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Howard Loewen
Anja Zorob *Editors*

Initiatives of Regional Integration in Asia in Comparative Perspective

Concepts, Contents and Prospects

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Volume 14

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Editors

Initiatives of Regional Integration in Asia in Comparative Perspective

Concepts, Contents and Prospects

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It was there where the idea of publishing the outcome of our conference was considered for the first time, yet tangible work on an edited volume was deferred. A few years later, we seized the suggestion of Francis Baert and successfully submitted a proposal to the editorial board of the United Nations University Series on Regionalism. We sincerely thank him for that.

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Bochum, Germany Anja Zorob
Erlangen, Germany Howard Loewen
May 2017

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List of Abbreviations

AA	Association Agreement
ACAA	Agreements on Conformity Assessment and Acceptance of Industrial Products
ACC	Arab Cooperation Council
ACD	Asia Cooperation Dialogue
ACFTA	ASEAN-China Free Trade Area
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
AGOIC	Arab Gulf Organization for Industrial Consultancy
AMRO	ASEAN + 3 Macroeconomic Research Office
AMF	Arab Monetary Fund
AMU	Arab Maghreb Union
APEC	Asia-Pacific Economic Organization
APTA	Asia-Pacific Trade Agreement
APTIAD	Asia-Pacific Trade and Investment Agreements Database
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
ASEAN + 3	ASEAN plus China, Japan and South Korea
ARIC	Asia Regional Integration Center
ASP	ASEAN Surveillance Process
BDA	Banco Delta Asia
BIMP-EAGA	Brunei Darussalam–Indonesia–Malaysia–Philippines East ASEAN Growth Area
BIS	Bank for International Settlements
BIT	Bilateral investment treaty
BRO	Border Roads Organisation
BTR	Bilateral Trade Relations
CACO	Central Asian Cooperation Organization
CAU	Central Asian Union
CBM	Confidence-building measure
CCTV	China Central Television

CEEC	Central and Eastern European Countries
CET	Common external tariff
CIS	Commonwealth of Independent States
CMI	Chiang Mai Initiative
CMIM	Chiang Mai Initiative Multilateralization
CNOOC	China National Offshore Oil Corporation
CNP	Comprehensive National Power
COMESA	Common Market for Eastern and Southern Africa
CST	Collective Security Treaty
CSTO	Collective Security Treaty Organization
CU	Customs Union
DCFTA	Deep and Comprehensive Free Trade Areas
DPRK	Democratic People's Republic of Korea (North Korea)
ECO	Economic Cooperation Organization
EEA	European Economic Area
EEC	Eurasian Economic Community
EFTA	European Free Trade Association
EMFTA	European-Mediterranean Free Trade Area
EMP	Euro-Mediterranean Partnership
ENP	European Neighbourhood Policy
EFSF	European Financial Stability Facility
ESC	Economic and Social Council
EU	European Union
EWEC	East-West Economic Corridor
FDI	Foreign direct investment
FGCCI	Federation of GCC Chambers of Commerce and Industry
FSF	Financial Stability Forum
FTA	Free-trade areas
GAFTA	Greater Arab Free Trade Area
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GCCIA	GCC Interconnection Authority
GDP	*Gross domestic product*
GMS	Greater Mekong Subregion
GNI	Gross national income
GSP	Generalized System of Preferences
GSTP	Global System of Trade Preferences among Developing Countries
GUCCIAAC	General Union of Chambers of Commerce, Industry and Agriculture for Arab Countries
HM	Hubness measure
HS	Harmonized System
IBRD	International Bank for Reconstruction and Development
IMF	*International Monetary Fund*
IMO	International Maritime Organization

IMU	Islamic Movement of Uzbekistan
IPR	Intellectual property rights
ISAF	International Security Assistance Force
LAS	League of Arab States
MAFTA	Mediterranean Arab Free Trade Area
MEED	Middle East Economic Digest
MEFTA	Middle East Free Trade Area
MEI	Middle East Institute
MENA	Middle East and North Africa
MERCOSUR	Mercado Común del Sur (Common Market of the South)
MFN	Most favoured nations
MOU	Memorandum of understanding
MPC	Mediterranean Partner Country
NAFTA	North American Free Trade Agreement
NAM	Non-Aligned Movement
NATO	North Atlantic Treaty Organization
NEG	New economic geography
NIE	Newly industrialized economies
NSEC	North-South Economic Corridor
NTB	Non-tariff barriers
OAPEC	Organization of Arab Petroleum Exporting Countries
OAS	Organization of American States
OAU	Organization of African Unity
ODA	Official development assistance
OECD	Organization for Cooperation and Development
OIC	Organization of the Islamic Conference
OSCE	Organization for Security and Cooperation in Europe
PetroVietnam	Vietnam Petroleum Corporation
PNOC	Philippine National Oil Company
PTA	Preferential trade area
PUST	Pyongyang University of Science and Technology
QIZ	Qualifying Industrial Zone
RATS	Regional Anti-Terrorist Structure
RCEP	Regional Comprehensive Economic Partnership
RIA	Regional international agreement
ROO	Rules of origin
RTA	Regional trade agreement
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Agreement
SAPTA	South Asian Preferential Trade Arrangement
SASEC	South Asia Subregional Economic Cooperation
SCO	Shanghai Cooperation Organization
SEC	Southern Economic Corridor
SKRL	Singapore-Kunming Rail Link
SME	Small and medium enterprises

SPT	Six-Party Talks
SSRC	Social Science Research Council
TEITC	Trade, economic, investment and technical Cooperation
TIFA	Trade and Investment Framework Agreement
TPLs	Tariff Preference Levels
UAE	United Arab Emirates
UEA	Unified Economic Agreement
UfM	Union for the Mediterranean
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UNESCWA	United Nations Economic and Social Commission for Western Asia
UNODC	United Nations Office of Drugs and Crime
US	United States
USAID	United States Agency for International Development
WTO	World Trade Organization

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Jünemann). Other publications include *Oman Caught Between the GCC Customs Union and Bilateral Free Trade with the US* (Ashgate 2008, ed. by S. Wippel) and *Intraregional Economic Integration: The Cases of GAFTA and MAFTA* (Ashgate 2008, ed. by C. Harders & M. Legrenzi).

Chapter 1
Initiatives of Regional Integration in Asia in Comparative Perspective: An Introduction

Anja Zorob and Howard Loewen

1.1 Background and Aims

In Asia, and its major sub-regions, formal attempts at regional integration via bi- or multilateral agreements negotiated and implemented 'from above' by national governments left no significant footprint during the *first wave of regionalism* in the 1950s and 1960s. Some Asian sub-regions though, such as the Middle East and Southeast Asia, in particular, witnessed several early integration efforts, mainly in the framework of the League of Arab States (LAS) and the Association of Southeast Asian Nations (ASEAN) as an endeavour to enable the newly established nation states to emancipate themselves from their colonial past and to manage regional security issues in a Cold War environment. Yet many of those initiatives, aiming at regional cooperation and integration among countries of what is called today the 'Global South' did not meet with success. Accordingly, the first phase of regionalism which has focused primarily on the European example and which many, rather mistakenly, referred to as the 'role model' of regional integration, went past the Asian continent. Yet, strategies of industrialization implemented in the following decades by the emerging "Asian Tigers", in particular East Asia (Northeast and Southeast Asia) became soon to be known as an outstanding example of economic regionalization "from below" based primarily on the establishment of regional cross-border production networks. With the *second wave of regionalism* unleashing its dynamics in the 1980s formal agreements designed to foster economic

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regionalization as well as political institution-building have apparently gained prominence in Asia. With Japan, Singapore, and China as the main drivers in the Eastern part of Asia, an increasingly complex network of bilateral and multilateral trade agreements took shape which due to its complexity and thus overlapping characteristics has been conceived of as the Asian ‘noodle bowl’.

Beyond the complexities of bilateral and multilateral free trade agreements (FTAs) other developments relevant for regional integration are significant. Financial cooperation became an important element of Asian regionalism especially as a reaction to the disastrous effects of the Asian Financial Crisis in 1997/98 on many economies in the region. The establishment of the Chiang Mai Initiative as a regional financial liquidity fund is a case in point. In addition, sub-regional and cross-border cooperation increasingly turned out to be a prominent model to follow in different parts of Asia. One of the main functions of sub-regional institutions is to foster investment in general and specifically in infrastructure development. Finally, the rise of regional powers, in particular China, and the need to manage security problems emanating from failed or unstable nation-states such as Afghanistan and North Korea fostered regional integration.

Against this empirical background the main aim of this book is to disclose the distinctive features of current regional integration agreements (RIAs) in Asia and, in particular, how they evolved during the 1990s and 2000s due to a changing global environment. Most of the literature and conferences or workshops organized on topics of regionalism and regionalization in Asia have concentrated to date on one specific area or sub-region, i.e. the Middle East or South-East Asia. In addition, they often have focused on a specific academic discipline. This book, however, brings together scholars with diverse disciplinary backgrounds who have specialized in research on processes and outcomes of regional integration in the different parts of the continent. Moreover, it strives to take up a genuinely ‘inter-Asian’ perspective. By analysing and comparing diverse manifestations of regional arrangements across Asia and its different sub-regions, it sets out to track their common characteristics and sub-regional facets with respect to their establishment, design and consequences. In addition, political processes accompanying their negotiation and implementation will be scrutinized. The analysis encompasses nine case studies written by renowned scholars who together as a group combine an extraordinary mixture of different disciplinary backgrounds as well as expertise on shapes and processes of regional integration in different parts of Asia. The case studies seize on some of the most important features and specific controversial issues characterizing the *second regionalism* and tackle its diverse aspects. Such are the emergence and impact of overlapping FTAs, regional financial and sub-regional economic integration and cooperation, power and the politics of regional integration as well as the nexus between conflict resolution, possible state failure and regional integration. The remainder of this introduction focuses in Sect. 1.2 on concept and definitions including a discussion of some of the main issues and specific features of the *second wave of regionalism* hinted at above. Section 1.3 explains the overall structure of the book and concludes with the main findings of the case studies.

1.2 Theory and Practice of Regional Integration

Economic Globalization[1] and the respective demand for interdependence management possibilities beyond the nation-state have stimulated the emergence of a multi-layered global governance system. This negotiated governance network consists of an ever growing array of international institutions, each of which may be conceived as a persistent and connected set of formal and informal rules that determine behavioural roles, constrain activity, and shape expectations. They may also assume different forms, such as international organizations, international regimes and conventions (Keohane 1989: 3). These institutions are located on the global, *inter-regional, regional*, *sub-regional* and *bilateral* level of the international system (Rüland 2002; Cable 1999).

The rise of *regional* integration initiatives in general and in Asia in specific is linked to the differentiation of the global governance system. It features the emergence of a regional policy layer. Cooperation and integration processes on this level of social organization are best understood when bringing to mind the concepts or basic definitions of *regional integration, regionalism*, and *regionalization*. Taking into account a holistic definition of the term "region", which besides economic factors also includes historical and cultural variables as well as already existent regional structures of cooperation, regionalization is to be understood as the entirety of transactions between the states of a region. These manifest themselves in the intensification of regional economic, political, and societal interactions. *Regionalism*, in turn, can be defined as a political tool for the active steering and intensification of interdependencies between states of a region (Brook 1998: 231; Roloff 2001: 18; Dent 2008). The concept of *regional integration* can be subsumed under the latter. It refers to the convergence or at least congruence of common foreign policies of states in the same geographical region that requires respective management initiatives (Dent 2002: 1–2).

While international institutions have primarily been established by nation-states in order to increase their problem-solving capabilities in different issue-areas with trans-border qualities, such as trade, finance and security, some of the respective institutions have often failed to perform their assigned tasks and thus contributed to the rise of regional initiatives. The inability of the World Trade Organization (WTO) to arrive at new trade rules in the current Doha Round, the slow pace of necessary reforms in the International Monetary Fund (IMF) and the United Nations (UN) are cases in point.[2] Against this background of global institutions' decreasing capability

[1] Holm and Sørensen define globalization as the intensification of economic, political and socio-cultural relations between states and societies in an increasingly borderless world. Important influencing factors of this dynamic process, which is without precedence in the history of international relations, are innovations in transport, communication and information-systems since the mid-seventies (Holm and Sørensen 1995:1; Diekheuer 2001: 27; Seitz 1995).

[2] The promising *trade facilitation agreement* that had been agreed upon by the 159 WTO member states in December 2013 collapsed in July 2014 as India decided to withdraw its support. This declaration would have been an important step for developing countries in the WTO since it

of problem solving other determinants have also contributed to the rise of regional integration agreements (RIAs) often accompanied by the establishment of new regional organizations. These determinants include the end of international or systemic bipolarity, the Asian Financial Crisis in 1997/98, and the economic rise of specifically China and India. Linked to the latter some also view China's accession to the WTO as the main event having triggered a "massive domino effect" in the negotiation and signature of RIAs in Asia and specifically in its Eastern part since the beginning of the 2000s (Baldwin 2011: 64).

In 2015 some 96 bilateral FTAs in Asia, comprising Central and West Asia, East Asia, Oceania, South Asia and Southeast Asia, were notified to the WTO, as compared to 9 in the year 2000, while another 61 had been in the process of notification (ADB 2016). The majority of these agreements achieved notification under GATT Art. XXIV (Customs Unions and Free Trade Areas covering trade in goods) while a smaller part has been accepted according to the rules of the *Enabling Clause* (preferential arrangements in trade in goods between developing countries) as exceptions from the *most favoured nation (MFN)* principle in the General Agreement on Tariffs and Trade (GATT). Many of these agreements also cover trade in services in line with the rules under Art. V of the General Agreement on Trade in Services (GATS).[3] Since the mid-2000s an increasing number of Asian RIAs, in particular those concluded by Japan, Singapore and Republic of Korea, include also so-called WTO-plus elements focusing on the 'Singapore Issues' competition, investment, public procurement and trade facilitation (Kawai and Wignaraja 2013). Accordingly, many countries in Asia are part of a steadily growing network of RIAs. These treaties may assume bilateral and multilateral institutional forms. Bilateral FTAs are legion. They are negotiated, signed, ratified and implemented by neighbouring countries or those that belong to the same sub-region. In Asia this pattern applies in particular to the sub-regions of both the Middle East and East Asia, including Southeast Asia. In recent years, however, bilateral FTAs were concluded or are in the making also between countries from across the region connecting countries like Jordan and Singapore, China and Pakistan or India and Japan.[4] In addition, there are a growing number of multilateral FTAs such as the ASEAN FTA (AFTA) signed in 1992, the

reflected many of their genuine interests such as the reduction of customs bureaucracy in trade affairs (The Economist, Bailing Out from Bali, 09.08.2014).

