

**ECONOMIC COOPERATION IN ASEAN  
AND THE RISE OF CHINA**

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## **Abstract**

Over the past decade, the Association of Southeast Asian Nations (ASEAN) has shifted from its original focus on regional peace and stability toward embracing a progressively economics-dominated agenda. A multitude of initiatives concerning cooperation in the areas of trade and finance have been launched. At the 2003 ASEAN Summit in Bali, ASEAN leaders even declared the goal of establishing an ASEAN Economic Community by 2020. This paper discusses two factors that have contributed to ASEAN's increasing focus on economic cooperation: (1) the Asian financial crisis, and (2) the emergence of China as a major international and economic power. It is argued that these determinants have paved the way for closer economic cooperation within the region despite the great heterogeneity and conflicting interests of the ASEAN member countries.

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## 1. Introduction

Over the past decade, the Association of Southeast Asian Nations<sup>1</sup> (ASEAN) has redefined itself as a grouping that is increasingly occupied with economic issues. It has shifted from its original focus on regional peace and stability toward embracing a progressively economics-dominated agenda. A multitude of initiatives concerning cooperation in the areas of trade and finance have been launched. At the 2003 ASEAN Summit in Bali, ASEAN leaders even declared the goal of establishing an ASEAN Economic Community (AEC) by 2020. The AEC is envisaged as a single market and production base with free flow of goods, services, investments, capital and skilled labor.<sup>2</sup>

These developments toward economic regionalism and the change of ASEAN's mission partly reflect the end of the cold war and the concomitant ideological conflicts between capitalism and communism. This paper discusses two other factors that have contributed to ASEAN's new focus on economic cooperation: (1) the Asian financial crisis, and (2) the emergence of China as a major international and economic power. It is argued that these determinants have created sufficient common ground amongst ASEAN member countries to initiate regional economic cooperation despite the great heterogeneity and conflicting interests of the ASEAN nations.

The remainder of the paper is structured as follows: after a brief look at the heterogeneity amongst ASEAN countries in the next section, section three discusses how the Asian financial crisis and its perceived mismanagement by the International Monetary Fund (IMF) and the U.S. government on the one hand, and the emergence of the Chinese economy on the other hand, have pushed ASEAN toward pursuing an economic integration agenda. Section four outlines a set of characteristics that illustrate ASEAN's evolving economic regionalism. Section five concludes.

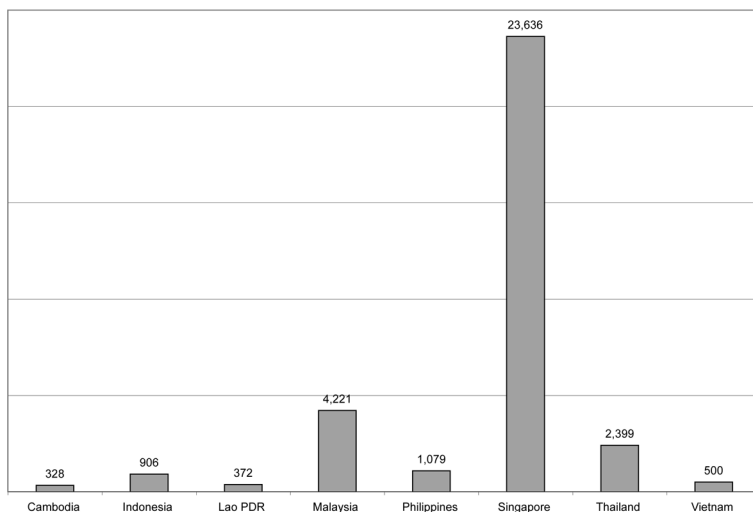
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## 2. Heterogeneity within ASEAN

East Asian and Southeast Asian countries have long been noted for their lack of interest in regional (economic) cooperation. While embracing an export-led strategy of development, they were more oriented toward the world markets than their regional neighbors. This can be attributed to the regions' heterogeneity: the ASEAN member countries represent a smorgasbord in terms of size of population, economy and political system.

