represents a *meso* level in an emerging structure of multi-level governance. Following this logic allows us to explain the emergence of a multiplicity of policy responses to recent economic issues in the Asia-Pacific reflecting Asian resistance to western driven models. Trade policy in the region operates at all levels--bilateral, regional and multilateral--with bilateralism currently dominant in trade relations. By contrast, monetary regionalism is proving an increasingly popular avenue of investigation. The traumatic experience of the Asian crisis, especially perceptions of humiliation by the West and piecemeal progress in IMF reform, has spawned an agenda for enhanced monetary cooperation in East Asia.

This paper does not argue the inevitability of monetary regionalism in East Asia rather than its *theoretical plausibility*. But to the extent that the theory of monetary regionalism is grounded in a narrative of contemporary East Asian economic diplomacy, the paper is also an exercise in plausible induction. True to the title of the paper, it is an exercise in (normative) exploration. Part 1 outlines the traditional understanding of regional economic integration and poses an alternative model of 'monetary regionalism'. An improvement of the existing multilateral institutions would be an alternative to monetary regionalism. But the IMF continues to suffer from too much influence by the American Treasury and Wall Street whose policies frequently result in doubtful results, in particular in East Asia and Russia. Even Joseph Stiglitz has now accused the IMF of implementing the wrong policies and he has asked if America and the IMF pushed policies because they 'believed the policies would help East Asia or because … [they] … would benefit financial interests in the United States and the advanced industrial world?' The answer is less significant than the perception it captures in East Asia, that the second motivation was undoubtedly prevalent.

In Part 2 I discuss the impact of this perception on policy. I identify the decreasing importance of trade-led regionalism in East Asia and the emergence of two counter trends. (i) an interest in monetary regionalism and (ii) an interest in bilateral preferential trade initiatives to bolster existing WTO commitments reflecting a decreasing importance in the APEC style trade agenda of the 1990s. Bilateral trade agreements reflect policy uncertainty, but also intellectual curiosity in the region. They also reflect regional concerns with the destabilising effect on the international trade agenda of enhanced unilateralism in US policy.

(1) The Economics of Regional Integration

The Limits of ASEAN and APEC.

The crises of late 1990s have contributed to the evolution of a new type of regionalism in Asia. The existing regional integration projects, in particular the ASEAN and APEC since then have had a diminished role. Both illustrate the inability of conventional, trade-based integration systems to avoid or mitigate, financial crises. Although ASEAN (at 30+) is one of the oldest regional integration projects it had nothing to offer in 1997. Neither liquidity, nor even good advice, was provided. ASEAN emerged damaged from the crisis and its vision—the establishment of a free trade area and the continuation of an institutionally low-key approach to regional integration—problematic. Although not stated by regional policy makers, the benefits from this type of supranational regionalism are now deemed in many quarters too limited to warrant other than minimum effort. Successful exporters to *world* markets can expect few advantages from the creation of a *regional* free trade area.

APEC's failure to provide any meaningful response to the biggest economic crisis in the Asia-Pacific region since 1945 made it, if not irrelevant, then less important for many Asian members. As with ASEAN, not even good advice was provided. The Vancouver Leaders' Declaration (APEC, 25 November 1997) did discuss the crises, but the suggested responses were limited to surveillance and, above all, the endorsement of the central role of the IMF as the key agent for any improved global regulatory capacity. With hindsight, this appeared to drive the region deeper into crisis and contributed little to its solution.

While it is true that control of financial volatility was never part of APEC's remit, and the Asian crisis did not result in a regional protectionist backlash, the countries in crisis were confronted with a sudden shortage of capital, not with an inflow of goods from other countries.

Increasingly, Asian observers evaluate APEC as a tool of American foreign economic policy. It has not been successful in creating the basis for further pan-Pacific co-operation and the lack of tangible benefits has been progressively criticised. APEC's concentration on facilitating contacts in the corporate and private sector, accompanied by an almost total neglect of developing an intra-regional network at the wider civil society level, has resulted in a weak or non-existent sense of community. As a consequence, APEC has failed to provide much needed political legitimacy for the wider regional liberal economic project.

Although rivalry between an Asian integration project and APEC is not new, policy elites in Asia do seem to be reconsidering the benefits of regionalism without the Anglo-Saxons. In particular, American opposition to the 1997 Japanese proposal for an "Asian Monetary Fund" sewed the seeds for a further polarisation and bolstered the development of a dialogue between Southeast and Northeast Asia.

The Asian crises of 1997/98 also underlined the weaknesses of the *informal personalised consensus building* that characterised the 'ASEAN way' to regional integration, in which both ASEAN and APEC had previously taken pride. Before the crisis, protagonists of APEC were happy to declare it as a new type of regionalism—economic integration without bureaucratic institutions—with the European Union as the model to avoid. The crises demonstrated the limits of non-formalised institutional commitment. The challenge for the Asian policy community since then remains to develop a new regionalism that addresses these deficiencies.