[3] For more information on the coverage of the trade agreements see WTO (2016), WTO Trade Agreements Information System, as well as Kawai and Wignaraja (2013); for an overview about the legal framework of exceptions from the MFN rule see Trebilock et al. 2013.

[4] Detailed information on Asian countries' bilateral as well as multi- or rather plurilateral agreements, their membership, type and scope of areas covered as well as their current status including whether they are notified to the WTO is available, inter alia, in the *Asia Pacific Trade and Investment Agreements Database (APTIAD)* developed by the *United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP)* or the *Asia Regional Integration Center (ARIC) FTA Database* maintained by the *Asian Development Bank (ADB)*. It should be noted, however, that Middle Eastern countries are either not listed or only mentioned as external partners of the countries included in the databases. For information on Middle Eastern countries' trade agreements see Zorob in this volume.

South Asian Free Trade Agreement (SAFTA) which came into force in 2006 or the FTA between the members of the Gulf Cooperation Council (GCC) in 1983.

Table 1.1 shows a list of multilateral regional trade agreements (RTAs) notified to the WTO, their membership, type of agreement and date of entry-into-force. While the GCC announced to introduce a customs union (CU) in 2001 and later a common market to come into effect in 2008, ASEAN members' heads of state promulgated in 2003 for the first time the aim to create an ASEAN Economic Community as a long-term goal or economic integration among ASEAN members (see Lawson in this volume). Though the plans of both organizations so far either struggled to get off the ground at all or faced serious hurdles in implementing the envisioned steps of integration. Yet multilateral FTAs were thus often negotiated and/or further deepened and widened in the framework of existing sub-regional organizations. The same sub-regional organizations signed FTAs with other countries either in their immediate neighbourhood or, specifically in the case of the GCC, also across Asia. The latter, for example, concluded a FTA with Singapore which entered into force in 2013. The GCC also negotiated with other countries including Japan, China and Republic of Korea. During the 2000s ASEAN members signed several "ASEAN +1" FTAs with China, India, Japan and the Republic of Korea.

Besides ASEAN and GCC new regional organizations were founded in the course of the 1980s and 1990s such as the Shanghai Cooperation Organization (SCO) established in 2001 by China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan, the Economic Cooperation Organization (ECO) launched in its first phase 1985 by Iran, Pakistan and Turkey or the South Asian Association for Regional Cooperation (SAARC) formed in 1985 too by Bhutan, Pakistan, India, Nepal, Sri Lanka and the Maldives. Moreover, existing regional organizations have been extended on either a formal or a rather informal basis such as 'ASEAN-plus-Three' (ASEAN+3), i.e. ASEAN member countries plus China, Japan and Republic of Korea which came together in the wake of the Asian financial crisis for the first time in 1997. Finally, Asian countries joined a number of bilateral as well as multilateral RIAs that include members in their 'non-Asian' neighbourhood. Examples of the latter group of agreements and/or organizations cover the *Greater Arab Free Trade Area (GAFTA)* signed in 1997 or the agreement between ASEAN, Australia and New Zealand which entered into force in 2010. Worth mentioning are in particular also the Asia Pacific Economic Organization (APEC) established in 1989 by twelve countries including, among others, Japan, Republic of Korea and Malaysia besides the United States of America and Canada as well as the Trans Pacific Partnership (TPP) signed in February 2016.[5] The U.S. withdrawal from the TPP in November certainly has encouraged further and decided negotiations of ASEAN member states and their six FTA-partners[6] on the Regional Comprehensive Economic Partnership (RCEP). An Asia-wide intergovernmental organization came into being in 2002 with the launch of the *Asia Cooperation Dialogue (ACD).* The

[5] The current member states of TPP comprise Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam.

[6] ASEAN's six FTA-partners are Australia, China, India, Japan, New Zealand and South Korea.

Table 1.1 Asian multilateral RTAs (and Developing Countries' Preference Systems) notified to the GATT/WTO, 2016

Agreement	Member Countries	Type of Agreement[a]	Coverage of Agreement	Entry into Force
Agadir Agreement	Egypt, Jordan, Morocco, Tunisia	FTA	Goods	2007
ASEAN Free Trade Area (AFTA)	Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam	FTA	Goods	1992
Asia-Pacific Trade Agreement (APTA)	Bangladesh, China (2004), India, Laos, Republic of Korea, Sri Lanka	PSA	Goods	1976
Economic Cooperation Organization (ECO)	Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyz Republic, Pakistan, Tajikistan, Turkey, Turkmenistan, Uzbekistan	PSA	Goods	1992
Global System of Trade Preferences among Developing Countries (GSTP)	Algeria, Argentina, Bangladesh, Benin, Bolivia, Brazil, Cameroon, Chile, Colombia, Cuba, Democratic People's Republic of Korea, Ecuador, Egypt, Ghana, Guinea, Guyana, India, Indonesia, Islamic Republic of Iran, Iraq, Libya, Malaysia, MERCOSUR, Mexico, Morocco, Mozambique, Myanmar, Nicaragua, Nigeria, Pakistan, Peru, Philippines, Republic of Korea, Singapore, Sri Lanka, Sudan, Thailand, Trinidad & Tobago, Tunisia, United Republic of Tanzania, Venezuela, Vietnam, Zimbabwe	PSA	Goods	1989
Greater (Pan-) Arab Free Trade Area (GAFTA / PAFTA)	Algeria (2009), Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Sudan, Syria, Tunisia, UAE, Yemen	FTA	Goods	1998
Gulf Cooperation Council (GCC)	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates	CU	Goods	2003
Protocol on Trade Negotiations among Developing Countries (PTN)	Bangladesh, Brazil, Chile, Egypt, Israel, Mexico, Pakistan, Paraguay, Peru, Philippines, Republic of Korea, Serbia, Tunisia, Turkey, Uruguay	PSA	Goods	1973
South Asian Preferential (Free) Trade Arrangement (SAPTA / SAFTA)	Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka	PSA / FTA	Goods	1997/ 2008
Trans-Pacific Strategic Economic Partnership	Brunei Darussalam, Chile, New Zealand, Singapore	FTA & EIA	Goods & Services	2006

[a]*PSA* Partial Scope Agreement, *FTA* Free Trade Agreement, *CU* Customs Union, *EIA* Economic Integration Agreement

Source: Own compilation based on World Trade Organization (2016), WTO Regional Trade Agreements Information System (RTA-IS); Fiorentino (2011). The Never-Ending Story of Regional Trade Agreements, Table 1A.1, pp. 28–30

ACD members currently comprise of 34 Asian countries, among them all members of both ASEAN and the GCC. Among the ACD's main aims is to enhance cooperation among its members and to "strengthen the 'voice of Asia' in the international arena".[7]

The last two decades witnessed also the emergence of a host of initiatives aiming at sub-regional and/or cross-border cooperation. Often closely associated with the concept of so-called 'growth-triangles' they primarily focus on the promotion of investment and particularly infrastructure development besides fostering transport, trade facilitation or cooperation in energy issues. In many instances this is in turn regarded as an appropriate way to support stronger economic and trade integration among the member countries. Examples include the *Greater Mekong Sub-Region (GMS)* established in 1992*, the Brunei Darussalam–Indonesia–Malaysia–The Philippines East ASEAN Growth Area (BIMP-EAGA)* and the Indonesia-Malaysia-Singapore Growth Triangle (IMS-GT) both launched in 1994 or the *South Asia Subregional Economic Cooperation (SASEC)* set up in 2001.

As mentioned at the beginning of the introduction, the literature usually distinguishes between two phases or waves of regionalism: the *first* or *old regionalism* during the 1950s and 1960s and the *new* or *second regionalism* which started to unfold in the late 1980s (Palmer 1991: 1–2, Hurrell 1995: 21). The second regionalism is characterized by several specific features which allow us to clearly differentiate it from the first. The old regionalism is typically, but not exclusively, associated with the process of European Integration initiated in the 1950s under the institutional umbrella of the European Communities, later the European Union (EU) (Hettne 1999: 9).[8] Besides political motives such as understanding Europe as a peace project especially in the early integration process, primarily economic interests were decisive over time: With the creation of a single market and the realization of the economic and currency union, the European states not only increased their economic clout. They also tried to counteract the North American competitive pressure through shielding and blocking (Hart 1999: 26). Due to this development other world-regions felt economically threatened by Europe and started building their own regional institutions. In the course of this process, new regional organizations emerged in the 1980s and 1990s, including the Mercado Común del Sur (MERCOSUR), the North American Free Trade Association (NAFTA) and the South Asian Association for Regional Cooperation (SAARC). Already existent organizations, such as the Association of Southeast Asian Nations (ASEAN) or the Andean Pact, deepened or broadened their cooperative relationships by establishing specific sub-regional institutions such as the ASEAN Free Trade Area (AFTA). (Rüland 2002: 185–186; Hurrell 1995: 332).

[7] For more information see ACD's official website: Asia Cooperation Dialogue 2016 and Ismail 2013.

[8] Other organizations of the old regionalism were, for instance, the Organization of American States (OAS), the Organization of African Unity (OAU) and the Organization of Arab Petroleum Exporting Countries (OAPEC).

The spread of new regional organizations, contractual arrangements and their deepening has been accompanied by frequent references on the part of both politicians negotiating RIAs and scientists following up these procedures to the slogan of *open regionalism*. Conveying the implicit impression that regional integration does not necessarily need to be protectionist in an effort of clearly dissociating the new initiatives from those having been signed among developing countries during the 1950s and 1960s, *open regionalism* soon emerged as the "idea of the 1990s" (Schiff and Winters 2003: 242). The emergence of the slogan apparently goes back to the establishment of APEC in the late 1980s. The declaration issued in the framework of the 3rd APEC Ministerial Meeting 1991 in Seoul adopted *open regionalism* as a principle (Drysdale et al. 1998: 103–105) though it remained unclear what it exactly means. *Fred Bergsten*, who chaired APEC's *Eminent Persons Group* for some years during the 1990s, characterized *open regionalism* as a viable tool "through which regionalism can be employed to accelerate the progress toward global liberalisation and rule-making". It would offer a way to reap the benefits of regional integration "without jeopardising the continued vitality of the multilateral system" (Bergsten 1997: 549). He proposed several definitions how *open regionalism* could be put into practice. These consist of open membership, most-favoured nation (MFN) treatment, global liberalisation and trade facilitation. While open membership would basically imply that any third country willing to accept the regional body's rules could join the club, MFN treatment can be understood as the possibility of the FTA members to extend the scope of trade liberalization to third parties outside the agreement on either an unconditional or conditional basis (Bergsten 1997: 551–557). Unsurprisingly, other authors were rather critical of this concept emphasizing the lacking feasibility to implement the criteria brought into discussion by Bergsten and to ensure compatibility between the spread of RTAs with multilateral liberalization in the framework of GATT/WTO (see, inter alia, Panagariya 1999: 33–38; Schiff and Winters 2003: esp. 242–244).

Primarily put forward by the staunchest critics of *open regionalism* another concept gained ground during the 1990s in the debate about the pros and cons of the *new regionalism*: the *spaghetti bowl phenomenon* or its Asian equivalent named *noodle bowl problem* (Baldwin 2009: 28). First introduced by Jagdish Bhagwati the *spaghetti bowl phenomenon* depicts the constantly growing and increasingly complex networks of overlapping free trade areas for which many parts in Asia seem to provide a paradigmatic example. While protagonists of *open regionalism* highlighted that membership in multiple FTAs would allow for limiting welfare-reducing *trade diversion,* Bhagwati and others invoked the many problems which may emanate from simultaneously negotiating and implementing multiple overlapping FTAs. The *systemic implications* of overlapping trade agreements including, most importantly, the administration of different schedules for the removal of tariffs and the application of often complex and restrictive rules of origin (ROOs) which are both indispensable elements of each and every FTA (see Bhagwati et al. Bhagwati et al. 1998) not only contribute to shed a critical light on the expected benefits of

FTAs. In addition and taking into account the “inherently preferential and discriminatory” (Bhagwati 1995: 2) characteristics of FTAs they cast serious doubts on the potential of regional trade liberalization to be compatible with or even complement multilateral trade negotiations.

A question arising immediately and almost naturally when exploring the “wildfire of regionalism” in Asia (Baldwin 2009: 18) is which country or countries are leading this process and what are their motives? Who kicked the first “domino”? Which country has the economic power and political clout to do so? How do existing trade relations and their relative strength matter in this case? This is where another main feature characterizing the *second regionalism* enters the stage, the *Hub-and-spoke* nature of many trade agreements or the spread of *Hub-and-spoke bilateralism*. With market access as the single “currency of exchange” that apparently counts in the eyes of politicians representing small economies (the spokes), the aim to secure preferential access to the World’s largest trade powers (the hubs) and even competing among each other to be the first, became one if not the main force behind the drive to negotiate FTAs. In addition, many economists pushed this development, deliberately or accidentally, by emphasizing that trade liberalization with large industrialized economies would provide developing countries with much better chances to reap the benefits of free trade and in particular to realize *dynamic* effects of integration. Against this background it comes as no surprise that many of the bilateral FTAs signed by Asian countries in recent years focused either on gaining access to the largest markets inside the region including Japan, China and Republic of Korea or to the EU and the US as the main ‘external’ hubs. On the downside, however, and apart from ‘problematic issues’ like costs of adjustment or preconditions for realizing dynamic effects, being a spoke and one among many of the same hub could turn out to become a risky endeavour specifically when missing liberalization among the spokes in the end fosters trade and investment diversion to the hub. This being said one should not forget that negotiating a genuinely multilateral agreement spanning a host of countries such as RCEP to prevent the emergence of or ‘streamline’ an existing spaghetti bowl of bilateral FTAs is a very complex and demanding issue.

Furthermore, regional integration agreements did not evolve in a straight-forward process as theorized in classical integration theories. Conventional regionalist theories emphasize ideal sequences of market integration as incentives for the development of cooperation. Whereas Moravcsik (1998) put stress on preference formation, international bargaining and institutional choice as necessary steps toward regional cooperation, Balassa (1961) suggested that it evolves in five distinct steps: free trade area, customs union, common market, economic and monetary union and finally political union. Balassa and other neo-functionalists share the idea that integration of markets for goods and capital fosters the evolution of cooperation at the regional level. This approach is shared by the customs union theory and the theory of optimum currency areas in economics. While they vary in terms of importance they attach to this factor, most analysts of East Asian regionalism agree that the market integration helps to induce governments to cooperate. The notion of trade preceding monetary cooperation is questioned by Dieter and Higgot (2003). Based on the obvious correlation between market integration and financial crisis they argue that East Asian regionalism is guided by monetary or financial integration rather than trade integration.