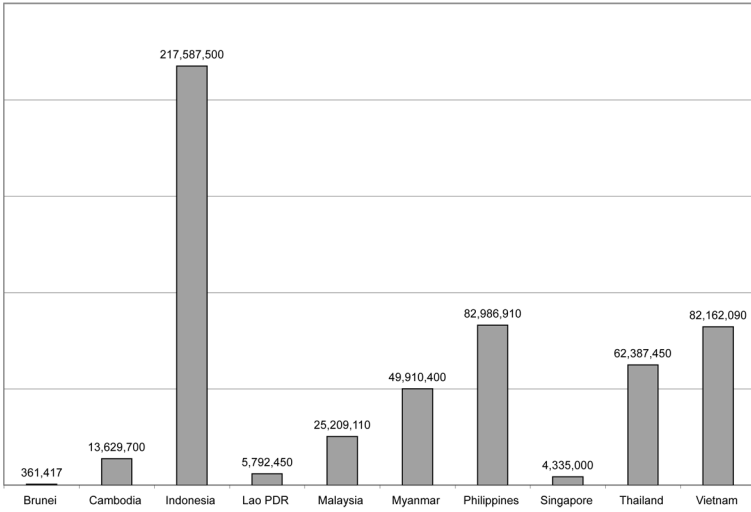
Figure one shows the great disparity of income between Southeast Asian countries. GDP per capita ranges from as little as USD 328 in Cambodia and USD 372 in Lao, over USD 4,221 in Malaysia to USD 23,636 in Singapore. In terms of population, ASEAN countries also differ widely, encompassing countries as small as Brunei (361,417 people), Singapore (4,335,000) and Lao (5,792, 450), and as large as Vietnam and the Philippines (about 82 and 83 million, respectively), and even Indonesia (217.6 m) (see figure two).

Figure 1: GDP per capita of ASEAN countries in 2004  
(in constant 2000 USD prices)



Source: WDI, note: data for Brunei and Myanmar are n.a.

Figure 2: Population of ASEAN countries in 2004



Source: WDI

Heterogeneity in terms of population and income does not automatically imply an obstacle to integration, as shown by the European Union (EU). The EU also encompasses countries as tiny as Malta (401,000 people) and Luxembourg (450,000 people) and as large as Germany with a population of 82,630,660. In terms of per capita income, EU countries are also uneven. For instance, per capita income in Greece, the poorest of the “old” EU member states, is only about a quarter of Luxembourg’s, the richest country. This income disparity widened even further with the EU enlargement in 2003 – people in the Slovak Republic, the poorest EU member country, enjoy on average only nine per cent of Luxembourg’s per capita income (all data are for 2004, source: WDI).

Yet a crucial distinction between the EU and ASEAN is ASEAN’s disparity with respect to their political and economic systems. While all EU member countries have established democratic societies and free market economies, ASEAN member countries encompass the full scale of political and economic systems, ranging from free democracies to authoritarian regimes, and free market economies to centrally planned command economies. Table one shows the 2005 Freedom House assessment of the state of freedom for ASEAN countries. For this index, countries are evaluated based on a checklist of questions on political rights and civil liberties that

are derived from the Universal Declaration of Human Rights. Each country is assigned a rating for political rights and a rating for civil liberties based on a scale of 1 to 7, where 1 represents the highest degree of freedom and seven the lowest. The combined average of each country's political rights and civil liberties ratings determines an overall status of "free", "partly free," or "not free." While, according to this classification, the people of the Philippines and Thailand live in "free societies" that grant them comprehensive political rights and civil liberties, the societies of Indonesia, Malaysia and Singapore are only classified as "partly free." Brunei, Cambodia, Lao, Myanmar and Vietnam are classified as "not free."

Table 1: Freedom rating for ASEAN countries 2005

<b>Country</b>	<b>Political rights</b>	<b>Civil liberties</b>	<b>Freedom rating</b>
Brunei	6	5	Not free
Cambodia	6	5	Not free
Indonesia	3	4	Partly free
Lao	7	6	Not free
Malaysia	4	4	Partly free
Myanmar	7	7	Not free
Philippines	2	3	Free
Singapore	5	4	Partly free
Thailand	2	3	Free
Vietnam	7	6	Not free

Source: Freedom House (2005)

Economic freedom also varies greatly between ASEAN countries, as shown in table two. From a list of 155 countries included in The Heritage Foundation/Wall Street Journal *Index of Economic Freedom*, Singapore ranked second<sup>3</sup>, which is in sharp contrasts with countries such as the Philippines, Indonesia and Vietnam, whose economies are classified as "mostly unfree," or Lao and Burma, whose economies are classified as "repressed."