Beyond Conventional Integration Theory

Since the early 1960s, theorising about regional economic integration has been influenced by Bela Balassa's (1961, 1987) fivestep approach : from free trade area to customs union to common market to economic and monetary union and finally political union. But this typology was first articulated well over 40 years ago in a different historical context. In the 1960s tariffs, as the principal barriers to trade, were much more important than today. Financial flows across the boundaries of national economies were much less important. Most countries, including the United States, used controls to ensure that fixed exchange rates were not undermined by high inflows, or outflows, of capital. Trade integration offered an answer to the economic goals of many countries. They could prepare for the world market or, in a more radical but popular version, they could dissociate their economies from the global economy, which was obviously easier for a group than for individual countries.

But that was then. Today, the most problematic aspect of Balassa's approach is that it provides no link between the monetary policies and the financial sectors of the participating economies on the first three levels of integration. In an era of globalisation and liberalisation, reflected in growing capital flows and financial deregulation, this constitutes a major theoretical and policy deficiency. Furthermore, the introduction of monetary union is a change of tune from the first three steps, where the emphasis lay on trade.

(2) A Theory of Monetary Regionalism

In contrast to conventional regionalism, monetary regionalism aims to contribute to the stability of currencies and financial markets in a region without formalising trade links. Like conventional regionalism, it requires participating states to enter a process, which, if successfully implemented, will lead at least to the creation of a common currency. This requires a willingness to give up a traditionally central element of a nation's sovereignty and independence; the ability to issue one's own currency. This is central to monetary regionalism. Such an integration process could be organised in four stages.

Table 1: Key components of monetary regionalism

	Level 1: Regional Liquidity Fund	Level 2: Regional Monetary System	Level 3: Economic and Monetary Union	Level 4: Political Union
Main Component	Creation of a public regional liquidity fund	Introduction of a regional monetary system with exchange rate bands	Permanent fixing of exchange rates and creation of a single currency	Creation of a political union, national political systems continue to exist and cover most issues
Political Measures	Creation of a forum for the central banks of the region, i.e. a regional monetary committee	Regular meetings of the regional monetary committee	Creation of common political institutions, establishment of a Regional Central Bank	Creation of supranational institutions in some, defined areas
Additional Components (crisis management)	Creation of a private liquidity fund	Expansion of coverage of existing regional liquidity funds		
Additional Components (crisis prevention)	Implementation of Universal Debt-Rollover Options with a Penalty (UDROP)			
	Capital controls of the individual countries, in particular on inflows, may continue to exist		Phasing out of capital controls	
Trade Components		Facilitation of regional trade by harmonising norms and standards	Customs Union	Free movement of labour
Macroeconomic Policy	Joint monitoring of monetary and fiscal policy; regional surveillance of financial markets	Co-ordination and harmonisation of monetary policy, in particular interest rate policy as well as fiscal policy, in particular on debt levels		

This proposal does not represent a complete list of regional measures that could be taken to improve immunity to financial crisis. Nor do all measures have to be implemented simultaneously. However, they represent a set of policies that aim at both profound regional integration and provide instant benefits for the participating economies.

Level 1: Regional Liquidity Fund. The central measure to be implemented at level 1 is the creation of a public regional liquidity fund. This is an attempt to provide a regional safety net if a financial crisis, primarily a credit crisis, hits. Countries participating would earmark part of their foreign reserves for a liquidity pool. A participating central bank, in such a system, would not only be able to use its own reserves, but also those of the other central banks. The advantages of a public regional liquidity fund are substantial:

- A central bank using other central banks' reserves has a much higher chance to act as a lender of last resort for the domestic financial sector, thus limiting the consequences of a credit crisis. Using the regional reserves, a central bank gains leverage; particularly relevant for economies that have partly or completely abandoned capital controls and given that loans denominated in foreign currency limit the ability of central banks to act as lender of last resort.

- Use of the region's foreign reserves reduces the need for individual central banks to maintain costly foreign reserves, typically held in highly liquid instruments that earn very small returns (often of not more than two percent per year.)

- The provision of liquidity in a region would avoid it having to go to the IMF immediately a financial crisis emerges. This is the biggest political advantage of a regional fund.

- Although a liquidity fund would only be activated in the event of a crisis, it would encourage participating central banks to engage in permanent monitoring of regional economic developments. Joint regional surveillance of financial markets could begin.

The creation of a regional liquidity fund would, of course, require substantial political will and mutual trust on the part of the participating countries and, in addition, participants would have to possess significant foreign reserves. Even if not more than 10 or 20 per cent of any reserves were available for a regional liquidity fund, this would constitute a major obstacle for monetary regionalism in many parts of the world, but not in East Asia, as Table 2 below.