Actually, shortly after the end of the financial crisis, ASEAN+3 had been created and with it a regional strategy to foster financial integration between Southeast and Northeast Asia. Manifestations of this development are the Chiang-Mai Initiative (CMI), the Asian Bond Market Initiative (ABMI), and the Asian Currency Unit (ACU). Especially the originally bilateral currency swap arrangements of the CMI evolved into a multilateralized system (Chiang Mai Initiative Multilateralization, CMIM). In contrast to regional trade agreements the basic motive for the initiation of these agreements is primarily to avoid regional financial crisis (Loewen in this volume). A key reason why financial regionalism has been able to advance in East Asia ahead of trade regionalism is that finance is generally perceived as being less political sensitive than trade (especially trade in agriculture and textiles). This pattern of a growing financial regionalism appears to be present not only among the more diversified economies of East Asia, but also inside the GCC. The GCC members announced their aim to introduce a common currency during the 2000s after the establishment of an FTA in 1983 and the declaration to form a customs union in 2001 and thus followed more closely, at least somehow, Balassa's model of consecutive stages. It should be noted, however, that the plans to introduce a common currency soon ran into serious troubles when Oman and later the UAE decided to opt out in 2006 and 2009 respectively (Zorob 2013: 187–188, Lawson in this volume).

Another specific element of the *second regionalism* with examples abounding in different parts of Asia are, as illustrated above, initiatives of sub-regional cooperation such as the Mekong River Commission or the Indonesia-Malaysia-Thailand growth triangle. These schemes often represent first of all efforts on the part of local businesspeople and provincial officials to forge linkages in areas such as trade and investment across parts or regions of neighbouring countries. Sub-regional cooperation aims at realizing comparative advantages by linking adjacent territories of different states with a heterogeneous factor endowment (e.g. land, labour, capital). The involved states and interested companies from the territories in question closely work together to foster private investment and infrastructure development.

Beyond the image of regional integration as a primary vehicle for the management of economic interdependencies in the issue areas of trade, finance and investment, national security developments and the foreign policy strategies and actions of regional powers may also affect the formation, maintenance and effectiveness of regional agreements. Regional powers qualify as such when the respective self-image of a state equals its material capabilities. It is therefore not sufficient for a state to claim or conceive of itself as a regional leader. Rather this rhetoric of power has to be complemented by material superiority over neighbouring states in terms of economic, military and demographic resources (Nolte 2010: 893). The foreign policy actions of regional powers may have two effects on regional integration processes: the first one draws on the positive correlation between hegemonic power and the establishment of international institutions (Kindleberger 1981). Cases in point are the domination of the Shanghai Cooperation Organization by Russia and China, the leading role of China in the establishment of the Asian Infrastructure Investment Bank (AIIB) in 2015 as well as the role of Saudi Arabia in deepening regional cooperation in the Middle East, especially by supporting the establishment of the Gulf Cooperation Council. The second effect would draw on the consequences of regional powers' foreign policies on the stability of regional integration processes. The factual cleavage between ASEAN states with regard to their affiliation with China and the US as well as the balancing function of regional institutions such East Asia Summit with regard to the rise of China illustrate the second effect.

While powerful states tend to impair rules of bilateral and multilateral cooperation, weak or fragile nations may also prompt their neighbours to cooperate in order avoid their collapse or to render them more accountable in terms of foreign policy outputs and behaviour. The connection between regionalism and conflict resolution warrants greater attention both at the South Western end of the continent and with regard to fostering tensions surrounding the Democratic People's Republic of (North) Korea at the North Eastern tip. State collapse might even provide strong incentives for surrounding governments to initiate regional co-operation. What policy-makers call "failed states" can pose real problems for neighbouring states, and looking at the case of Afghanistan after 2001 offers a good deal of insight into a possible positive effect of governmental collapse.

Furthermore, regional cooperation in Asia is basically characterized by informal, non-binding and process-oriented institutions. Although institutional dynamics have been gaining momentum especially in the issue-area of economic cooperation since the Asian crisis in 1997 and 1998 they are marked by low levels of delegation and commitment. Furthermore, they tend to have multiple geographic configurations and include members from outside the region. This assessment largely explains why many analysts do not give great weight especially to East Asian institutions in generating cooperation in the region. At the same time, European Integration is often regarded as the counterpart to Asian cooperation, thereby stressing supranationalism, formalization, binding decisions and output-orientation as means to attain an effective management of regional cooperation. Exceptions are Higgot (2000) who puts emphasis on the role of the Asia-Europe Meeting in forging links and a common identity between Southeast Asian and Northeast member states. Katzenstein (1997) stresses the importance of informal transnational networks as equivalents of formal integration in East Asia. Although not effective in the traditional sense, Archarya (1999) emphasizes regional institutions as vital for the initiation of confidence building measures or in other words, for the ability of the region to manage cooperation problems the "ASEAN way".

This book is divided into four broad categories: (1) Chaps. 2 and 3 shed a light on the Asian 'noodle' or spaghetti bowl of overlapping free trade agreements focusing on the emergence and impact of hub-and-spoke bilateralism in different parts of Asia (Chen, Zorob), (2) Chaps. 4 and 5 move beyond pure trade liberalization by looking at regional financial and sub-regional economic integration (Krahl and Dosch, Loewen,), (3) Chaps. 6, 7 and 8 concentrate on the link between power and the politics of regionalism (Ahmad, Bünte, Lawson) and finally (4) Chaps. 9 and 10 analyse the connection between potentially failed states, conflict resolution and regional integration (Frank, Gavrilis). The articles by Lurong Chen, Ishtiaq Ahmad, Rüdiger Frank, Georg Gavrilis and Fred Lawson are comprehensively revised and updated versions of papers that were originally presented at the first Conference on Inter-Asian Connections organised by the Social Science Research Council (SSRC), held in Dubai in February 2008.

1.3 Structure of the Book and Main Findings

The first two chapters deal with the "wildfire of regionalism" in different parts of Asia. They both put the seemingly unstoppable spread of *Hub-and-spoke Bilateralism* at the centre of their analysis which reflects one of the 'hot topics' in current debates and main features of the new regionalism. While Lurong Chen discovers in Chap. 2 which country or countries may emerge as a hub based on the strength of existing bilateral trade relations among East Asian countries Anja Zorob explores in Chap. 3 what kind of problems spokes must expect to confront when trying to liberalize trade among each other as a way to contain the risk of being marginalized. In addition, Chap. 2 is the first in a bundle of chapters in this volume focusing on the rising power of China and trying to disclose its impact on the present track record and future path of regionalism in Asia.

Chen, Research Fellow at the Institute on Comparative Regional Integration Studies of the United Nations University (UNU-CRIS), seizes in his chapter *Japan and China in a Two-Hub Formation of Regional Integration in East Asia* on a widely held view that formal initiatives of trade liberalization and institution building in East Asia will most probably build upon "*de facto* regional integration" having been fostered in the past mainly via the bottom-up establishment of regional production networks. Keeping in mind the political forces pushing specifically governments of smaller or spoke economies to rush in and compete among each other in signing free trade agreements with large trade hubs, he tries to assess if and how regionalism in this part of Asia could be expected to evolve as a "two-hub formation". Such a pattern of how regionalism may move forward in East Asia has been first suggested by Baldwin 2004 calling it an *East Asian Bicycle*. Chen, however, complements the HM Index for measuring a country's dependence in trade on a partner country market by additionally calculating a *Bilateral Trade Relation (BTR) Index* which aims at quantifying the degree of *de facto* trade liberalization among pairs of countries and the relative *Economic Distance* between them. Based on these calculations Chen is in a similar manner as Baldwin able to identify Japan and China as the players with the highest potential to serve as regional hubs with whom all other countries around will be most eager and prepared to invest the necessary political resources for negotiating FTAs. Contrary to Baldwin, however, Chen sees the "Chinese wheel to be the main cycle fuelling the movement of regional integration" in East Asia and specifically after China has been the first to sign an 'ASEAN +1' trade agreement.[9] Such a perception may, in turn, have contributed to propel the Japanese administration to actively seek FTAs with its East Asian neighbours in recent years as well as to jump at a relatively late stage on the TPP wagon.

While spoke country governments, as mentioned above, are usually said to try their utmost to sign FTAs with large *hubs*, the same would rather easily accept negotiations on trade liberalization among themselves to founder thereby accepting a "self-inflicted peripherality" (see Baldwin 2009: 6–8). But how far is this peripherality indeed "self-inflicted"? *Anja Zorob,* co-editor of this volume and member of the board of directors of the Centre for Mediterranean Studies (ZMS) at Ruhr-University Bochum takes a closer look on the contents and impact of Hub-and-spokes bilateralism. In her contribution on *Regional Integration among Arab Countries in the Shadow of EU and US Free Trade Initiatives* she calls into question the claim often voiced by European Union (EU) and US officials that agreements with them would offer their (developing) partners 'positive spill-over effects' for integration among themselves. For this purpose, she investigates the *systemic implications* of FTAs signed by Arab Countries with external partners, and most importantly *hubs* outside the region which cover in this case primarily the EU and the US. Rules of origin and in particular those anchored in bilateral Hub-and-spoke FTAs may not only generate high costs of compliance. They could also seriously constrain the spokes' policy space in negotiating and implementing agreements aimed at liberalizing trade among them. For analysing if and to what extent provisions anchored in Arab countries' bilateral Hub-and-spoke FTAs could be hold accountable for the bumpy track record of both the Greater Arab Free Trade Area (GAFTA) and the Agadir Agreement the author takes, among others, a closer look on the apparently 'never-ending' GAFTA-internal negotiations on ROOs. Although the Hub-and-spoke ROOs are only one among various obstacles and the ROOs agreed to with the EU allow for diagonal cummulation, she concludes that the FTAs with external partners apparently foster regional fragmentation. In addition, the aim to "harmonize" intraregional ROOs with those included in the Hub-and-spoke agreements may have contributed to open GAFTA-internal negotiations for 'protectionist capture'.

The following two chapters go beyond pure trade integration on a regional level by turning the perspective to sub-regional cooperation in infrastructure and financial regional institution building in East and Southeast Asia. In Chap. 4 *The Greater Mekong Subregion (GMS) at 20 – Infrastructure Development and the Prospects for the Emergence of a Security Community* Jörrn Dosch, Chair of International Politics and Development Cooperation at the University of Rostock and Timotheus Krahl, MA, PhD candidate at the School of Arts and Social Science, Monash University, focus on the notion of sub-regional cooperation. The idea of sub-regional economic

[9]According to information available on the website of the Chinese Ministry of Commerce China and ASEAN members started in 2014 with the first round of negotiations to achieve an "upgrading" of the China-ASEAN FTA which has entered into force in July 2005; in 2015 China signed an FTA with Republic of Korea while trilateral negotiations on a China-Japan-Korea FTA were launched in 2012 (see People's Republic of China 2015).

cooperation has been closely associated with the concept of "growth triangles", a term first used to paraphrase economic cooperation among Singapore, the Malaysian state of Johor, and the Indonesian province of Riau. The Greater Mekong Sub-region, an area which during the Cold War had long been characterized by intense rivalry and confrontation, has been proposed officially in the early 1990s and therefore was part of a new type of cooperation in Southeast Asia. According to their main sponsor, the Asian Development Bank (ADB), "… growth triangles help solve the practical problems of regional integration among countries at different stages of economic development, and sometimes, even with different social and economic systems" (Krongkaew 2000: 34–35). The GMS Programme aims at promoting the development of GMS markets and facilitating the movement of goods and people across common borders. Accordingly, infrastructure investments form one of the main elements to enhance "connectivity, competitiveness and community" among the GMS members. Following a detailed assessment of progress achieved in infrastructure development during the last 20 years and covering, among others, the three so-called GMS "economic corridors", the authors explore, drawing on the transactionalist approach proposed by Karl W. Deutsch, how this affected cross-border trade and human traffic among GMS members. Whether the cross-border transactions will ultimately create a "suitable basis" for the emergence of a "pluralistic security community" might remain a point for discussion though.

In Chap. 5 *Institutional Development and Institutional Interplay within the Global Financial Regime Complex – The IMF and Regional Financial Cooperation in East Asia* Howard Loewen, Professor of Political Science at the University of Erlangen-Nuremberg, argues that the emergence and specific implementation of an international or regional institution such as the *Chiang Mai Initiative Multilateralization* (CMIM), a regional currency reserve mechanism, can only be understood if it is seen as part or element of a larger regime complex. The latter is composed of loosely connected yet not integrated financial institutions on the regional and the global level. The empirical puzzle starts with the observation that the CMIM member-states decided to outsource conditionality by capping the reserves that can be withdrawn from the fund in a crisis without an IMF linkage to 30 percent of the total amount. This ridicules the very purpose of CMIM as voiced out by the ASEAN+3 states in the wake of the Asian Financial crisis in 1997/98 and that is to delink Asia from IMF conditionality. On the basis of a model derived from Regime Complex Theory Loewen holds firstly that the CMIM as an elemental institution of the financial regime complex has not been built on a *clean slate*. Cases in point are the lending and surveillance functions, each of which are prior rules that have been developed in the IMF. Secondly, the establishment of the CMIM created *forum shopping* possibilities that have not been used to date. In this regard member states try to avoid overdependence on IMF-conditionality while at the same time maintaining close institutional linkages with it. Thirdly, there is no clear division of labour between the CMIM and the IMF, which points to *legal inconsistencies* at the boundaries between these regimes. Meanwhile CMIM roughly supplements the IMF functions at the regional level. Fourthly, the CMIM is dominated by politics of implementation where the specifics of surveillance and conditionality are being negotiated only after the initiation of the regime.