Such disparities in terms of population size, economic development, as well as political and economic systems can provide an explanation as to why ASEAN countries have long struggled to engage in cooperation that goes beyond a broad political and security dialogue.

Table 2: 2005 Index of Economic Freedom

Country	Rank (out of 155 countries)	Score	Classification
Singapore	2	1.60	Free
Cambodia	63	2.89	Mostly free
Malaysia	70	2.96	Mostly free
Thailand	71	2.98	Mostly free
Philippines	90	3.25	Mostly unfree
Indonesia	121	3.54	Mostly unfree
Vietnam	137	3.83	Mostly unfree
Lao	150	4.33	Repressed
Burma	154	4.60	Repressed

Source: The Heritage Foundation/Wall Street Journal (2005)

Note: The definition of scores is: 1-1.99: free, 2-2.99: mostly free, 3-3.99: mostly unfree, 4-5: repressed

While the disparities just described have not lessened over the past years, the drive toward regional cooperation, and particularly economic cooperation, has indeed become more serious. It is thus worthwhile to ask why – despite their heterogeneity – Southeast Asian countries seem to have overcome their qualms with respect to regional (economic) integration.

### **3. Push factors for ASEAN economic integration**

There are certainly multiple factors that have directed ASEAN toward pursuing an increasingly economics-based agenda. One such factor is the end of the cold war and the concomitant ideological conflicts between capitalism and communism.

Another factor is a general trend toward economic regionalism that has become most visible through trade blocs such as the EU, the North American Free Trade Agreement (NAFTA) and the Mercado Común del Sur (Mercosur). Indeed, the creation of the ASEAN Free Trade Area (AFTA) in 1992, for long one of the most notable – albeit somewhat half-hearted – efforts of economic integration within ASEAN, can be partly explained by concerns that the emergence of other trade blocs would put ASEAN countries in a disadvantage.

In what follows, two other factors are scrutinized that are argued to have paved the way for closer economic cooperation within the region despite the great heterogeneity and



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conflicting interests of the ASEAN member countries: the Asian financial crisis and the rise of China.

*The Asian financial crisis*

The Asian financial crisis of 1997/98 sparked great political interest in economic and particularly monetary and financial cooperation and integration in the region. The crisis revealed the fragility of the region's prevailing monetary and exchange rate arrangements and led to the understanding that a strengthening of the regional financial architecture is urgently needed. Cooperation on a regional level is now regarded as a potentially promising way forward. Arguably, the Asian financial crisis has been "the key catalytic event to propel regional cooperation" (Padoa-Schioppa 2005, p. 30). The move toward regionalism is indeed not limited to Southeast Asian countries. The Northeast Asian countries too, i.e. China, Japan and Korea, have shown ample interest in fostering economic cooperation within the region.<sup>4</sup> Bergsten (2000) even suggested that East Asia may be on the brink of a historical evolution, as Europe was half a century ago.

The Asian crisis has played such a pivotal role in pushing regional integration tendencies for two reasons. Firstly, it has made East Asian countries realize that they are closely tied together economically. After Thailand was hit, the crisis spilled over to the other countries in the region, even affecting those countries that were regarded as pursuing relatively sound and sustainable economic policies. Contagion, i.e. the cross-country transmission of shocks, makes it increasingly difficult if not impossible for open economies to isolate themselves from shocks to their trading partners. Research by Glick and Rose (1999) has shown that currency crises tend to spread along regional lines, and that trade linkages are an important transmission channel for crises. Glick and Rose's findings suggest that countries may be attacked because of the actions – or inaction – of their neighbors, who tend to be trading partners merely because of geographical proximity. They conclude that "[c]ountries who trade and compete with the targets of speculative attacks are themselves likely to be attacked." (Glick and Rose 1999, p. 604) For East Asia – a region in which intra-regional trade accounts for almost fifty