Table 2: Foreign reserves of East Asian economies

Country	Reserves in 2000 (March) in billions of US-Dollar	Reserves in 2001 in billions of US-Dollar	20 % available for a regional liquidity fund
China	156.8	206.5 (Oct)	35.6
Hong Kong	96.3	111.2 (Dec)	22.9
Indonesia	26.3	27.3 (Nov)	4.5
Malaysia	30.6	29.8 (Oct)	5.4
Philippines	12.9	12.2 (Oct)	2.4
Singapore	74.3	75.8 (Dec)	16.0
South Korea	74.0	101.6 (Nov)	18.9
Thailand	34.1	32.6 (Nov)	6.3
Japan	305,5	402,0 (Dec)	75.5
Total	**810.8**	**999.0**	**199.8**
Taiwan	103.5	110.1	22.0
Total inc. Taiwan	**914.3**	**1109.1**	**221.8**

Sources: *The Economist*, 4 March 2000; *The Economist*, 12 January 2002; Brunei Currency Board, Japanese Ministry of Finance (www.mof.go.jp/english).

The creation of a regional liquidity fund is not primarily targeted towards stabilising exchange rates. The main purpose of a fund is limited, initially at least, to providing sufficient liquidity for banks and corporations that, due to sudden swings in market sentiment, may be confronted with an inability to rollover existing debt denominated in foreign currency. The reason for limiting the use of regional liquidity for credit crises is simple. Stabilising exchange rates is difficult and may easily be unsuccessful. The risk of failure is more limited in credit crises. But the establishment of a regional monetary committee could contribute to the creation of ”intra-regional policy networks”, to enable policy makers to deepen their knowledge of one another prior to the development of a strategy for exchange rate stabilisation. Such a regional liquidity fund is aimed at challenging the IMF monopoly on crisis management.

Moreover, a *public* regional liquidity fund could be accompanied by *private* regional liquidity funds in which private banks and other financial intermediaries create a system that also provides liquidity in the event of a banking crisis. When a bank gets into trouble, the other banks supply fresh money to the initially agreed limit. (This is not as revolutionary as it sounds, such a system has been in place in Germany since a major banking crisis in 1974.) The creation of this system of two liquidity funds would be a significant step forward for a regional integration project. It would both provide powerful instruments to limit financial crises and generate the functional basis for further integration.

In addition to the creation of a regional liquidity fund, measures to reduce the likelihood of financial crises are a vital element of monetary regionalism. A major aim here is to force the private sector to consider the risks associated with lending and borrowing. Without strict accompanying measures, a large regional liquidity fund could cause moral hazard. Borrowers and lenders would assume that they would be bailed out and not properly evaluate risk in the first place. Thus a regional liquidity fund ought to be implemented with high interest rates in order to avoid moral hazard.

On the first level of monetary regionalism, as in conventional forms of regionalism, the economies of the participating countries are likely to be heterogeneous. Measures for the protection of weaker countries will be required. A main element of such protection would be the permission to continue the use of capital controls. The experience of Malaysia in 1998 and 1999 shows how they can enable a government to follow a strategy of low domestic interest rates, a fixed exchange rate and the restoration of economic growth.

The establishment of a formal scheme to facilitate trade is not necessarily part of level 1. The creation of a free trade area or customs union can be misinterpreted as the formation of a trade bloc and consequently can be used by policy makers in other countries to justify retaliatory import restrictions. These notions are particularly relevant for economies producing high surpluses in their trade accounts over longer periods of time as in East Asia.

Level 2: Regional Monetary System. The second step should be characterised by further preparation for monetary union. The introduction of a regional monetary system, with exchange rate bands, enables the participating economies to gain macroeconomic stability. The advantage of this system over a system with permanently fixed rates is obvious, it permits adjustments of exchange rates. But there is no room for a currency system built merely around one individual currency, i.e. the Japanese Yen. That is not the suggestion. The Japanese central bank lacks the transparency and cohesion necessary to achieve the status of a widely accepted reserve currency. Nor would China or other countries in East Asia agree to an effectively hegemonic role for the Japanese central bank.

Enhanced regional co-operation as a route to the stabilisation of exchange rates may turn out to be a more plausible, albeit not perfect, strategy than either completely flexible exchange rates or hard pegs in the form of currency boards. The establishment of a regional monetary system, although separate currencies will continue to exist, will require an intensification of co-operation between monetary authorities.

While the establishment of a free trade area is not suggested, trade facilitation could start to play a greater role at level 2. Given the undesired administrative costs and the potential political vulnerability caused by formal trade regimes, the creation of a free trade area could be interpreted as a protectionist measure. Despite these reservations, trade facilitation via the harmonisation of norms and standards could make an added longer-term contribution to the integration process.

In preparation for level 3, the economic and monetary union, monetary and fiscal policy will have to be harmonised. The experience of the Euro zone offers no blueprint for application elsewhere. But the convergence criteria used in the process leading to the creation of the Euro zone have been useful and the development of such criteria provides a start for a more harmonised economic and fiscal policy.