The next three chapters investigate the link between power and politics of regionalism in Asia. As part of the analysis presented in these chapters the role and motives of China as a key driver of regionalism and regional institution building gain again centre stage. *Ishtiaq Ahmad,* Vice Chancellor of University of Sargodha in Pakistan, starts in Chap. 6 with an analysis of the *Shanghai Cooperation Organization: China, Russia, and Regionalism in Central Asia*. Established in 2001 by Russia, China, Kazakhstan, Tajikistan, Kyrgyzstan and Uzbekistan the organization covers more than one fourth of the world's population. In addition, the member-states of the Shanghai Cooperation Organization (SCO) including India and Pakistan which both acceded to the SCO in 2015 and its observers, among them Iran and Mongolia, account for around half of the global gas reserves and one sixth of the world's oil reserves (Bailes and Dunay 2007). Against this background one is tempted to think that the SCO primarily feeds into China's strategy to secure access to energy resources it urgently needs to keep its economy growing while Russia aims at forming an 'energy club'. The concept of the so-called 'Great Game' by which other authors tried to analyse SCO's emergence, would however, according to Ahmad, "have little relevance to the reality of regionalism in Central Asia". He focuses instead on the "objective interests" of the SCO member states. The author emphasizes that the main achievements of the SCO during its first years concentrated primarily on security cooperation covering, in particular, the fight against terrorism. Regional stability was and is apparently a core objective of cooperation that both China and Russia share with their Central Asian neighbours. In addition, political dialogue and coordination among the SCO members registered some progress. In this process, however, the various economic interests of the SCO members, including the "need" of the relatively small and landlocked Central Asian members to tap the large Chinese and Russian markets, and the "mutual compatibility" of these interests would have played a crucial role. This does not mean, however, that initiatives designed to foster economic cooperation on a multilateral level have received the same priority. Rather on the contrary, China seems keen to strengthen cooperation with Russia and the Central Asian countries via bilateral routes in diverse fields far beyond energy. Finally, Ahmad compares the track-record and appeal of SCO with the performance of other regional organizations involving Central Asian countries. While admitting that SCO suffers from different problems including shortage of funds and overlapping institutional memberships too, the author points to what the SCO was able to achieve in recent years in contrast to other organizations and most importantly with respect to building confidence among its members. This would have been made possible due to the extraordinary role and capacity of China as a focal point for economic development of the Central Asian countries besides the declining, but still considerable political clout of Russia.

China's core interests of securing regional stability and access to resources apparently play a major role also in its relations with the ASEAN member countries.

Marco Bünte, Associate Professor of Politics and International Relations and currently Deputy Head of the School of Arts and Social Sciences, Monash University, however, investigates the growing role of China based on an analytical framework which links the concept of leadership with power transition theory. In Chap. 7 *China's Rising Power in Southeast Asia and Its Impact on Regional Institution-building: Who is leading Whom?* he initially argues that China increasingly sets the rules in this part of the world. The author outlines how China has progressively deepened its ties with Southeast Asian neighbours in terms of trade, aid, foreign direct investment and education in recent years. Although China engaged in addition in the set-up of diverse multilateral initiatives such as the Greater Mekong Sub-region Initiative (GMS) or the Gulf of Tonkin Initiative (Pan Beibu) those measures should, according to Bünte, rather not be interpreted as a preference for multilateralism. On the contrary, China seems, in a similar manner as discovered by Ahmad with respect to China's relations with Central Asian countries, to make use of both multilateral and bilateral initiatives as a way to achieve its core interests of regional stability and resource seeking. Finally, while ASEAN member countries make room for a rising China enabling them to benefit from growing trade and security, most of ASEAN members are at unease with the idea to abandon the traditional role of ASEAN as a driver of regional integration. Moreover, due to the different interests of ASEAN members and looking at the issue in a longer term perspective, China's rise would also generate potential for greater conflict in inner-ASEAN relations.

Fred Lawson, Senior Fellow at the Centre for Syrian Studies, University of St. Andrews, explores in Chap. 8 *Comparing Modes of Regional Economic Governance: The Gulf Cooperation Council and the Association of Southeast Asian Nations* the dynamics of regionalism in two Asian sub-regions. Both regional organizations initially grew out of attempts by states to promote common security interests. Turning 'economic' sooner or later both the GCC and ASEAN were previously viewed by most observers as not being able to provide a sound foundation for greater political, economic or social integration. Generalizations of this sort would, however, not only fail to pay attention to the alternating bursts and regressions of 'regionalist activism' both organizations experienced since their inception. In addition, they obscure the strikingly different modes of regional governance of "such superficially similar – but inherently disparate – entities as the ones that can be found across contemporary Asia". For discovering and analysing the "crucial variations in structures, policy-making procedures and developmental trajectories across different cases" which according to Lawson existing scholarship would "tend to ignore", the author makes use of a typology of regionalist projects. The typology he has laid down in an earlier work to elucidate differences in governance modes of various sub-regional schemes in the Middle East and North Africa (Lawson 2008) is further tested and refined here. It distinguishes different types of regionalist projects based on the interplay of variables covering among others the degree to which regional institutions possess the authority to design and implement policy and the extent to which regional institutions and/or individual member-states are prepared to provide incentives fostering compliance with regional rules. Drawing on this framework Lawson traces the changes in the kind and level of governance that occurred in both the GCC and ASEAN over a period of more than three decades and ascertains their rather diverse trends and processes stimulating, consolidating and sustaining sub-regional integration. The author is able to contrast the key developments that have transformed the GCC from an initially loose security arrangement into a more integrated regional project today with those that prompted ASEAN members to spur collaboration among each other and, more recently, with 'large' neighbouring countries such as China, South Korea and Japan (ASEAN+3).

The next two chapters offer illustrations of the link between regional integration, conflict management or resolution and potentially failed states or collapsing states. So far multilateral talks between North Korea and the US, China, Japan, South Korea and Russia have on both sides been driven explicitly or implicitly by *confrontational cooperation*. Alliances were formed and pitted against each other or against a single country. North Korea's denuclearization was the normative final goal of such efforts. Against this background *Rüdiger Frank*, Professor of East Asian Economy and Society at the University of Vienna and Head of its Department of East Asian Studies, explores in Chap. 9 *East Asian Regionalization and Korea: From Confrontation to Cooperation* the possibilities for another form of multilateralism, *cooperative cooperation*, i.e. a form of cooperation with a focus on what is in the interest of all involved partners. This concept conceives of regional cooperation as just another tool of power politics. In this paper Frank first discusses a few core characteristics of multilateral and regional cooperation based on the existing International Relations literature. He then analyses the interests of the Democratic People's Republic of Korea (DPRK) and its leadership and how these are informed by ideological issues, economic challenges and typical reform dilemmas of a socialist system. It is argued that the only promising ways to link economic reforms and political stability and thus regime stability in North Korea is through international and regional cooperation. However, the DPRK conceives of such as a risky, yet at times contingent endeavour. This explains its reluctance to committing to formal international agreements. Frank further states that theoretically an ASEAN based multilateral regime with China leading from behind would allow for the inclusion of North Korea's preferences. This could pave the way for a normalisation of diplomatic relations between the DPRK and the international community, help to foster economic exchanges and eventually lead to possible advances in the country's denuclearisation process.

George Gravillis, a senior consultant to international organizations and philanthropic institutions and until recently a visiting scholar at Columbia University's Institute for Religion, Culture, and Public Life (IRCPL), proposes in Chap. 10 *State Failure and Regional Containment: The Case of Afghanistan* a rather unconventional concept assuming that state collapse might serve as an incentive or starting point for regional integration. His analysis focuses on the six countries sharing borders with Afghanistan, namely Tajikistan, Turkmenistan and Uzbekistan besides Iran, Pakistan and China. In addition, India is included in his investigation which does not share a border with Afghanistan but would have started early to restore relations with the latter and to play an important role as a donor and partner. As the territory of Afghanistan links the Middle East with South and Central Asia the author is even able to explore how countries try to adapt to state failure in their neighbourhood across different Asian sub-regions. From a conceptual point of view Gavrilis distinguishes four ways or strategies countries may choose. Neighbouring countries could concentrate on containing negative spill-overs emanating from a failed state and/or aggressively try to take advantage of the failing state's weakness. Alternatively, they may choose to support the latter's reconstruction and recovery bilaterally or through participation in multilateral initiatives. The empirical discussion offered in this chapter shows that Afghanistan's neighbours responded in varying ways to its collapse. In addition, while some of them such as Iran, India and China opted for different cooperative strategies these measures and policies disclosed a rather clear bias towards bilateral initiatives. Moreover and contrary to what other chapters in this volume discovered with respect to China's role as a key driver of cooperation and integration in Asia it apparently took rather a backseat in responding to the crises in Afghanistan. This applies to both the measures China adopted on the bilateral level to support the reconstruction of Afghanistan and its influence inside the SCO. This is not to say, however, that other regional organizations such as the GCC, ECO or the South Asian Association for Regional Cooperation (SAARC) would have featured more prominently in this process and specifically if compared to the much larger engagement of external or international actors such as, inter alia, the NATO International Security Assistance Force or the United Nations.

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Chapter 2
Japan and China in a Two-Hub Formation of Regional Integration in East Asia

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JEL Classification: F02 F15 R11
Region: East Asia, Japan, China, Southeast Asia, Association of Southeast Asian Nations (ASEAN)

2.1 Introduction

The participation of Japan, Korea, China and the Association of Southeast Asian Nations[1] (ASEAN) has made it feasible for the East Asian countries to come together to create the third largest regional economic entity in the world. Some eighty regional and bilateral free trade agreements (FTAs) have been concluded in Asia as of 2008, more than half of which were signed by East Asian countries. The various degrees of market liberalization and the different pace in the negotiations create a convoluted network that prevents us from having a comprehensive picture on the real process of East Asian regionalism. In contrast to the European Union (EU) and the North American Free Trade Agreement (NAFTA), it is widely accepted that regional integration in East Asia is primarily market-driven or, in other words, mainly fostered by cross border activities within the business sector instead of having been promoted by formal political initiatives. Fundamentally, the development of an intensive regional production sharing network has been considered as one of the core characteristics of

[1]The ten member countries of ASEAN cover Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

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the 'Asian way' of regional economic integration.[2] In contrast to the centuries it took for some of the world's most advanced economies, some Asian economies needed only a few decades to achieve the same level of industrialization. This mirrors the expansion of international trade of intermediate goods and services, particularly in a regional context. Moreover, as countries are competing for outsourced tasks from advanced economies, the emergence of 'factory Asia' has been supporting competitive unilateral liberalization. Accordingly, the market engines behind this process of regional integration in East Asia were mainly powered by the *de facto* cross-border linkages among individual economies.

Regionalization in East Asia has reached, however, such a 'critical stage' that a region-wide institutional scheme might be necessary to deepen and widen economic integration in Asia. According to Watanabe East Asian countries would be working to carve out agreements enforcing their *de facto* market-driven integration (Watanabe 2006). Kuroda shared this opinion but extended it to a pan-Asian integration which follows a "multi-track and multi-speed approach" and in which some countries would "play a leadership role" (Kuroda 2006). Assuming that prospective institution building in East Asia will most probably build upon the existing market-driven regionalization the question is, however, how formal initiatives supporting the deepening and widening regional integration could look like? What role countries involved will or could be expected to play in this process? Which formal contractual arrangement could trigger a domino effect of regionalism? The aim of this chapter is to explore how regional integration in East Asia could evolve in the future based on an analysis of *de facto* economic and trade relations among East Asian countries. By generating a Bilateral Trade Relation (BTR) index and a Hub-ness (HM) index it will be tested how market-initiated integration could transform the region into an *East Asian Bicycle* as suggested first by Baldwin (ibid. 2004) and thus into a 'two-hub-formation' of regionalism in East Asia.

The chapter is structured as follows. The next section briefly reviews the current debates on East Asian regional integration. Section 2.3 summarizes the key features of a Hub-and-spokes bilateralism. Section 2.4 elaborates on the potential of both Japan and China to act as hub nation(s) in Asia. Section 2.5 discusses the potential impacts of the ASEAN-China FTA on the process of East Asian regional integration. Section 2.6 concludes.

2.2 Debates on East Asian Regional Integration

As hinted at in the introduction, East Asian regional integration evolved primarily bottom-up rather than based on political design or on a politically agreed blueprint. This corresponds to the path of Asian industrialization following a "wild-geese-flying" pattern ('*Ganko Keitai*') which characterizes the Asian economies as "a

[2] Production sharing can be defined as "the internationalization of a manufacturing process in which several countries participate in different stages of a specific good's fabrication" (Ng and Yeats 2001).

comparatively small [wild-geese-flying] group with Japan taking the lead" (Akamatsu 1962).[3] Even though the initial flying order has been broken by the fast growth of China and Vietnam, the flying-geese model can still explain the sequential industrialization in the region as supported by the development of a dense network of trade and investment linkages and the role therein of regional hub(s).

According to Fujita, "… the economic integration of East Asia has been attained mostly through market mechanisms, … [h]owever, now East Asia has reached a critical stage such that for a further promotion of regional integration, developing region-wide political institutions is indispensable" (Fujita 2005: 3). In contrast to the North American Free Trade Agreement (NAFTA) in which the position of the USA as a leader is evident and as distinct from the EU whose integration is based on treaties among the member states and settled within an institutional framework, the situation in East Asia has in the past often been viewed as rather intricate because of the lack of an effective supranational institution or a dominant regional leader. The existence of two big economies in the region, Japan and China, makes it even harder to predict the direction of the institution-building of regional integration in East Asia. Neither the experience of the EU nor that of NAFTA could be simply cloned in East Asia. In the case of the EU common institutions include the European Commission, the European Council and the European Parliament. The external trade and commercial policy of the EU has long ago been transferred to the supranational authority of EU institutions. The ultimate goal is to create a political union. This is almost impossible to be repeated in Asia. Economic interests are still the prime driver of Asian regionalism.

Initiatives for institutional cooperation among East Asian countries could be supported by three aspects (Kawai 2004). First, Asian countries have long enjoyed 'market-driven' integration through trade and foreign direct investment (FDI). The intensive regional production networks and supply chains located different subprocesses in various countries in Asia. Second, the formation of the EU and NAFTA made most Asian countries realize their disadvantages in global competition. It therefore became more urgent to establish a regional common market especially when multilateral trade negotiations proceed at an extremely slow pace. Finally, the Asian financial crisis taught Asian countries a lesson on the importance of regional

[3] When arranging East Asian "wild geese" into a four-tiered formation one may regard Japan as the lead goose followed by the four Asian Newly Industrialized Economies (NIEs) (the second tier), the four main ASEAN countries (the third tier) and finally other developing economies such as China and Vietnam. International trade and investment are the key linkages among them. For an insightful account of the development of Japan's postwar economy see inter alia Uchino 1978. On the role of the USA in Japan's economic development which seems to be somewhat downplayed in Akamatsu's model see Ozawa 2003. Even today, the regional economy is still highly dependent on the US economy. The share of East Asian economies in the US trade deficit continued to increase until 1992 when it reached the peak at about 48 percent or almost half of the total. It declined gradually afterwards and remained at a level slightly less than 40 percent during the 2000s. The volume of the region's total trade surplus with the US amounted to more than USD 1 trillion in 2005.

monetary and financial cooperation.[4] Many East Asian countries have recognized their lack of individual capacities to meet the challenges of globalization (Kim 2004). In short, these three drivers can be summarized as “long term regional trends”, “competitive regionalism” and “the Asian economic crisis” (Stubbs 2002).