per cent of overall trade – the danger of financial contagion provides a strong argument for strengthening regional cooperation and surveillance in the spheres of money and finance. Furthermore, because of the strong intra-regional trade linkages and East Asian countries' competition against one another in third markets – North America and Europe in particular – exchange rate spillover effects from one country to another are of great importance. Hence, mutual exchange rate stability is the “quintessential public good” (McKinnon 2005). This provides an explanation for the region's interest in developing a formal regional exchange rate mechanism, or even a common currency.

The second important effect of the financial crisis is that it has evoked a strong feeling of discontent with the handling of the crisis by the international community and the IMF and U.S government in particular. The IMF has been accused of responding too late and giving flawed advice to the crisis economies.<sup>5</sup> Lincoln (2004, p. 254) asserts that the crisis had caused a “common sense of irritation, frustration, and disagreement with the U.S. government and the IMF” throughout the region, and partly even anti-Western and particularly anti-American attitudes.

The dissatisfaction with the IMF is also due to the region's under-representation in the Fund. While ASEAN constitutes 8.6 percent of the world's population (6,345,127,000), they hold a meagre 3.5 percent of IMF voting rights (cf. table three). This contrasts sharply with the influence of the big shareholder countries (US with 17.08 percent, Japan with 6.24 percent, Germany with 6.09 percent and France and the UK with 5.03 percent each). The IMF is considered to be overly dominated by U.S. interests and unresponsive to Asian concerns, creating a strong incentive for East Asian countries to increase their formal multilateral economic cooperation in order to limit dependence on IMF support (Fukuyama 2005a, p. 79).

Already during the Asian crisis, attempts were made to establish a regional scheme for financial cooperation. In August 1997, only weeks after the outbreak of the crisis in Thailand on July 2, the Japanese government proposed the

creation of an Asian Monetary Fund (AMF) as a framework for financial cooperation and policy coordination in the region. The AMF, it was argued, would provide a means of defense against financial crises in Asia. Kwan (2001, p. 35) sees the endeavor to build an AMF “as an attempt by Asian countries to escape domination by Washington and to achieve financial independence.” It is therefore not surprising that the AMF was averted by the objection of the U.S. government and the IMF.

Table 3: IMF quota and voting rights of ASEAN countries

	<i>Quota</i>		<i>Votes</i>	
	Millions of SDRs	Percent of total	Number	Percent of total
Brunei	215.2	0.10	2,402	0.11
Cambodia	87.5	0.04	1,125	0.05
Indonesia	2079.3	0.97	21,043	0.97
Lao	52.9	0.02	779	0.04
Malaysia	1486.6	0.70	15,116	0.69
Myanmar	258.4	0.12	2,834	0.13
Philippines	879.9	0.41	9,049	0.42
Singapore	862.5	0.40	8,875	0.41
Thailand	1081.9	0.51	11,069	0.51
Vietnam	329.1	0.15	3,541	0.16
ASEAN	7333.3	3.42	75,833	3.49

Source: <http://www.imf.org/external/np/sec/memdir/members.htm#1>

The idea of an AMF – though under a different name – was revived when the ASEAN finance ministers met with their Chinese, Japanese and Korean counterparts (known as the ASEAN + 3 grouping) on May 6, 2000 in Chiang Mai, Thailand, where they agreed to establish a system of bilateral short-term financing facilities within the group. This agreement, called the Chiang Mai Initiative (CMI), provides for mutual assistance consisting of swap arrangements in the event of a financial crisis.<sup>6</sup>

The feeling of being let down by the international community and the demand for a regional response was exemplarily expressed by Il Sakong, president of the Institute for Global Economics in Seoul, during the meeting in Chiang Mai where he stated that “[w]e need to have some kind of defense mechanism. Since not much is expected to be done at the global level, something should be done at the regional level“ (cf. Dieter 2000, p. 22). The wording of the declaration of the ASEAN + 3 Finance Ministers (2000) at Chiang Mai

diplomatically depicts the region's desire for reducing dependence on the IMF:

“In order to strengthen our self-help and support mechanisms in East Asia through the ASEAN + 3 framework, we recognized a need to establish a regional financing arrangement to supplement the existing international facilities. As a start, we agreed to strengthen the existing cooperative frameworks among our monetary authorities through the ‘Chiang Mai Initiative.’”