- the level of existing public debt shall not exceed 60 per cent of GDP,
- new public debt has to be less than 3 per cent of GDP,
- the inflation rate should not be more than 1.5 per cent above the inflation rate in the three countries with the lowest inflation,
- the economies must have participated successfully, i.e. without adjustments, in the European Monetary System for at least two years,
- long-term interest rates should not be more than 2.0 per cent above the respective rates for the three best economies.

The combination of these measures to evaluate public debt and inflation is simple enough to be workable. It includes criteria primarily determined by markets (exchange rate, long-term interest rate) as well as criteria that directly reflect fiscal policy. In Latin America, Mercosur agreed to introduce ceilings for inflation (5 per cent maximum), public debt (40 per cent of GDP maximum) and new public borrowing, (inspired by the convergence criteria set out in the Maastricht Treaty) (3 per cent of GDP maximum) (*Frankfurter Allgemeine Zeitung*, 18 December 2000, p. 18).[1]

Level 3: Economic and Monetary Union. Stringent conditions may be imposed in the creation of an economic and monetary union, and an economic and monetary union has some disadvantages that countries may not wish to accept. The inability to react to differing economic developments within the union through exchange rate adjustments is a major disadvantage. However, an economic and monetary *union* clearly has advantages over a mere regional monetary system. Transaction costs are permanently reduced and competition within the union is strengthened. Above all, exchange rate adjustments within the union cease to be a threat. Companies no longer have to pay for hedging against exchange rate volatility.

Once the third level of integration is reached, at least a customs union is required. Although, theoretically, trade within a project of monetary regionalism could still be subject to tariffs and other forms of trade restrictions, one of the aims of a common currency, i.e. the strengthening of competition, could not be achieved fully. A free trade area, however, should not be implemented, because of the need to administer certificates of origin: Trade would not be facilitated as much as in a customs union. At the same time, restrictions on migration could remain in place. In particular in areas with greatly differing levels of development, the introduction of the freedom of employees to move within the union ought to be limited to the last and final level of integration. This is particularly so in East Asia where it is clearly a very sensitive political issue.

Level 4: Political Union. The completion of the integration process, the creation of a political union, will not require many additional measures with regard to economic policy, but rather demands political action. In particular, supranational political decision making bodies have to be established. In most areas, economic policy integration will have been implemented on lower levels of integration. A deepening of the integration process could see the reduction of

[1] Needless to say that these became illusionary goals after the Argentinian collapse.

national tax systems in favour of a uniform union-wide tax system. But measures of that nature do not seem to be vital for the success of the political union. A certain variation of tax rates would not undermine the integration project. The main benefit of the integration project continues to exist during the implementation phase. The region would gain independence and would be more immune to financial crises. The economic preconditions for such a scheme are high, and probably only in East Asia can monetary regionalism can be successfully implemented.

The Evidence from Asia?

The preceding discussion has been an exercise in speculative, but plausible, economic theorising. But no economic integration system emerges in a political vacuum. Indeed, it is the political constraints and opportunities that are very often the most salient variables. Boldly stated, we believe that evidence of an emergence of monetary regionalism is indeed to be found in East Asia. The region—policy elite and wider community alike—perceived IMF policy throughout the late 1990s as humiliating and wrong. In the summer of 1997 the IMF (and the US government) impeded the Japanese initiative to create an Asian liquidity fund. The Asian Monetary Fund (AMF as it would have been called) was explicitly intended to apply softer conditions than those of the IMF. The AMF's concept corresponded more to that of a 'lender of last resort' than the IMF. Essentially, the AMF idea was about providing unconditional loans to overcome liquidity crises.

By the end of 1999, the worst impact of the Asian crisis was over and East Asian policy circles once again addressed the topic of more intensive regional co-operation. The regular ASEAN summits were expanded by the participation of Japan, China and South Korea, the new body being called ASEAN+3 (or APT). Since then, steps in the search for a new monetary regionalism have been have been numerous. Several are worth noting:

- The first ”East Asian Summit” (EAS) took place in Kuala Lumpur in December 1997. Not surprisingly, monetary issues were discussed.

- During the ASEAN+3 meeting in Manila in November 1999, the scope for regionalism in Southeast and East Asia was discussed. The summit chair, then Philippine President Joseph Estrada, told the news media the goals were a common market, monetary union and an East Asian Community (*Financial Times*, 29 November 1999: 4).

- Increasing numbers of Japanese observers have begun to advocate monetary cooperation. Eisuke Sakakibara, former state secretary of the Japanese finance ministry, spoke out for a co-operative monetary regime in East Asia (World Bank, *Development News*, 12 January 2000).

- During the fourth ASEAN finance ministers' conference in March 2000 plans for a regional liquidity system were discussed (Conference declaration at www.asean.or.id).