Yamazawa emphasizes that China’s entry into the World Trade Organization (WTO) and emerging move toward regional free trade agreements also motivates other Asian countries to go for deeper integration (Yamazawa 2001). China is the biggest economic entity in the region in terms of the volume of annual GDP. It has constantly expanded trade relations with its neighbours, especially Korea and some key members of ASEAN which were traditionally close trade partners of Japan. The slow pace of a more formally institutionalized Asian regional integration till 2000 might have been due to Japan’s reluctance to lead the process. As China began to show growing interest in regional integration, most prominently illustrated by the conclusion of the ASEAN – China FTA in 2002,[5] Japan quickly adjusted its strategy and soon became active on concluding regional free trade agreements with its Asian neighbours. The term “competitive regionalism” does to some extent not only refer to the competition from other big blocs but also that within East Asia.

The approach towards regional integration based on bilateral free trade agreements (the way that NAFTA was formed, we call this ‘the NAFTA type’ in the context to simplify) might be applicable but needs to be employed by East Asia under preconditions. Though a balanced situation without hegemony in the region seems to be preferred by most Asian countries, there are thirteen states (the ten ASEAN members plus Japan, Korea and China) in the region (fifteen in total including Australia and New Zealand) which requires a network composed of at least 78 bilateral FTAs! However, if the ASEAN member countries spoke with one voice the number of bilateral FTAs that are needed to set up a complete network of free trade areas in East Asia would reduce to six (between Japan, Korea, China and the ASEAN). This is probably why the initiative of ‘ASEAN-plus-Three’[6] has received so much attention since its first summit even though the development of a close partnership between Japan and China is another ‘hard-to-deal-with’ issue.

Indeed, since the geopolitics of East Asia are quite different from that in Europe or North America, it is reasonable to argue that East Asia will find its unique approach to regionalism based on its *de facto* region-wide integrating economy that is generated by the market. Basically, any approach to the community building of East Asia (and the Pacific) will be acceptable as far as it could meet the three

[4] On the financial crisis and Asian countries’ reactions see also Loewen in this volume.

[5] The Agreement on Trade in Goods took effect in 2010 when China and six ASEAN member states (Brunei, Malaysia, Philippines, Indonesia, Singapore and Thailand) eliminated tariffs on 90 percent of goods. Free trade in goods is planned to be extended to the remaining four ASEAN member states (Cambodia, Laos, Myanmar and Vietnam) by 2015. The Trade in Services Agreement entered into force in 2007. In addition, an Investment Agreement was signed in 2010.

[6] ‘ASEAN-plus-Three’ is an informal group whose formation was motivated by the East Asian crisis. It does not have its own secretariat but meets at the invitation of ASEAN. The group came together annually since the first meeting in December 1997. Updates on the ASEAN +3 summits can be found on the website of the ASEAN secretariat at http://www.aseansec.org/.

principles of so-called “open regionalism”: openness, equality and evolution (Drysdale, Elek and Soesastro 1998; Bergsten 2007).

2.3 Hub-and-Spoke Bilateralism

The theory of New Economic Geography (NEG) illustrates interactions between trade policy and industry relocation across country borders. Though trade liberalization can increase overall welfare, it is not guaranteed that all participating countries will be better off due to cross border industry relocation or agglomeration effects, and, as a consequence, ‘polarization of benefits’. Throughout the process of market integration policy makers from each party need to choose the appropriate trade policies and implement the appropriate strategies in designing the blueprint of trade liberalization. Even a temporarily inappropriate policy during the process of integration might lead to a significantly unrecoverable welfare loss at the end (Fujita, Krugmann and Venables 1999; Neary 2000; Baldwin et al. 2003).

Trade liberalization urges producers to reconsider their production and marketing strategies to adapt to a new situation of an integrated market. When trade barriers are high and markets segmented, producers could choose to locate in different markets in order to gain or secure access. The removal of trade barriers, however, will make large markets more attractive in general. Industries may find it more profitable to locate their production processes in big markets to be able to supply the host market directly and export to smaller markets. There are three key advantages of locating in a large domestic market: first, given demand from the whole free trade zone, sales to the domestic market can bring about higher markups than exports to foreign countries because of the existence of trade costs. Second, to be located close to upstream and downstream partners will help firms increase their efficiency. Third, though the competition effect in large markets will reduce firms’ profits by lowering the industry price index, the nominal wages will also decrease in the long run (Krugman 1993).

Baldwin (2004) investigated the potential emergence of a hub-and-spoke bilateralism in East Asia based on the theoretically expected effects of a trade agreement in combination with the experiences of regional integration in both Europe and North America. It refers, in short words, to one possible outcome of trade liberalization where one or few hub nation(s) become the centre of the regional economy and absorb more economic activities at the cost of market marginalization in the spokes (so called “spoke trap”). The hub-and-spoke pattern is not likely to occur under multilateral trade liberalization. In case of regional trade liberalization, however, the alleviation of the spoke traps becomes an important issue faced by policymakers. A typical path of forming a hub-and-spoke system is that each potential spoke country only signs bilateral trade deals with the (potential) hub nation but does not synchronically liberalize trade with other spokes.[7]

[7] On Hub-and-spoke systems see also Zorob in this volume.

Once a country falls into the spoke trap, it may face discrimination in the hub's market when new spokes get more favourable treatment from their trade agreement with the hub. Even if this does not happen, and all the spokes are treated in a non-discriminatory manner, there remain several negative consequences. First, without free trade among spoke markets, (potentially lower-cost) exports from the spokes tend to be replaced by those from the hub because the existing trade barriers between spokes raises the trade costs of bilateral trade between spoke countries compared to the trade costs between the hub and the spokes. Second, as firms in the hub will gain additional efficiency with free imports of intermediate goods or services from the spokes, eventually they could be more competitive in the global market. Third, since the hub gets preferential market access to all the spokes, firms originally located in the spokes tend to move to the hub. This will drive new investments to agglomerate in the hub as well. Fourth, it is very likely that the waves of industry agglomeration are self-sustaining, leading to a one-way process of industry reallocation towards the hub. Thus it will be hard to revise the hub-and-spoke pattern once the formation gets started. In short, the spoke economies risk to be marginalized and to lose competitiveness. A further problem accrues from the proliferation of preferential trade agreements. The overlapping of trade rules leads to the so called "noodle bowl effect" (Baldwin 2004) or "spaghetti bowl effect" (Bhagwati 1995). Typically, when there is a complex network of preferential trade agreements, and each agreement contains different provisions for rules of origin (ROOs), both the public administration and the enterprises will find it difficult to apply different rules to different trade partners.[8] The similar noodle bowl effect can be observed when there are different provisions of intellectual property rights existing in different trade agreements, and these provisions will get entangled with each other as well as with domestic regulations on intellectual property rights (Kotera 2006).

In general, the hub-and-spoke bilateralism is 'bad' economically. However there are some specific political economic interests that can drive it to happen. Baldwin (2004) provides two possible explanations on the formation of hub-and-spoke bilateralism in East Asia. First, the law of the jungle could impact on the regional trade agreement – there will be much stronger political forces backing market opening with the hub compared to support for market opening with other spokes. Second, introducing the domino theory to the analysis on hub-and-spoke systems shows that spoke nations tend to race to be first to conclude FTAs with the hub to maximize trade gains. Alternatively, the logic behind the establishment of a hub-and-spoke pattern in East Asia can also be explained from the aspect of global production sharing. The fragmentation of the global value chains allows countries to participate in different sub-stages of production. In this case there will be strong support for the government to liberalize trade and investment with those markets whose industry structure is most complementary to the domestic industry in order to maximize the benefits from specialization or those 'production partners' whose roles in production sharing are vital in order to secure its own advantages in the whole industrial value chain.

[8] See Baldwin (1994), Wonnacott (1996) and Zorob (2008) as well as Zorob in this volume for further discussion on the role of ROOs, hub-and-spoke bilateralism and the problems of overlapping free trade agreements.

2.4 Japan and China as Two Individual Hub Candidates

2.4.1 BTR Index *and* Economic Distance *Between Asian Countries*

Since the development of an intensive regional production sharing network already fostered regionalized trade patterns or some kind of *de facto* regional integration in East Asia, it is possible that there is/are already hub candidate(s) existing in the region. Baldwin proposed an *East Asian Bicycle* of regionalism as part of which Japan would present the core of the bigger wheel while China would form the core of the smaller one (Baldwin 2004). Though there are no 'standard criteria' yet to judge a country's potential to become a hub we apply two basic conditions (a) hub candidate(s) should meet: first, the candidate has opened-up its economy and made it easy for other countries to gain access to its market. Second, the candidate is 'attractive' to others in terms of market size. The hub nation and the spoke nation are asymmetrically dependent on each other: bilateral trade is much more important for the spoke candidate than for the hub candidate.

To measure each country's attractiveness in terms of its relative market importance and the degree of trade facilitation we employ the *de facto* Bilateral Trade Relation (*BTR*) index and the Hub-ness (*HM*) index. The basic idea to generate a *BTR* Index is to measure the policy frictions affecting international trade. As the gravity model illustrates, bilateral trade between countries increases with the expansion of economic size and shrinks with increasing costs of trade. Trade costs are determined by two groups of frictions – the policy frictions or policy-related factors of trade costs and the natural frictions such as geographic distance, level of technology and transportation cost. The policy-related factors of trade costs may play a more decisive role on trade than the natural frictions. Suppose two countries, country A and country B: Both countries enjoy all the *a priori* advantages needed for opening trade with each other. In other words, both of them are big economies and they are adjacent. In addition, they dispose of, among other things, a similar cultural background and a similar language. This, however, does not necessarily mean that they would become close trade partners. For instance, if the government of country A implements extra restrictions on trade with country B, then it is very unlikely that the two countries will end up trading at the level that *a priori* natural factors would suggest. In this case, even though natural conditions would encourage the two countries to trade freely, we may fail to observe substantial trade flows between them because the government of country A artificially undermined natural trading preferences.

The aim of the *BTR* index is to assess the degree of *de facto* bilateral trade liberalization by decomposing the effective policy frictions from countries' bilateral trade flows. Intuitively, the *BTR* index is designed to show how easy it is for one country to access the other's market. $BTR_{ij} < 1$ can be interpreted as a signal of 'pro-trade' effects of bilateral trade policy that encourage country i to import more from country j, while $BTR_{ij} > 1$ is a signal of 'anti-trade' effects reflecting the additional costs of country *i*'s import from country *j* due to political frictions. Since one country's imports from other countries are usually not only affected by its own import policies but also by export policies applied by its trading partners, one might think of bilateral trade relations to be the 'pool' of both countries' import and export policy. For this purpose we further calculate the *economic distance* as a product of geographic distance and the *BTR* Index based on the assumption that countries treat each other reciprocally. Technically, the estimate of the *BTR* Index could be lower than its real value when the geographic distance used in the estimation is larger than the real distance of transportation. Therefore it might be less accurate for those countries with a large geographic size than for smaller countries. For instance, in reality most of the exports from China to Malaysia should be shipped via GuangZhou harbor which is much closer to Malaysia than the Chinese capital Beijing. However, in this dataset, the distance between Beijing and Kuala Lumpur, the capital of Malaysia, has still been used to proxy the transportation cost between the two countries. The artificial magnification of transport distance leads to an underestimation of the *BTR Index* (see also Appendix A for details on the measurement).

Tables 2.1 and 2.2 show the symmetric *BTR Index* and *economic distance* between major Asia-Pacific economies including Australia and New Zealand. One can observe first that the relatively low value of the *BTR Index* reflects a rather 'free' intraregional trade environment in East Asia. Since there is so far no formal institutional arrangement in the region it proves evident this *de facto* regional integration is mainly driven by market forces. Second, the six major ASEAN member states covering Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam are not only geographically but also economically close to each other. In addition to the short geographic distance that facilitates their bilateral trade the political interests behind economic integration might also have contributed to the strengthening of economic ties via cross-border exchanges of commodity and services. Third, the observed *economic distance* between China and Korea is just about one-fifth of either that between Japan and China or that between Japan and Korea. The bilateral trade between China and Korea has expanded rapidly since the 1990s. China has overtaken the United States of America and Japan as Korea's most important trading partner in 2004 while fifteen years before China had only been Korea's seventh biggest export market. Besides the fast growth of both countries' economies trade facilitation is also one of the significant factors in explaining such an expansion of bilateral trade.

Forth, trade costs between China and the main ASEAN countries have been relatively low in general. In history, ASEAN economies have played a significant role in developing the Chinese economy. A large number of Chinese immigrated to Indonesia, Malaysia (Singapore) and Philippines in the late 1800s and early 1900s. These people and their offspring are often called '*Nanyang Huaqiao*' ('overseas Chinese in Southeast Asia'). Based on the statistics as compiled by the Overseas Chinese Affairs Commission of the Republic of China, there are in total about 40 million Overseas Chinese worldwide. 60 percent of them are living in ASEAN countries. Though Overseas Chinese still form a minority in most of these countries (except in Singapore), their economic power seems to be quite significant. It is gen-

Table 2.1 *BTR Matrix* for Selected Asian Countries

	Korea	China	Australia	New Zealand	Indonesia	Malaysia	Philippines	Singapore	Thailand	Viet Nam
Japan	0.85	0.45	0.36	1.03	0.34	0.27	0.69	0.29	0.27	2.38
Korea		0.20	0.17	0.50	0.06	0.08	0.14	0.12	0.11	0.17
China			0.14	0.39	0.01	0.05	0.04	0.13	0.04	0.05
Australia				0.34	0.17	0.17	0.24	0.17	0.17	0.68
New Zealand					0.30	0.16	0.22	0.40	0.26	0.56
Indonesia						0.12	0.03	0.27	0.06	0.02
Malaysia							0.05	0.28	0.07	0.11
Philippines								0.23	0.06	0.09
Singapore									0.14	0.15
Thailand										0.15

Source: Chen (2008): Table 2, pp. 31

Table 2.2 Relative *Economic Distance* between Regional Countries

	Korea	China	Australia	New Zealand	Indonesia	Malaysia	Philippines	Singapore	Thailand	Viet Nam
Japan	980	938	2770	9836	1975	1435	2032	1520	1239	8651
Korea		188	1443	5126	296	364	372	558	403	461
China			1215	4303	73	215	120	568	133	111
Australia				784	922	1137	1494	1036	1240	5240
New Zealand					2353	1412	1846	3407	2573	5616
Indonesia						135	83	233	127	70
Malaysia							117	88	81	220
Philippines								530	130	149
Singapore									195	325
Thailand										144

Source: Chen (2008): Table 3, pp. 32

erally believed that Overseas Chinese have represented the 'bridges' between China and most of Southeast Asian countries. Indeed, the majority of foreign direct investment inflows to China came from Overseas Chinese in Southeast Asia in during the first ten to fifteen years after China started its 'open door' policy in 1979 (Zhuang and Wang 2010).