The CMI consist of an expanded ASEAN Swap Arrangement (ASA) that includes the ASEAN countries and a network of Bilateral Swap Arrangements (BSAs) among ASEAN + 3 countries. The ASA is now USD 1 billion in size, while sixteen BSAs have been successfully concluded with a combined total size of USD 36.5 billion.

Another important regional initiative in the field of money and finance is the ASEAN Surveillance Process, which the ASEAN Finance Ministers agreed on in Washington in October 1998. The terms of understanding for the establishment of the ASEAN Surveillance Process describe its objective as strengthening cooperation by (1) exchanging information and discussing the economic and financial development of member states in the region, (2) providing an early warning system and a peer review process to enhance macroeconomic stability and the financial system in the region, (3) highlighting possible policy options and encouraging early unilateral or collective actions to prevent a crisis, and (4) monitoring and discussing global economic and financial developments which could have implications on the region and proposing possible actions on a regional and national level (ASEAN 1998).

A third field of cooperation directly resulting from the crisis is the development of regional security markets. For instance, ASEAN + 3 countries have developed the Asian Bond Market Initiative (ABMI). The ABMI was originally proposed by Japan in 2002. The aim of the ABMI is to develop efficient and liquid bond markets in Asia in order to enable a better utilization of Asian savings for Asian investments and to avoid

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the currency and maturity mismatches in financing that exacerbated the financial crisis. The ABMI includes efforts to modify existing regulations to facilitate the issuance of and investment in local currency denominated bonds, as well as the development of new securitized debt instruments, credit guarantees and investment mechanisms, foreign exchange transactions and settlement issues and rating systems. Complementary activities are the launch of the Asian Bond Fund I and II by the Executives' Meeting of East-Asia and Pacific Central Banks (EMEAP).<sup>7</sup>

As Padoa-Schioppa (2005, p. 31) notes, “these initiatives are more than just a first step towards greater cooperation, they have also created important fora for an ongoing policy dialogue at the level of finance ministers and central bank governors.” And indeed, they would have been unthinkable without the changes in the ASEAN policymaker’s attitudes toward regional cooperation brought about by the Asian crisis.

### *The rise of China*

The second factor that has promoted ASEAN economic cooperation is the rise of China. The past years have seen what Napoléon Bonaparte allegedly predicted two hundred years ago: “Quand la Chine s’éveillera, le monde tremblera.” Like much of the rest of the world, ASEAN countries have watched China’s transformation and international opening since the 1970s. As Zheng (2005, p. 18) describes it:

“Since starting to open up and reform its economy in 1978, China has averaged 9.4 percent annual GDP growth, one of the highest growth rates in the world. In 1978, it accounted for less than one percent of the world economy, and its total foreign trade was worth \$20.6 billion. Today, it accounts for four percent of the world economy and has foreign trade worth \$851 billion – the third-largest national total in the world. China has also attracted hundreds of billions of dollars of foreign investment and more than a trillion dollars of domestic nonpublic investment. A dozen years ago, China barely had mobile telecommunications services. Now it claims more than 300 million mobile-phone subscribers, more than any other

nation. As of June 2004, nearly 100 million people there had access to the Internet.”

China’s progress has unsettled many of its neighbors and trading partners. The rise of China is different from that of any other country because of its sheer size. Even for a grouping as large as ASEAN with a population of almost 550 million, China poses a great challenge (cf. figure three). According to predictions, China’s population will reach 1.5 billion in 2030 (Zheng 2005, p. 18).