- In May 2000, Japan suggested a network of currency swaps, in effect a regional liquidity fund, at the annual meeting of Asian Development Bank member finance ministers. The idea was that Asian countries should be able to borrow from each other via short-term swaps of currency reserves. As Il Sakong, chairman of the Korean Institute for Global Economics, noted at the now famous Chiang Mai Meeting: "We need some kind of defence mechanism. Since not much is expected to be done at the global level, something should be done at the regional level" (*Financial Times*, 6/7 May 2000, p. 9). The finance ministers of the ASEAN countries, China, Japan and South Korea reached an agreement, although major elements of the proposal still have to be finalised. [2]

- In September 2000 Thailand's then Deputy Prime Minister and now WTO-Secretary General, Supachai Panichpakdi, underlined the need for an Asian Liquidity Fund. Even taking US views on the future of the IMF into consideration (see Williamson, 2000), he argued that IMF resources would be insufficient to cope with future crises.

2 In the Chiang Mai meeting, the envisaged volume of the swap agreements was very limited. Thailand, Malaysia, Singapore, Indonesia and the Philippines discussed an expansion of their existing swap arrangements from $ 200 million to $ 2 billion (*Financial Times*, 8 May 2000: 10). Such a step is clearly is too limited for an effective regional liquidity fund, which needs both Japan and China as

- During the 2000 ASEAN+3-Meeting in Singapore, the Chiang Mai-initiative was reaffirmed. At the same time, the Chinese Prime Minister Zhu Rongji made a proposal for a free trade area between China and ASEAN. (*Financial Times*, 27 November 2000: 3).

- In January 2001 France and Japan tabled a joint paper during the ASEM finance ministers meeting in Kobe. The paper suggested that stable exchange rates and financial flows are reachable at a regional level. The paper implicitly advocates monetary regionalism. (See www.mof.go.jp/english/asem/aseme03e.htm).

- In May 2001, the Chiang Mai-initiative was clarified during the annual meeting of the Asian Development Bank in Honolulu. The network of bilateral swap agreements was more precisely defined. Japan pledged up to $3 Billion to South Korea, up to $2 billion to Thailand and up to $1 billion to Malaysia. However, only 10 per cent of these sums should be available automatically. For sums above the 10 per cent level the approval of the IMF will be required.

The decision to require IMF approval appeared a setback for monetary regionalism in East Asia. However, the need for IMF approval has been interpreted as a useful condition to allay fears about financial support for unwise policies. (Saker, 2001). This position would be more plausible if the IMF itself had implemented *wise* policies during the Asian crisis. This, however, has not been the case. (Stiglitz, 2000 and 2002)

Why create a separate credit facility if it cannot be used independently? Does the need to get IMF approval put the entire project of a regional liquidity fund into question? Maybe. But there are good historical-cum-practical reasons not to view it this way. Past crises have usually had a strong regional flavour. Support packages, although organised by the international institutions, have been primarily under written by regional funds. A regional body to coordinate such packages in the future thus makes sense and merely reflects reality on

contributing partners. On a point of historical note, this plan is similar to the one drawn up in the early 1960s by the G10 industrial nations as a way of addressing similar global monetary questions.

the ground. It could also focus greater attention on crisis *prevention*, as opposed to crisis management, which has been the principle *modus operandi* in the past (Rajan 2000).

Most important, the theory of monetary regionalism only makes sense *in practice* if appropriate funding is available. It could not be countenanced in the absence of a sufficient level of foreign reserves. The funds to meet it are available in East Asia where reserves are not only high, but well distributed. The two largest economies, Japan and China, have the largest reserves. In the event of a crisis, those two economies would make the highest contribution. Also, considering the high level of reserves, a regional liquidity fund is plausible even without using too high a percentage of the reserves of participating central banks. Asia has more foreign reserves than any other region. Between 2000 and late 2001 alone, reserves in the APT countries have risen by over $180 billion. Even without Taiwan, which alone enjoys reserves of more than US$100 billion, the central banks of East Asia together have US$1000 billion at their disposal. The inclusive character of the project is underlined by China's participation. Today, China has no need for additional liquidity from the region. Together with Hong Kong's monetary authority, China's central bank has reserves of over US$ 00 billion, more than enough for an economy that enjoys the additional safety net of comprehensive capital controls.

The Growth of Bilateral Free Trade Agreements:

In contrast to the theoretical speculation about the prospects for monetary regionalism in East Asia we must juxtapose a growing interest by regional states in bilateral strategies for trade expansion. This revived interest in bilateral agreements reflects the ineffectiveness of APEC and the hiatus in the WTO, a putative Doha Round notwithstanding. From January 1995 to December 1999 alone 69 new regional trade agreements were notified to the WTO. Including previously existing arrangements 113 were in power at the end of 1999 (Sapir 2000, p. 1135).

These figures do not include regional agreements still in negotiation stages and yet to be notified to the WTO.