Fifth, although the value of the *BTR Index* between Japan and its partners is on average higher in comparison to that between other East Asian countries, it is generally less than one, meaning Japan also applies a 'trade-promoting' rather than 'trade-resisting' policy with its neighbouring countries in Asia. Even though costs of trade with Japan are relatively high, Japan is still one of the most important intra-regional trading partners to most East Asian economies. The gravity equation implies that international trade is not only determined by trade cost but also by the size of the participants' economies. Japan is currently the world's third largest economy in terms of GDP. In 2011 Japan's per capita GDP was eight times that of China (International Monetary Fund 2012). To some extent, the 'mega-size' and the large demand potential of the Japanese market could compensate for its relatively closed economy and thus 'long' *economic distance* between Japan and other Asian countries.

2.4.2 The Relative Market Dependence on the Hub Nation(S)

Beyond comparing bilateral trade relations and *economic distance* between East Asian economies, one may also assess the degree of countries' relative market dependence on each other when classifying the individual hub candidate(s). For this purpose Baldwin (2004) developed the "*HM Index*" as an empirical measure of "hub-ness" and applied it to describe the pattern of an *East Asian Bicycle* in which Japan plays the hub of the bigger wheel while China forms the centre of the smaller wheel. The formula to calculate this index is:

$$HM_B = X_{AB} \bullet \left(1 - M_{BA}\right)$$

where HM_B measures the degree of country *B's* relative market dependence on country *A*. X_{AB} denotes the exports from *A* to *B* as a share of country *A*'s total exports; M_{BA} denotes country *B*'s imports from *A* as a share of its total imports. The value of *HM* ranges from zero to one, of which the closer the value to one, the deeper the relative dependence of country *A*'s exports on country *B*'s market.

Table 2.3 presents a matrix of HM measures between East Asian countries. The countries listed in the first column are the source countries (country B as in the formula), and the countries listed in the first row are the destination (country A as in the formula). For instance, the degree of relative dependence of Japan on China is 9.4 percent, while that of China on Japan is only 4.9 percent; the degree of relative market importance of China to Korea 14.7 percent, much higher than that of Japan

Table 2.3 East Asian Hub-ness Measures (in percent)

	Japan	China	Hong Kong, China	Taiwan, China	Korea	Singapore	Indonesia	Malaysia	Philippines	Thailand	Vietnam
Japan		9.4	4.1	3.4	3.7	2.5	1.0	1.7	1.0	2.2	0.5
China	4.9		10.7	1.7	2.9	2.7	0.8	1.3	0.5	0.8	0.5
Hong Kong, China	6.6	28.3		3.2	2.9	6.3	0.2	3.1	1.6	1.5	0.2
Taiwan, China	7.4	15.4	15.7		3.7	4.6	0.6	2.5	1.9	1.9	0.7
Korea	4.3	14.7	5.2	2.9		3.4	0.6	1.6	1.0	0.8	0.6
Singapore	5.2	10.6	10.2	4.0	4.5		7.7	12.4	1.7	3.8	0.9
Cambodia	1.6	0.3	0.5	0.5	0.2	25.6	0.4	0.3	0.1	5.8	11.3
Brunei	0.7	0.4	0.9	0.0	0.0	48.6	0.1	24.8	0.1	0.7	0.0
Indonesia	12.9	3.2	3.1	1.1	1.5	26.2		5.4	2.1	4.8	1.6
Malaysia	5.9	6.8	6.9	2.1	1.6	13.8	1.3		1.0	4.3	0.6
Philippines	14.5	12.2	11.5	4.4	3.2	6.6	0.8	5.8		2.5	0.3
Thailand	11.4	8.5	6.2	2.4	1.7	7.3	3.0	5.0	2.2		1.3
Vietnam	30.3	4.7	3.7	1.8	2.3	3.7	0.9	1.7	4.6	8.7	

Source: Calculation based on UNCOMTRADE data (bilateral trade flows are an average of 2005–2008, unless indicated otherwise)

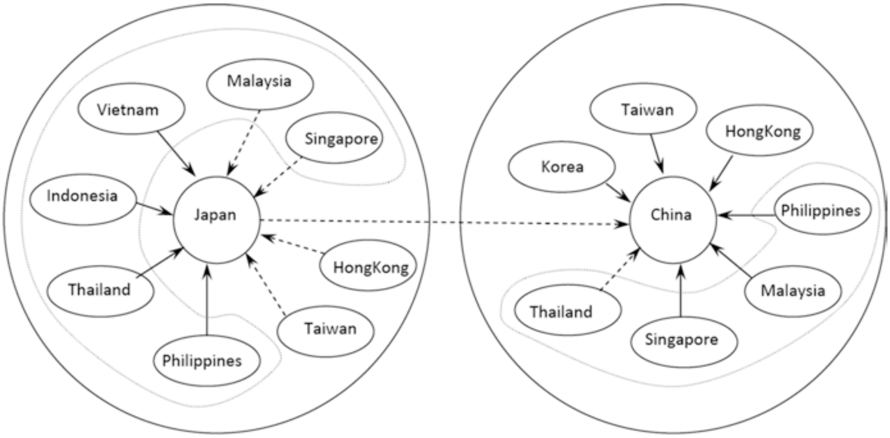

Fig. 2.1 An 'East Asian Bicycle'
Notes: ________ illustrates the value of Hub-ness measure larger than or equal to 10 percent
- - - - - - illustrates the value of Hub-ness measure larger than 5 percent but smaller than 10 percent
Source: Own compilation adapted from Baldwin, R. (2004). *The Spoke Trap: Hub and Spoke Bilateralism in East Asia.*, Fig. 6, pp. 19. The author recalculated the indices based on UNCOMTRADE data (bilateral trade flows are an average of 2005–2008, unless indicated otherwise) and adapted the pattern

(4.3 percent). Based on these HM measures, Japan and China are the two most important markets. Accordingly, our 'East Asian Bicycle' (Fig. 2.1) is also composed of a 'Chinese wheel' and a 'Japanese wheel'. However, the former consists of China, the four NIEs covering Korea, Taiwan, Singapore and Hong Kong plus Malaysia, the Philippines and Thailand while the latter contains Japan, ASEAN-5 plus Singapore, Hong Kong and Taiwan.[9] While there is an overlap of the spoke economies the four NIEs are, relatively speaking, linked closer to the Chinese market while ASEAN-5 rely more on the Japanese market as illustrated in Fig. 2.1.

This is in line with Baldwin's conclusion on Japan and China as the two cores of East Asian regionalism. However, our findings suggest the 'Chinese wheel' to be the main cycle fuelling the movement of regional integration even though individually China's position as a hub is not as strong as Japan's position yet. On the one hand, Japan's position can't be replaced, at least not in the near future. Most Asian economies would not like to lose the Japanese market which is so big in both absolute and relative terms even though the *BTR Index* indicates that negotiations with Japan will not be as easy as those with Singapore or Korea. In other words, the benefits from accessing the Japanese market would urge other countries to invest more resources in free trade negotiations with Japan. However, unlike the United States in North America, the Japanese economy is not overwhelmingly dominant in

[9] ASEAN-5 refers to Malaysia, Indonesia, Philippines, Thailand and Vietnam. For reasons of simplification the analysis here ignores the four small ASEAN member states: Brunei, Cambodia, Laos PDR and Myanmar due to the fact that their contribution to regional trade is marginal.

the region from the aspect of market interdependence. Japan's leading position in the region is indeed challenged by China who has been the world's second largest economy in terms of GDP since 2010. Moreover, China and the ASEAN members have already set up a free trade area. Therefore it has become something like a 'must-do' for Japan to be more active in promoting East Asian regional integration in order to compete for the regional leadership.

On the other side, the 'Chinese wheel' consists of the most dynamic emerging economies in the region. Japan and Korea are highly dependent on the Chinese market. The close economic interdependencies between China and the ASEAN members have been further deepened by the launch of the ASEAN-China FTA. For instance, China has been ASEAN's largest trading partner while ASEAN has overtaken Japan to become China's third largest trading partner by 2011. Moreover, the fact that China is also Korea's largest trading partner may urge Korea to consider China instead of Japan as a prior choice of bilateral trade liberalization. From this perspective, the 'Chinese wheel' may grow faster than the one cored by Japan.

2.5 The Significance of the ASEAN-China FTA

The ASEAN member states are individually small in terms of economic size. It will be better for them to move as a unity in the process of Asian regionalism. They still need to seek either China or Japan as their initial ally in order to generate an enhanced market large enough to persuade other countries to join the agreement. The ASEAN members signed an initial FTA with China in 2002 to create the most populous FTA in the world with over 1.7 billion consumers and a total GDP of nearly USD 2 trillion. Compared to the progress of the free trade negotiations between Japan and Korea, the talks between China and the ASEAN started later but were concluded earlier. This could be one of the factors that had made the Japanese government feel under pressure to sign similar trade agreements with the ASEAN members.[10]

In principle, either the ASEAN-China FTA or the ASEAN-Japan FTA could give birth to a market that is big enough to marginalize the economies outside the arrangement. The fact that ASEAN-China FTA is already there, plus Korea's high dependence on the Chinese market, could give China some sort of advantages in competing for the regional leadership. Once Korea joins the ASEAN-China FTA, it is very likely this arrangement could trigger a 'domino effect': Other countries in the region will be eager to join this framework because it will become more and more costly to 'stay outside' as the free trade zone expands. At the end, an integrated market will cover the whole region. China has moved from being a relatively passive participant in regionalism to a promoter of regional trade liberalization after

[10] Japan negotiated and signed agreements with each individual ASEAN member state. For reasons of simplification these FTA/FTA negotiations are loosely called the Japan-ASEAN FTA/FTA negotiations in the following.

its entry into the WTO. At least, the birth of the ASEAN-China free trade zone has played as an alarm for other countries to accelerate their pace toward trade liberalization. As one can witness, Japan, Korea, Australia and New Zealand started to talk to either China and/or ASEAN for an FTA since ASEAN and China concluded the FTA. The rationale behind the scene is that once there is a dominant market generated by a FTA in the region, the risk of falling into the 'spoke' trap for outsiders will increase as a consequence of the regional trade liberalization.

From the perspective of Japan, the ASEAN-China FTA seems to be the last FTA that it would like to see. The complementarities of Japan and China are rather apparent. The former is capital abundant, labour expensive but resource deficient while the latter has the largest population and the third largest territory in the world. It is very likely that Japan 'enjoys' treating China as one of its 'production bases'. As Japan is shifting its economy to high value-added, service-focused industry, it needs China to absorb more and more fragmented manufacturing processes. One of the typical routines is that it exports high-tech intensive or capital-intensive parts and components to China, and finishes those labour-intensive procedures there. The cheap labour cost in China guarantees the overall competitiveness of Japanese products in the global market. Japan has been China's largest trade partner since the early 1990s while China has been Japan's most important partner since the 2000s as well. An FTA between China and some other nations would negatively impact on Japan's exports by diverting trade and weakening its competitiveness because China will not only import more final goods from those countries having FTA with it but also buy more intermediate goods from those preferential partners.

Similarly, the ASEAN-China free trade area is likely to exert additional pressure on the export sectors in Korea. Korea's export industries depend on the Chinese economy much more than on the Japanese market. China is the largest market for Korea while ASEAN is the fifth. The implementation of the ASEAN-China FTA has generated the world's most populous market. The preferential treatment between China and ASEAN could lead to a serious diversion of Korea's exports to these markets. More seriously, effects of market agglomeration will not only force more industries to relocate to the ASEAN-China free trade zone but also divert foreign investments away from Korea. In order to avoid these negative effects, Seoul might choose either to join the agreement or to contend with it by initiating, for instance, its own FTA with Japan. As a result, ASEAN became a focus of East Asian regionalism as Japan, Korea, Australia, and New Zealand rushed in for an FTA. By 2005, all of them opened free trade negotiations with at least one ASEAN member state. However, in order to play a role as a real nucleus of Asian regionalism, ASEAN members need to realize the crucial importance of a highly integrated market among its ten member nations, which is not easy to achieve due to the wide difference in economic development among its members.

2.6 Concluding Remarks

This chapter reconstructed an *East Asian Bicycle* of regionalism close to Baldwin's (2004) argument based on a quantitative assessment of *de facto* trade liberalization and relative market dependence. Japan and China are the two hub candidates who may play a determinant role in the process of regional integration in East Asia. It shows that the economy of the four newly industrialised economies (NIEs), namely Hong Kong, Korea, Singapore and Taiwan are linked closer to the 'Chinese wheel' while that of ASEAN-5 rely relatively more on the Japanese market. The *East Asian Bicycle* may get more fuel from its 'Chinese wheel' than from the 'Japanese wheel'. The formation of an ASEAN-China free trade area can effectively spur regional integration in East Asia as the fear of falling into the 'spoke trap' will drive other nations to be more active in trade liberalization. In light of this, the ASEAN-China FTA could develop as a milestone of East Asian regional integration.