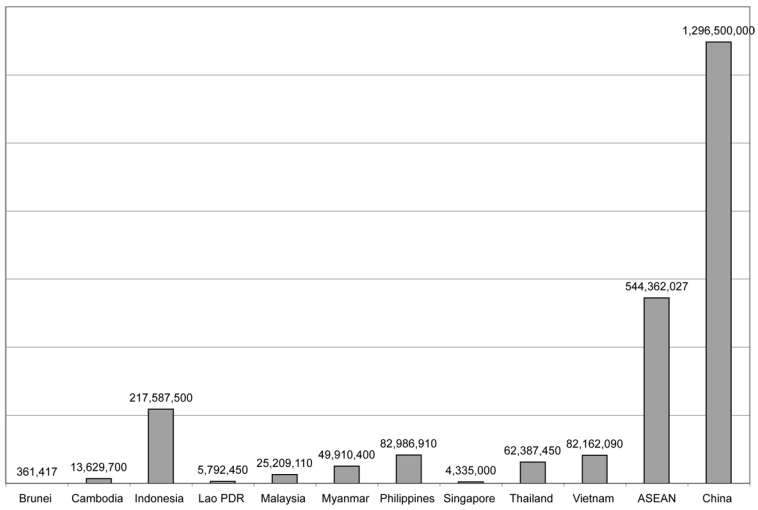
China’s economy is already much larger than that of all ASEAN countries combined (cf. figure four). China is now the second largest economy in the world after the U.S. when measured in purchasing power parity, and the fourth largest in nominal terms.

In an increasingly competitive and globalized environment, there are deep concerns in Southeast Asia that it will be overtaken by China. Fears exist that China’s seemingly unlimited supply of cheap labor (cf. figure five) will erode ASEAN countries’ competitiveness. While China is also seen as a potential export market, with one billion “new capitalists” and consumers (cf. Prestowitz 2005), ASEAN countries worry about losing their competitive edge, especially in high-technology markets (Hale and Hale 2003).<sup>8</sup>

China has also become the largest recipient of foreign direct investment (FDI) flows in the Asia-Pacific region (cf. figure six). There is a growing perception that China’s rapidly expanding economy diverts FDI inflows away from ASEAN toward China. While empirical evidence gives no indication of crowding out, and suggests that FDI flows to China did not have much impact on FDI to other countries in Asia (Mercereau 2005), the fears persist.

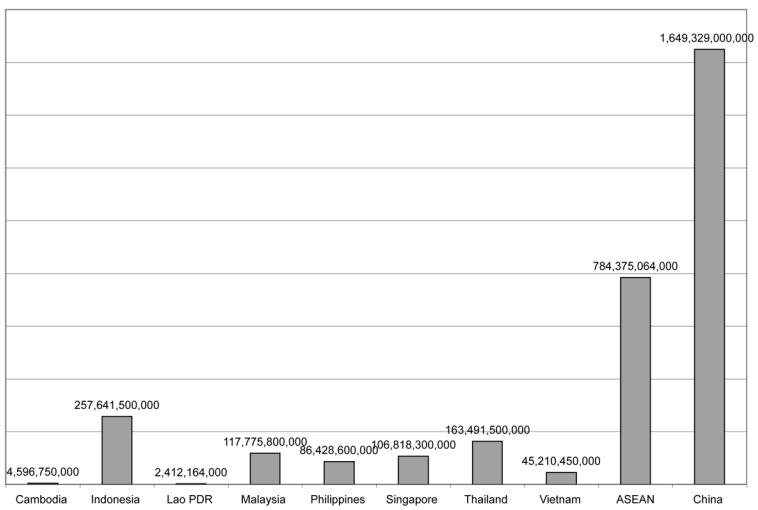
Whether the fears are well founded or not – they seem to have nurtured the notion that ASEAN countries need to restructure and integrate their economies in order to stay competitive and remain an important growth pole in the global economy.