The degree to which Bilateral Free Trade Agreements, or other forms of preferential trade agreements (PTAs), are sub-optimal in comparison to the multilateral freeing of trade are well explained in the theoretical economic literature. The important question is why sound economic theory does not automatically lead to good public policy? The answer, which most economic theorists miss, Bhagwati (2002) being a notable exception, is that good economic theory is often bad politics. Policy makers are prepared to engage in uncoordinated bilateral decision-making—often leading to inferior outcomes (especially asymmetrical bargains for weaker states)—*to create an illusion of control over one's own policy processes and policy choices*. The fear of being shut out of agreements in times of low trust in the multilateral trading system sees governments developing bilateral strategies. This is a global phenomena and one in which the world's major economic power, the US, is currently showing a form of leadership the world could well do without. (Bhagwati, 2001)

Given the interest of the Bush Administration in the Free Trade Agreement of the America's (itself a massive PTA) it is no surprise that, since 2000, there has been an increase in the tempo of bilateral negotiations in other parts of the world, including East Asia (see Table 3). Whether it is a bilateral deal between Australia and China, Singapore and the USA, Japan and Singapore, China and ASEAN or Vietnam and the United States, there is a similar rhetoric that underpins the arguments advanced by trade ministers.

Notwithstanding the global nature of this trend, other region-specific reasons lie behind it in East Asia. At one level, bilateral trade arrangements are felt to give regional policy elites greater control over their own national trade policies, reflecting a view that their influence over deliberations within the context of the WTO are not always as significant as they would wish. To this extent, they are statements of sovereignty. They also reflect the decreasing salience of ASEAN as an economic, if not necessarily political, organisation. But, given the success of GATT/WTO in reducing tariffs and, albeit to a lesser extent non-tariff barriers, the benefits from regional free trade agreements are much less significant than they used to be.

More importantly, industry leaders in the region (*de facto* agents of market-led economic integration) are acutely aware of the degree to which manufacturing is now more global than regional. Building regional trade blocs in an era of globalisation is deemed less relevant. As the head of the Philippine Federation of Industries noted: 'If you are not global you are dead' (*Far Eastern Economic Review*, 9 December 1999: 22). East Asia is eschewing regionalism in favour of neither globalism nor bilateralism. No states pursue purely one-dimensional trade policies, or indeed foreign policies in general. Rather it is the argument of the paper that we are seeing the emergence of a new regionalism in Asia that exhibits three over-lapping and complex trends:

(1) An interest in monetary regionalism arising from the desire that has emerged, since the financial crises of the late 1990s, to combat financial volatility.

(2) An interest in bilateral trade initiatives within the context of the wider multilateral system, largely at the expense of the APEC style open regionalism of the 1990s.

(3) The emergence of a voice of region beyond that of the sub-regions—Southeast and Northeast Asia—but more restricted than that of the Pacific as a mega region. In keeping with earlier analysis (Higgott and Stubbs, 1995) and recently picked up by others (Bergsten 2000; Webber 2001; Rapkin 2001) the voice of region in the global political economy that is emerging is a new one, an 'East Asian' one.

Table 3: Bi- and Multilateral Free Trade Agreements in the Asia-Pacific at the beginning of 2002

	ASEAN-Australia-New Zealand

FTAs formally proposed and studied	Australia-Japan Australia-South Korea Australia-Thailand Australia-USA Canada-Japan Canada-Singapore Chile –Japan Chile-Singapore Japan-Mexico Japan-New Zealand Japan-South Korea New Zealand-South Korea New Zealand-Thailand New Zealand-USA South Korea-Thailand South Korea-USA Taiwan-USA
FTAs currently negotiated	ASEAN-China Australia-Singapore Chile-New Zealand Chile-South Korea Chile-USA Hong Kong-New Zealand Japan-Singapore Mexico-Singapore Mexico-South Korea Singapore-USA
FTAs ratified and implemented	ASEAN Free Trade Area (AFTA) Australia-New Zealand (CER) Australia-Papua New Guinea (PATCA) Canada-Chile Canada-Mexico-USA (NAFTA) Chile-Mexico New Zealand-Singapore Vietnam-USA (Trade agreement)

(3) The Politics of the 'New' Asian Regionalism

In part 3 I address three elements of the politics of the new regionalism in Asia. Firstly, it identifies a Japanese desire for greater regional leadership on questions of monetary co-operation, albeit constrained by the realities of Japanese economic life in the late 20th and early 21st centuries. Second, China's participation in the Chiang Mai initiative is argued to reflect its aspirations to greater regional leadership. The China and ASEAN negotiations for a bilateral FTA commenced in November 2001 underscore the growing acceptance of China as a leading regional power. Third, part 3 argues that successful regional policy coordination will be as much dependent on Sino-Japanese relations and leadership as on US relations with these two states, either singularly or collectively.