Appendix A: Measuring BTR Index and Economic Distance

Chen (2008) generates *BTR* index and 'economic distance' based on the gravity model. The gravity equation simplifies the determinants of bilateral trade between countries (or regions) into two categories: partner countries' properties, such as *GDP*, population, *GDP* per capita, etc. and trade cost of trade between partners, such as transport costs, tariff barriers, quotas, etc.. Lower trade costs will encourage bilateral trade between countries while higher costs will discourage it. Loosely speaking, there are two types of trade costs. One is related to 'natural frictions', such as the geographical distance, level of technology, etc., and the other is related to 'policy frictions', primarily the degree of bilateral liberalization. Assuming that the marginal effect of either *GDP* or *GDP* per capita on bilateral trade is identical over a certain time period, the marginal effect of distance can be magnified or shrunk by individual bilateral trade relations. This can be seen in eq. (2.1):

$$Trade_{ij} = \frac{\left(GDP_i \cdot GDP_j\right)^{\alpha} \cdot \left(K_i \cdot K_j\right)^{\beta}}{Dist_{ij}^{\gamma_{ij}}} \tag{2.1}$$

where α, β and γ_{ij} represent the marginal effect of *GDP*, *GDP* per capita(K) and distance respectively. The coefficients, α and β, are assumed to be identical while the coefficient γ_{ij} may vary for each pair of countries. γ_{ij} is the variable in the equation that contains the country specific propensity. Imagining that policy frictions can affect a country's bilateral trade flow through their impact on the geographic distance, the *economic distance* (ED_{ij}) can be defined as geographic distance ($Dist_{ij}$) multiplied by a parameter A_{ij}, which essentially reflects the relative degree of bilateral trade liberalization.

$$\text{EDij} = \text{Aij} \times \text{Distij} \tag{2.2}$$

Accordingly a revised version of gravity equation looks like.

$$M_{ij} = \frac{\left(Y_i^{\beta_1} \cdot Y_j^{\beta_2}\right) \cdot \left(y_i^{\beta_3} \cdot y_j^{\beta_4}\right)}{\left(A_{ij} \times Dist_{ij}\right)^{\beta_5}} \tag{2.3}$$

It transforms into eq. (2.3) by taking in logarithm form.

$$\begin{aligned} \log\left(M_{ij}\right)_{\mathrm{t}} &= \beta_1 \times \log\left(Y_i\right)_{\mathrm{t}} + \beta_2 \times \log\left(Y_j\right)_{\mathrm{t}} + \beta_3 \times \log\left(y_i\right)_{\mathrm{t}} \\ &\quad + \beta_4 \times \log\left(y_j\right)_{\mathrm{t.}} + \beta_5 \times \log\left(Dist_{ij}\right) + \beta_5 \times \log\left(\hat{A}_{ij}\right) \end{aligned} \tag{2.4}$$

We therefore use two-step regressions to estimate the parameters in the equation above based on the fixed-effect regression on panel data.

$$\begin{aligned} \text{Step one}: \log\left(M_{ij}\right)_{\mathrm{t}} &= \hat{\beta}_1 \times \log\left(Y_i\right)_{\mathrm{t}} + \hat{\beta}_2 \times \log\left(Y_j\right)_{\mathrm{t}} + \hat{\beta}_3 \times \log\left(y_i\right)_{\mathrm{t}} \\ &\quad + \hat{\beta}_4 \times \log\left(y_j\right)_{\mathrm{t}} + FE_{ij} + v_{ij,t} \end{aligned} \tag{2.5}$$

$$\text{Step two}: FE_{ij} = C + \hat{\beta}_5 \times \log\left(Dist_{ij}\right) + u \tag{2.6}$$

where $\hat{\beta}_i$ (i = 1 … 5) denotes the estimated marginal effect of each independent variable, FE_{ij} denotes the fix effect, $v_{ij,t}$ and u are the disturbance terms.

Combining equation (2.5) and (2.6) with the targeted function (2.4), we have $\mathrm{BTR}_{\mathrm{ij}} = \hat{\mathrm{A}}_{\mathrm{ij}} = \dfrac{\exp\left(\mathrm{FE}_{\mathrm{ij}} / \hat{\beta}_5\right)}{\mathrm{Dist}_{\mathrm{ij}}}$. The smaller value of BTR_{ij} hints the higher degree of market openness of country i to country j. Furthermore, BTR_{ij} <1 can be interpreted as a signal of 'pro-trade' effects of bilateral trade policy that encourage country i to import more from country j, while BTR_{ij} >1 is a signal of 'anti-trade' effects showing the additional cost of country i's import from country j due to political frictions.

With further assumption that countries i and j are treating each other reciprocally and therefore the bilateral trade preference between them is symmetric, BTR_{ij}=BTR_{ji}. Accordingly the *economic distance* is calculated based on the definitionED_{ij}=$BTR_{ij} \cdot Dist_{ij}$. One country's import from country j is not only affected by its own import policy but also by its trading partner, country j's export policy. Empirically it would very difficult to distinguish the different effects from these two parties accurately. Holding this assumption, the symmetric BTR index is estimated based on equation (2.7):

$$T_{ij} = T_{ji} = \left(IM_{ij} + IM_{ji}\right) = \frac{\left(Y_i + Y_j\right)^{\alpha} \cdot \left(y_i + y_j\right)^{\beta}}{\left(A_{ij} \times Dist_{ij}\right)^{\gamma}} \tag{2.7}$$

where T_{ij} and T_{ji} is the overall trade volume between the two countries (aggregate imports plus aggregate exports).

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Chapter 3
Regional Integration in the Middle East in the Shadow of EU and US Free Trade Initiatives

Anja Zorob

JEL Classification: F 15
Region: Middle East and North Africa (MENA), Mediterranean

3.1 Introduction

Against the background of the *Arab Spring* regional economic integration found its way back into the development debate as a tool to promote Arab economies' industrial diversification and job creation (UNDP and LAS 2011; Chauffour 2011). It is no secret, however, that the numerous efforts aimed at strengthening integration among the countries of the Middle East and North Africa (MENA) hardly encountered success in the past. On the contrary, they were beset by numerous constraints tempting observers to ascribe the region an "aura of exceptionalism" (Aarts 1999). Although some of the previous stumbling blocks of Arab integration may have diminished in recent years, new constraints apparently entered the scene including "systemic implications" of overlapping free trade areas or the many problems behind what Jagdish Bhagwati termed the *spaghetti-bowl phenomenon* (Bhagwati 1995; Bhagwati et al. 1998). Since the beginning of the 1990s Arab countries became members of multiple and partly overlapping free trade agreements (FTAs). Like other countries in the 'global South' they were particularly interested in negotiating bilateral 'Hub-and-spoke' agreements with the European Union (EU) in the framework of the Euro-Mediterranean Partnership (EMP) and/or with the United States as part of the Middle East Free Trade Area Initiative (MEFTA). Whether these agreements were indeed able to offer 'positive spill-over effects' for

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intraregional integration, similar to what officials in the 'hubs' were always keen to emphasize, shall be looked at in this chapter. Based on an analytical framework which combines the concepts of Hub-and-spokes bilateralism and complementary South-South integration with the systemic implications of overlapping FTAs, this chapter investigates to what extent negotiation and implementation of trade agreements among Arab countries were affected by their contractual arrangements with external partners and, in particular, their accompanying rules of origin systems.

The structure of the chapter will be as follows. Section 3.2 explains the analytical framework. Section 3.3 outlines the *Spaghetti Bowl* of formal agreements Arab countries have signed with external partners. Section 3.4 elaborates on intraregional trade agreements covering, most importantly, the *Greater Arab Free Trade Area* (GAFTA), the *Agadir Agreement* (establishing the *Mediterranean-Arab Free Trade Area*, MAFTA) and the many bilateral trade agreements among Arab countries as well as between them and both Turkey and Israel. Section 3.5 introduces first into the diverse rules of origin systems anchored in the FTAs. In the second part, it explores if and how Arab countries' FTAs and specifically those with the EU including the extension of the Pan-European System of Cumulation of Origin to the Mediterranean Partner Countries (MPCs) could be hold accountable for the bumpy track-record of both the Agadir Agreement and the GAFTA. Section 3.6 concludes.

3.2 Overlapping Trade Agreements and Complementary South-South Integration

3.2.1 Hub-and-Spoke Bilateralism: Chances and Risks

During the last two decades MENA countries' governments were keen to negotiate bilateral 'Hub-and-spoke' FTAs with large partners 'in the North'. The drive to secure preferential access to the World's most important trade powers resembled a distinctive feature of the new or second regionalism. According to theory, a free trade area (FTA) or customs union (CU) is expected to generate a number of benefits for their members given that several pre-conditions are fulfilled. Potential positive effects include trade creation and specialization, economies of scale and scope, increased competition and efficiency as well as stimulating investment, transfers of technology and learning effects. Compared to South-South FTAs, an agreement with a large industrialized country is expected to provide developing countries with better chances to realize dynamic effects of regional integration. Moreover, those agreements would be less prone to trade diversion and offer partners to gain from so-called non-traditional effects such as 'securing market access' and 'locking-in economic reform and enhancing its credibility' (for a detailed discussion of potential effects see Baldwin and Venables 1995; Kennes 2000; Schiff and Winters 2003).

Political or non-economic effects, however, such as consolidation of peace, security cooperation or enhancing bargaining power, are considered by many authors to be the true motives behind the conclusion of bilateral or regional FTAs. They could also serve as a platform for project and/or financial cooperation including the adoption of compensation mechanisms to support partners in coping with adjustment costs. Whereas most benefits and in particular dynamic effects can be expected to unfold, if at all, only in the medium or longer term, adjustment costs accrue mainly in the short term or initial phase of integration. Finally, there is a risk that the benefits of regional trade liberalization may be distributed unevenly among FTA members due to location effects of integration. Based on the core-periphery-model developed by Krugman and later refined by Venables regional integration seems to lead almost inevitably to the clustering of economic activity in the industrial centers of the North and, as a consequence, to diverging income development (for details see Baldwin 1994; Baldwin and Venables 1995). These risks are expected to be particularly high in case of bilateral Hub-and-spoke agreements or, in other words, when liberalizing measures do not cover trade among the spokes.

In a Hub-and-spokes system the members will realize less collective income gain from trade liberalization than in a genuine FTA and the hub will attain a larger share of the smaller total income. The spokes, however, would be confronted with several disadvantages, among them the risk of trade and investment diversion and their marginalizing effects on the spokes. This is because companies located in the hub enjoy “extra”-privileges compared to firms operating in the spokes. The privileges include first of all the hub’s duty-free access to the markets of all spokes whereas exports by companies located in the spokes still face restrictions in access to the markets of the other spokes. Second, only companies located in the hub enjoy the benefit of duty-free imports from all spokes. Third, MFN tariffs applied by the hub on inputs originating in third countries are in many cases lower than in spokes. In addition, *rules of origin* agreed to in the framework of bilateral Hub-and spoke FTAs matter too (see Sect. 3.2.3). With all these factors or extra-privileges at work, potential cost advantages of production in the spokes risk to fully erode diverting investments to the hub (see Wonnacott 1996; Baldwin 1994: 131–132).

3.2.2 Complementary South-South Integration: Potential Levels and Prerequisites

Representatives of the European Commission have always been keen to emphasize that the MPCs need to ‘complement’ integration with the EU with trade liberalization among them. The crucial question is, however, what a ‘parallel’ and geographically (i.e. with respect to the number of spokes) limited South-South integration is able to offer? Theoretically there are different levels by which integration among the spokes may contribute to reduce the risks of bilateral free trade with the hub as well as to improve the prospects for realizing its expected benefits (for a detailed discussion see Zorob 2008: 171–172, 2006: 18–20). First, cost-reducing and efficiency-enhancing effects emanating from increased competition and economies of scale on the enlarged spoke-spoke market could help Southern companies to better 'prepare' for future competition and thus to mitigate the adjustment costs accruing from opening-up to the hub. Second, a liberalized intra-regional market could serve as a training ground for spokes companies before they enter the hub's market. Third, trade liberalization among the spokes might contribute to contain the risks of trade and investment diversion by reducing transaction costs of intra-regional trade. There are, however, several prerequisites which need to be fulfilled. The capability of a South-South FTA to reduce trade diverting effects, to increase efficiency and to enhance competitiveness is determined by the magnitude of intraregional trade relations and the opportunities of member countries to achieve specialization in inter- and intra-industry trade. The latter, in turn, depends primarily on the factor endowment, level of industrial development, size and number of members in terms of 'spokes' covered by an agreement. To utilize this potential effectively, it is of crucial importance to what extent transaction costs in intraregional trade will be diminished beyond the elimination of customs duties or in other words if it includes measures to reduce barriers 'behind the border'. Finally, complementary integration among the spokes may offer better chances if it preceded negotiations with the hub. South-South integration based on a common institutional framework and close coordination could provide the spokes with ways of demanding collectively better conditions of market access. Moreover, it might enable them to negotiate a genuine multilateral FTA instead of a multitude of individual agreements from the outset. Otherwise, issues like rules of origin adopted in Hub-and-spoke agreements are likely to hamper the effectiveness of South-South agreements, an issue which will be looked at in greater detail in the following section.

3.2.3 The Systemic Implications of Overlapping Trade Agreements

According to the proponents of the open regionalism approach, membership in multiple overlapping FTAs is expected to offer primarily two things: Gaining market access to and being able to source duty-free imports from a multitude of trading partners which, in turn, would allow for limiting welfare-reducing trade diversion. According to Jagdish Bhagwati, however, trade agreements would be "inherently preferential and discriminatory" (Bhagwati 1995: 2). Bhagwati was the first to describe the ensuing establishment of large, but increasingly complex and opaque networks of trade agreements during the last decades as a *spaghetti-bowl phenomenon*. One of the "systemic implications" or ensuing difficulties in the administration of multiple overlapping trade agreements refers to the issue that each treaty incorporates a specific schedule for the removal of tariffs. In most cases these schedules provide for a gradual reduction of tariffs over a multi-year transition period and are based on different positive lists. Given that a country is involved in various FTAs which it is required to implement simultaneously, customs officials are stuck in a myriad of different tariffs to be applied on one and the same good depending on where the product is coming from (Bhagwati et al. 1998: 1139). Mastering the proper application of different tariff schedules may, in turn, require additional personnel in customs authorities. Beyond an expected scarcity of trained staff in customs authorities, developing countries could, and specifically in contrast to hubs like the EU, also face severe constraints with respect to capacities necessary for negotiating trade agreements (Schiff and Winters 2003: 239–240).

Capacities are also needed for the control of *rules of origin* systems. Rules of origin (ROOs) are a necessary feature of all FTAs. The principal function of ROOs is to avoid *trade deflection*. They are used to prove that a good was produced fully or partially *(substantial transformation)* in a FTA member country making it eligible to be granted duty-free access to the markets of the other members. At the same time, however, they feature as one if not the most important "systemic implication" of overlapping trade agreements. Both their formulation and implementation are characterized by a high degree of arbitrariness (Bhagwati et al. 1998: 1138). Because they often raise transaction costs of international trade to a significant degree, they are regarded as non-tariff barriers (NTBs) with far-reaching impact on market access conditions (see, inter alia, Cadot and de Melo 2008). In general, ROOs are highly technical and in many cases complex. Moreover, they often vary by products inside ROO systems and differ between one system and another. Each FTA includes a separate chapter or protocol on ROOs identifying so-called regime-wide rules besides product-specific criteria based on which goods are able to gain *originating status*. Regime-wide rules include, inter alia, provisions on *cumulation of origin*, roll-up, duty-drawback and certification of origin. Product-specific rules confirming *substantial transformation* make in most cases use of one or a combination of the following three methods: a change of tariff classification, a value content rule or local content requirement and a specific process of manufacturing or so-called technical requirement. Those criteria are often formulated on the basis of the Harmonized System (HS) at the 4-digit or sometimes 6-digit level which differentiates between more than 5.000 goods (Gasiorek et al. 2009: 147–148). In this context, one is tempted to ask why it should be necessary to distinguish between different methods as a basis for fixing product-specific criteria and why for each and every single good? For some authors the main motive behind is simply to provide the floor for "protectionist capture" by national actors (Bhagwati et al. 1998: 1139). Protectionism is allowed to be re-invented through the back-door while local industries try to influence the process by which those rules are drafted, negotiated and formally written down.