Figure 3: Population: ASEAN vs. China (2004)



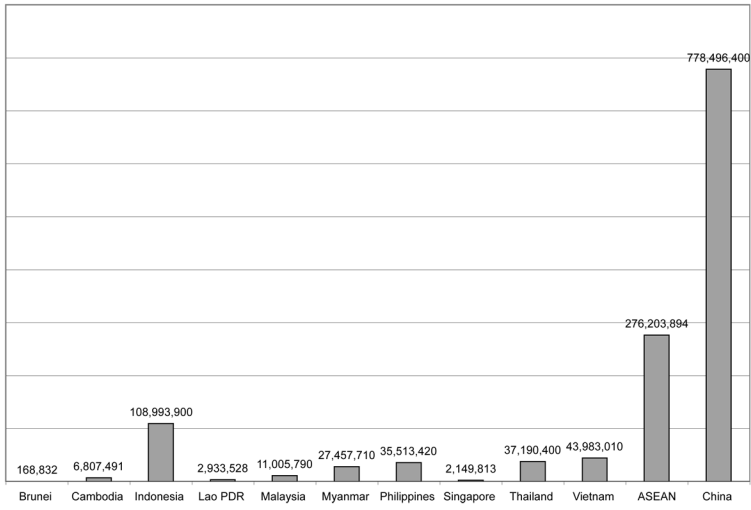
Source: WDI

Figure 4: GDP (current USD): ASEAN vs. China (2004)



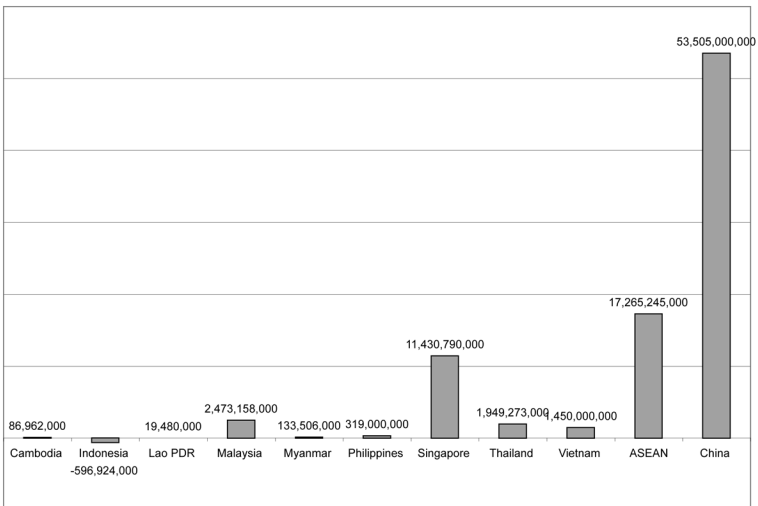
Source: WDI, Note: data for Brunei and Myanmar is n.a.

Figure 5: Total labor force: ASEAN vs. China (2004)



Source: WDI

Figure 6: Foreign direct investment (net inflows, current USD): ASEAN vs. China (2003)



Source: WDI



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The rationale is that an integrated ASEAN market with a combined population of more than 500 million should keep the region competitive vis-à-vis China – and the other rising giant, namely India. The proposed AEC mentioned earlier could provide the means for ASEAN to revitalize and remain competitive in the face of the challenges posed by the rise of China as well as globalization. The establishment of an AEC could strengthen the position of ASEAN member states with regard to its neighbors as well as international institutions like the IMF or the World Trade Organization, and give them a bigger voice on the world stage (Hew 2003).

#### **4. Characteristics of ASEAN economic regionalism**

Having discussed the reasons for ASEAN's increasing interest in fostering economic integration, some characteristics of Southeast Asian economic regionalism will be outlined below.

##### *Contextualism*

ASEAN economic regionalism has to be seen in the context of the regional as well as global setting (Henning 2005). As described above, the drive toward regional integration is born less out of love, but rather conditioned on a realization of its benefits in containing external factors. These external factors – the international community's response to the Asian crisis and the rise of China – as well as the relatively successful example of the EU have transmitted the idea of strengthening each country's position by means of forming a closer economic alliance.