Irrespective of the explanations of the Asian financial crises of the late 1990s[3] the closing years of the twentieth century have convinced Asian regional policy elites that, '…they no longer want to be in thrall to Washington or the West when trouble hits in'. (Bergsten 2000, 20) Bergsten, with Stiglitz, is rare amongst American observers in recognising the degree to which East Asian states felt that they were 'both let down and put upon by the West' in the crisis. For others, triumphalism and *schadenfreude* was rampant (cf. Zuckerman 1998). The Asian financial crisis was more an opportunity to displace the 'Asian developmental state' with the Anglo-American model. It is in this context that regional initiatives, since 1997, especially the dialogue about monetary regionalism and the process of East Asia wide summitry via the APT need to be located. The APT reflects a grouping of Asian states mirroring Dr Mahathir's proposal for an East Asian Economic Group (EAEG) that was strongly opposed by the Anglo-Saxon members of APEC, especially the USA, in the early 1990s.

It is the general hope in the region that APT and an AMF (by any other name) would give Asia a stronger voice in determining the shape of the new international institutional architecture—a point not lost on the US in its opposition to the AMF proposal in 1997. The US clearly understood that, despite stated best intentions, an AMF would not long be likely to adhere IMF policy prescriptions if they appeared at odds with an Asian view of how the world economy should be organised. Thus a successful AMF would, *ipso facto*, contest the 'Anglo-American' view of global economic organisation. (Higgott and Rhodes, 2000)

When state interests are disaggregated, different members of the APT have different agendas. For the key ASEAN states, the prospects of stronger relations with two of the world's major economic powers (Japan and China) are clearly evident, for all their current economic limitations. Moreover, it is not only Dr Mahathir who has long recognised that influence over the international institutional architecture depends on being part of a much larger group reflecting a collective position. ASEAN leaders like Lee Kuan Yew, and major opinion formers in the region such as Tommy Koh and Noordin Sopiee (see Koh 1999: 8) regularly express similar views.

But more important than the views of the individual ASEAN partners to the longer-term evolution of the APT is the position of the major powers, notably Japan and China from within the APT, and the US from outside of it. For example, Japan has come under increasing pressure, both for internal and external reasons over the last decade, to sort itself out. Its economy is in a *cul-de-sac*, saddled with public debt, deflation, bad loans and a lack of consumer confidence that will, sooner or later, have to be addressed. This economic reality according to Peter Katzenstein (2000: 360) has changed East Asia's perception of Japan. Today, the fear of too much influence by Japan has been replaced by the fear of too little power to deal with its internal economic problems.

However, such problems notwithstanding, there is considerable evidence of a Japanese agenda for greater regional monetary cooperation, although an AMF is an institution that presently dare not speak its name. Since the time of the abortive attempt in 1997, Japan has consistently developed initiatives of its own and backed the activities of others in the region wishing to advance policies that might lead to greater AMF-style monetary regionalism.

Indeed, on close inspection, Japan has played a greater leadership role on these issues over the last few years than most of its critics will concede.[4] Yet, still to be tested is the Japanese will

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[3] But see *inter alia*, Wade and Veneroso 1998; Higgott 1998; Dieter 1998; Pempel 1999; Jomo 1998; Bello 1998.

4 Initiatives such as the Miyazawa agreement cannot be discussed here. But see Hayashi, 2002.

to resist a full assault by the US on Asia's attempts to smuggle in an AMF style organisation through the back door. The major problems in the organisation of the region in years to come resides in the relationship between the US and Japan on the one hand and between Japan and China on the other. As David Rapkin has argued, both the US and Japan are in a situation where neither can push through its own vision of the policy future for the region in the absence of acquiescence from the other. By the US veto of the first AMF initiative and the Japanese veto of US desires for early sectoral trade liberalisation within APEC, the two allies are shown to have 'blocking power' over each other (Rapkin 2001).

Smaller countries might accept a leading role for Japan in Asian integration, but China is likely to be less acquiescent. The management of the Sino-Japanese relationship represents as big a challenge for Asian regionalism as does the relationship between the US and Japan. According to Webber (2001) the past, the present and the future continue to strain the relationship. The past, because Japan has neither apologised in an accepted manner for the atrocities committed during World War II and the occupation of China and other countries in the region nor has Japanese society come to terms with its role in the region. At present there is an element of systemic competition between Japan and China. But most importantly the future casts a shadow over the relationship. If current economic trends continue it is not difficult to see the day when, in terms of the material and intellectual capacity for leadership, China might eclipse Japan.

Understandably, this makes Japanese leaders more nervous than their counterparts in China. China may worry about contemporary Japanese economic power, but the Chinese can imagine a day when this gap will be smaller than it is now. Conversely Japan can only speculate on what the decreasing asymmetry in the economic capabilities of the two countries implies for China's longer-term regional intentions in a range of policy areas, especially the security domain. This view will only be partially assuaged by China's increasingly responsible regional role in its strong support of the idea of an AMF style organisation.

We are thus faced with a paradox. The absence of acceptable or credible hegemonic power in East Asia remains a major obstacle to the successful implementation of the monetary regionalism project at the same time as it adds force to the very idea of, and need for, collective action problem solving via a body like the APT. It is this paradox that gives ASEAN its strategic role (at least in the short run) in nurturing the APT dialogue. In so doing, playing the intermediary role between the two major regional powers provides ASEAN with a raison d'être at a time when its institutional viability has been under pressure from the financial crisis. This role, however, can be only a stopgap measure. ASEAN has none of the material power of the larger players. Moreover, if something like an AMF were to develop, it would need conditions attached to the financial support it offered. This means *rules*. But 'ASEAN way' diplomacy, built on consensus decision-making, remains inimical to the development of strong rule-driven conditionality. It would thus be necessary to move beyond ASEAN-way decision making. While not easy, such a movement may not prove impossible. Indeed, there are signs that this approach may have outlived its usefulness.

Asian policy makers are looking to create regional agreements that allow them to eschew hard-line IMF medicine of the kind administered in the late 20^{th} century. Small states in particular, for it is they that will rely on the support of the richer states, may be more willing to accept conditionality. They may be willing to accept it if it emanates from a regional institution in which they regard themselves as stakeholders. In their relationship with the major international institutions, most Asian states have seen themselves to-date largely as 'rule takers' rather than 'rule makers'. Thus seemingly cosmetic differences are more significant, albeit more intangible, than can ever be caught in any narrowly rational economic model of financial reform.

Conclusion

This paper has proposed a theoretical approach to how regionalism in East Asia might develop over the near to mid term future. But the paper acknowledges the manner in which politics can derail theory. Thus it has located this exercise in theory building within a realistic empirical context. Events on the ground in Asia, particularly the wishes of the regional policy elites for mechanisms to cope with financial volatility, are driving this process. In the wake of the financial crises of the late 1990s, and in the absence of cast iron guarantees emanating from the international financial architecture, policy makers aspire more to collective problem solving at the regional level than in the past. It is this changing context that makes the kind of theoretical exercise developed in this paper germane.

It is also an *evolutionary* model that takes account of the changing dynamics of economic interdependence under conditions of globalisation; especially the increased importance of financial markets at the expense of markets in manufactures that prevailed at the time that the Balassian model or regional integration was developed. It is under-written by assumptions of regional 'policy learning' that assumes that the mistakes of the past are not necessarily due to be repeated. Of course, in any specific historical circumstance, if diplomacy fails and a stable or balanced security environment brakes down, all other areas of policy are inevitably adversely affected.

But the 'learning' assumption of this paper is that Asian policy makers do not automatically assume that conflict over contested issues in the politico-security domain is at some stage inevitable. For all its limitations, the multilateral security dialogue in the region has developed positively in the last decade of the twentieth century. There is no reason why this trend should not continue. Rather than ignore the security issues, or suggest that there is no linkage between them and economic questions, this paper argues that it is quite plausible to see regional policy communities pursuing different co-operative initiatives in the domains of security, finance and trade. In short, they are quite capable of playing a multi-dimensional diplomatic game.

Consider for example the relationship between Beijing and Tokyo—a central relationship in any discussion of the future of the region. Beijing has benefited from the developments of the late 20th and early 21st century. But still the key question to be resolved in coming years is the degree to which increased economic ties between Japan and China might alleviate the climate of mutual distrust in other domains and allow them to cooperate in the enhancement of regional economic policy coordination. This is not an easy question to answer. Analysis can be of two types. We have chosen to downplay determinist arguments of a structural realist type (*pace* Kenneth Waltz 1979) from which we would assume conflict of a destabilising nature at a later stage. Rather we have attributed greater theoretical strength to the role of agency and the influence of actors in the policy process. As such, and notwithstanding that the 1994 Chinese devaluation of the *renminbi* was a significant factor in the Asian financial crisis, the general view in the region is that China has behaved responsibly and cooperatively in efforts to mitigate the prospects of further financial volatility (Wang 2000: 210).

That distrust of China's motives amongst other sections of the East Asian regional policy elite remains is not at issue. The real question is over the degree to which this mistrust can be mitigated as a problematic factor in the development of (monetary) regionalism and the consolidation of the APT. It is around such questions that the prospects for East Asian co-operation via the APT in general, and the development of monetary regionalism (by the creation of an AMF or some such like institution) will be determined.

The financial crises of the 1990s may have been a sufficiently traumatic learning experience, especially for some of the weaker state policy making elites, to recognise a need to shed a little sovereignty, in order to preserve wider state building capacity and regional stability. Vulnerability to financial market volatility is now the major challenges to policy autonomy. It may be this sense of vulnerability that is the key to the further development of regional collective action in the monetary sphere.

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Asia Pacific Acronyms

ASEAN	**Association of Southeast Asian Nations**
APEC	**Asia Pacific Economic Cooperation**
APT	**ASEAN + Three** (PRC, Japan and South Korea)
ASEM	**Asia-Europe Meeting**
AECF	**Asia-Europe Co-operation Framework**
AFTA	**ASEAN Free Trade Area**
AMM	**ASEAN Annual Ministerial Meeting**
ARF	**ASEAN Regional Forum**