##### *Non-exclusive process*

So far, the process of integration has been relatively open and non-exclusive. That is, while Southeast Asian countries have fostered economic integration within the ASEAN framework, it has not been the only platform for regional cooperation. Cooperation has also developed with China, Japan and Korea within the ASEAN + 3 framework or through other regional fora such as EMEAP. Another platform for cooperation has been the Asia-Pacific Economic Cooperation

Forum (APEC), a grouping that not only includes East Asian countries and the United States but also Australia, Canada, Chile, Mexico, New Zealand, Papua New Guinea, Peru and Russia. While APEC, which was established in 1989 partly as a strategy by the U.S. to prevent the emergence of an East Asian regionalism that would deliberately exclude the U.S.<sup>9</sup>, has lost in importance and appeal to East Asian countries, there are few signs that ASEAN or ASEAN + 3 are aiming for a closed economic bloc that would exclude and discriminate non-participating countries, a concern raised by Lincoln (2004). Indeed, despite the anti-Western rhetoric that is sometimes heard in East Asia, the economic self-interest of East Asian nations in maintaining and improving trade and investment linkages with the United States and Europe is far too large to let them form a closed economic bloc that is hostile to the West. Indeed, ASEAN countries have been very open toward the West, as shown by the recent and highly successful attempts of East Asian countries to attract foreign, and particularly American and European, direct investment.

*Evolutionary process without clear strategy*

Despite the stated goal of forming an AEC, ASEAN economic regionalism remains a very patchy framework without clear leadership and weak institutionalization. It has not yet become clear what form of integration is to be achieved (Volz 2005). There is a lack of clarity and consensus about the direction in which (South) East Asian economic integration is heading. The countries involved seem to have different interpretations of integration and even more diverse ambitions.

For instance, it is not clear what degree of sovereignty national governments are willing to give up in the process of integration. The Bali Concord II emphasizes the importance of the principle of non-interference which apparently contradicts the declared goal of forming a real community, as it more or less rules out the transfer of parts of national sovereignty to the community (cf. Hatakeyama 2005). But if ASEAN member countries refuse to concede sovereignty to ASEAN or the AEC, the whole point of creating such a community is redundant.

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## 5. Conclusion

The Asian financial crisis and the rise of China have created a situation in which ASEAN countries find closer regional economic cooperation a compelling necessity in order to shield off further crises and remain competitive in an increasingly globalized world. But despite declarations of forming an AEC and various other initiatives, the realization of such plans has been slow. ASEAN member countries do not appear to have agreed on a clear vision for ASEAN economic cooperation. Instead, they seem to be driven by differing strategic interests. But as Hatakeyama (2005) points out: “...unless both ASEAN countries and non-ASEAN economies can agree on a definition of community, there is a possibility, as the old saying in China goes, that they might have different dreams despite being in the same bed.”

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## Notes

<sup>1</sup>The ten members of ASEAN are Brunei, Cambodia, Indonesia, Lao, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

<sup>2</sup>The ASEAN “Vision 2020” of 1997 already declared the goal of creating “a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities.” (ASEAN 1997) On the AEC see Hew and Soesastro (2003) and Plummer and Click (2005).

<sup>3</sup>Hong Kong ranks number one, and the U.S. ranks twelve.

<sup>4</sup>The term “East Asia” is here used for the whole region, i.e. both Southeast Asia and Northeast Asia.

<sup>5</sup>For criticism on the IMF’s handling of the Asian crisis see, for example, Feldstein (1998).

<sup>6</sup>On the CMI see Park and Wang (2003).

<sup>7</sup>On the Asian Bond Fund see Ma and Remolona (2005).

<sup>8</sup>ASEAN has indeed attempted to explore trade and investment opportunities with China. For instance, ASEAN and China have agreed to create the world’s largest free trade area by 2012, with more than 1.7 billion people. A similar trading arrangement between ASEAN and Japan has been established, and a trading arrangement between ASEAN and Korea is underway. These arrangements are envisaged as building blocks for a possible establishment of an East Asia Free Trade Area (EAFTA) involving ASEAN +3.

<sup>9</sup>Such tendencies did exist. For instance, in 1990, the former Malaysian Prime Minister Mahathir proposed the creation of an East Asian Economic Caucus, a multilateral grouping of East Asian countries that would exclude countries like the U.S. and Australia. The U.S. and Australia were vehemently opposed to this. At American behest, the Japanese quietly sought to kill the idea, while the Australians worked hard to promote a more inclusive APEC forum as an alternative (cf. Fukuyama 2005b).