Restrictive and complex product-specific criteria basically constrain a company's decision on where to source intermediate goods. Doing so, ROOs probably bite heavily into the preferences accorded to partner countries because of their potential trade diverting and/or trade suppressing effects. As a result, they contribute to set up artificial production networks by discriminating against more efficient suppliers and, in the end, raise production costs (see, inter alia, Cadot and de Melo 2008:

86–90; Gasiorek et al. 2009: 149–154). Moreover, administrative costs associated with fulfilling ROO requirements add to the so-called *cost of compliance*. Anson et al. estimated these costs inside NAFTA to hover around 6 percent on average in ad valorem equivalent “undoing the tariff preference” granted to Mexican exporters for many goods (see Anson et al. 2005: 501). High compliance costs often induce exporting companies to refrain from complying with ROOs and to pay duties instead. In case different ROO systems apply to multiple FTAs a country has signed, things become even more complicated. Companies have to differentiate between diverse ROO regimes in the design of production processes, calculation of costs as well as fulfilling red tape to prove origin while customs authorities and affiliated agencies have to check their compliance depending on the sales market and associated treaty concerned.

3.2.4 Rules on Cumulation of Origin and Effectiveness of South-South FTAs

ROOs anchored in Hub-and-spoke agreements may not only generate high costs. They could also hamper the effectiveness of South-South FTAs or, in other words, seriously constrain implementation of existing and parallel negotiation of trade agreements between the spokes, an issue which seems to have rarely been seized on in the literature. The spokes are, one may say, ‘left to the hub’s grace’ if the latter is willing to accept a ‘regionally owned’ South-South FTA. This is because the design of ROOs as part of Hub-and-spoke agreements and, most importantly, rules on *cumulation of origin* not only decide about the extent to which the spokes are able to benefit from trade liberalization among each other in trade with the hub. They may even constrain the spokes’ *policy space* of negotiating and their capability of implementing trade liberalization among themselves. Their ‘power’ to do so depends first of all on their specific configuration or, in other words, if they allow for *partial* or *full* as well as *bilateral* or *diagonal* cumulation of origin. *Partial* cumulation means that only goods which have obtained *originating status* in a partner country, i.e. products that underwent processes of working or processing which fulfil the product-specific requirements listed in the ROO protocol, can be cumulated as *local content*. With *full* cumulation also non-originating processes of working or processing are allowed to be added which makes things easier or less restrictive. *Bilateral* cumulation, on the other hand, permits only inputs sourced in the partner country of a bilateral FTA to be added while *diagonal* cumulation allows members of different FTAs to exchange and cumulate inputs among each other (see, inter alia, Priess and Pethke 1997: 782–785).

Depending on the configuration of cumulation provisions, the restrictiveness of product-specific ROOs as well as the status of a ‘complementary’ trade agreement between the spokes, if such a treaty is existing or will be negotiated in parallel, one may distinguish different scenarios of how those rules affect the spokes’ capability to *negotiate*, *implement* and *benefit from liberalization of trade among them*. A first or 'worst-case' scenario may occur when Hub-and-spoke agreements grant solely the right to bilateral combined with partial cumulation. Beyond goods produced 'at home' exporters located in the spoke are allowed to count as local content only inputs *originating* in the partner country / the hub, i.e. goods which were either fully processed or underwent *substantial transformation* in the latter. Given that ROOs are in addition generally restrictive calling for high local content values and/or prescribing specific production processes which have to be fulfilled in the exporting country, the power of companies located in the spokes to source (potentially cheaper) inputs from each other and/or to share production processes will be seriously constrained if not rendered impossible. Consequently, Hub-and-spoke FTAs may simply *'crowd-out' a complementary trade agreement* between the spokes. As mentioned in the section on the risks of Hub-and-spoke bilateralism they would not only contribute to *divert trade* and *investment* to the hub. Given that (a) spoke-spoke FTA(−s) exist(s), companies and customs authorities have also to distinguish between two or multiple separate systems of ROOs and documents to prove origin which in the end might seriously affect proper *implementation* of the agreements concerned.

In another scenario the concerned Hub-and-spoke agreements allow for *diagonal cumulation*. Referring to the introduction of the *Pan-Euro-Mediterranean System of Cumulation* Baldwin stipulated that it "tamed" the spaghetti bowl of European FTAs as it requires all members to apply the same ROOs (Baldwin 2011: 70). It goes without saying that the more countries or markets are included in such a system the better for all. But what are the benefits of *diagonal cumulation* with respect to the spokes' capability *to negotiate, implement and benefit from liberalization of trade among them* and what are its inherent limits? Contrary to the scenario of bilateral cumulation, diagonal cumulation may provide the spokes with the possibility to source inputs from each other and thereby use former or simultaneously negotiated agreements to liberalise trade among them as a tool to curb potential risks of trade and investment diversion to the hub. Second, and given that ROO systems included in the different FTAs are harmonized, there is no need for companies and customs authorities to distinguish between different ROO systems when conducting trade transactions at both the inter- and intraregional level. Third, when spokes decide to carve out a new treaty among each other they could avoid 'protectionist capture' and protracted negotiations by adopting the ROOs anchored in their treaties with the hub.

However, these 'ideal case benefits' are apparently only one side of the coin. First, a harmonization of rules of origin via 'adoption' of Hub-and-spoke ROOs into (an) existing agreement(s) among the spokes could turn out to be 'counter-productive'. Hub-and-spoke ROOs may not only reflect protectionist strategies of domestic industries. In addition and illustrating the asymmetrical bargaining power between the hub and the spoke, developing partners in many cases rather 'accept' lists covering product-specific rules tabled by the developed partner instead of genuinely 'negotiating' ROOs (see also al-Megharbal 2001: 63). If these rules are more restrictive than the ROOs anchored in the existing South-South agreement(-s) they will most probably work against the liberalization of intraregional trade and further complicate spoke-spoke trade rather than boost it. Second, one needs to take into account that an ‘adoption’ of Hub-and-spoke ROOs necessitates a re-negotiation of existing rules on the level of the South-South agreement(-s) AND that the membership of *existing* regional FTAs may not match the group of spokes having signed a treaty with the same hub. If the right to cumulate inputs is limited to some members only this may spur a process further complicating or even undermining the existing South-South agreement. Assuming that ‘non-spoke’ members refuse to agree on a harmonization of rules of origin, the members of the existing agreement will have to cope with at least two different ROO systems as well as associated documents and red tape in trade among each other depending on the final destination of their exports. This will almost inevitably generate controversies and make *implementation* of the FTA in any case more difficult. Once the ‘spoke-members’ start to negotiate a new free trade agreement by which they adopt the Hub-and-spoke ROOs for trade among them, a procedure usually seen as a prerequisite for enjoying the right to cumulate, they and their regional neighbours may end up with a situation in which traditional intraregional frameworks get fragmented while the hub imposes his own *concept of regionness* on the spokes (see also Tavares and Tang 2011: 227–228). Third, even if there is no former South-South trade agreement, the risk or potential flipside with adopting Hub-and-spoke ROOs into a new agreement among the spokes remains the same as mentioned above: The spokes probably ‘accept’ ROOs which due to their high degree of restrictiveness seriously constrain the effectiveness of a spoke-spoke treaty to liberalize trade and thus its capability to complement parallel trade integration with the hub. Accordingly, the above mentioned benefit of being able to avoid protectionist capture of negotiations on rules of origin may turn out to be simply a delusion. Although it is not local industries trying to influence the process by which rules of origin as part of a spoke-spoke trade agreement are negotiated, protectionism is allowed to be ‘imported’ via the adoption of Hub-and-spoke ROOs. Which way is better or worse with respect to an effective liberalization of trade between the spokes remains an issue to be empirically tested on a case-by-case basis. However, what is clear in every case is that the spokes divest themselves of the opportunity to agree on simpler and/or less restrictive rules of origin governing trade among them. Accordingly, by adopting the Hub-and-spoke ROOs the spokes run the risk to limit their own *policy space* on *how* and *with whom* to negotiate trade agreements besides complicating the implementation of trade liberalization.

Moreover, one should not forget that hubs like the EU maintain an ever growing network of spokes all over the globe. Accordingly, spokes such as the MPCs are forced to negotiate and sign FTAs with a large number of other countries far beyond their regional neighbours. Apart from putting additional strain on developing countries’ scarce capacities for negotiation and implementation of trade agreements such an endeavour seems to lack real feasibility simply because many spokes have no interest in opening-up their economies to so many competitors only for the sake of ‘being able to cumulate inputs’. Looking at the issues at stake from another perspective one may also ask what happens if there are two or more hubs with which the members of a South-South FTA want to sign trade agreements? If these hubs maintain divergent ROO systems as part of their trade agreements with third countries, 'harmonization' will be an issue completely out of reach for the spokes. The Southern partners must rather be expected to end up with a bundle of parallel subregional groupings connecting those countries with the 'same hub' and his rules with all the risks attached in terms of fragmentation and complication of transactions in intraregional trade.

Finally, the crucial question remains if *diagonal cumulation of origin* is in fact able to substantially mitigate the product-specific ROOs' impact on production costs including costs of management of production and administrative costs to prove origin. Exporting companies are most probably burdened with providing additional detailed information about the sources and use of inputs besides complex and in many cases costly as well as time-consuming procedures to get hold of origin certificates. This also remains an issue on which empirical research will need to find convincing answers. The following sections explore how provisions anchored in Arab countries' bilateral FTAs with the EU and the United States affected negotiation and implementation of intraregional schemes of trade integration with a particular focus on GAFTA and the Agadir Agreement. The central hypotheses guiding the analysis are that ROO systems as part of the Hub-and-spoke FTAs and specifically those with the EU including the extension of the Pan-European System of Cumulation of Origin to the Arab MPCs did not only foster some kind of fragmentation in the region as exemplified in the creation of the Agadir agreement. In addition, they opened the door for 'protectionist capture' of negotiations on rules of origin and generated new factors constraining the proper implementation of intraregional trade agreements.

3.3 Arab Countries' Spaghetti-Bowl of Trade Agreements with Extra-Regional Partners

3.3.1 Overview

Since the 1990s MENA countries signed a host of trade agreements with partners outside the region. These agreements contributed to construct an increasingly complex and opaque *spaghetti bowl* of multiple and partly overlapping FTAs Arab countries are currently members of (see Fig. 3.1). In the framework of the EMP seven Arab countries signed bilateral FTAs with the EU (see Table 3.1). Morocco and Jordan as well as the GCC members Bahrain and Oman negotiated FTAs with the Unites States although the GCC Supreme Council had already decided to establish a customs union (see Table 3.2). In addition, Jordan and Egypt passed so-called Qualifying Industrial Zone (QIZ) agreements with Israel and the United States. Jordan concluded an FTA with Canada too (The Hashemite Kingdom of Jordan 2014). Finally, all of Morocco, Tunisia, Egypt, Jordan, Lebanon, the Palestinian

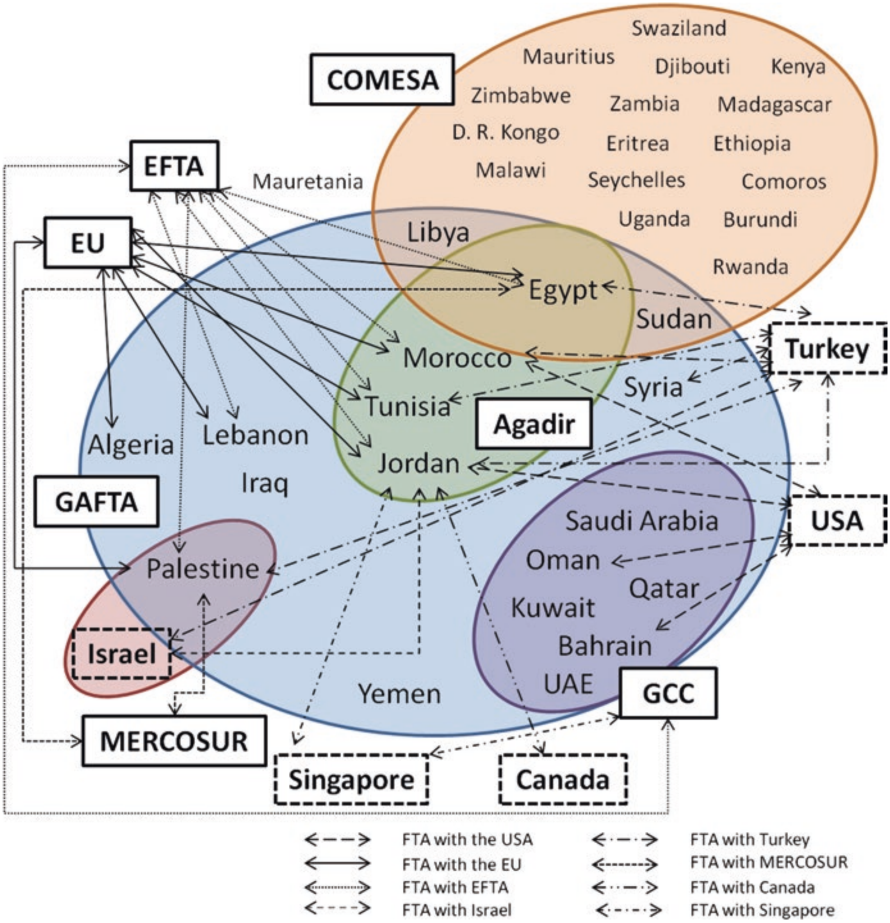

Fig. 3.1 Spaghetti Bowl of Arab Countries' Free Trade Agreements, 2014 (FTAs with external as well as regional partners excluding bilateral agreements among Arab countries) (Source: Own compilation)

Authority and the GCC passed bilateral FTAs with the members of the European Free Trade Area (EFTA) (EFTA 2014).[1] Beyond the FTAs with 'Western' trade powers, Arab countries started increasingly to look to the East. Jordan and the GCC both signed an FTA with Singapore while the GCC initialled another treaty with New Zealand. Jordan, the regional 'frontrunner' among those seeking to secure preferential access to industrialized markets, belongs to five bilateral FTAs with partners outside the region. Morocco forms part of 'only' three and Egypt of two FTAs with industrialized partners. However, all three are members of a multitude

[1] The FTAs with EFTA follow the model of the EuroMed agreements; they include the Pan-Euro-Mediterranean ROOs.

Table 3.1 Trade and cooperation agreements between Arab countries and the EU (Source: Own compilation based on European Commission, DG Trade (2016). Overview of FTA and other Trade Negotiations, May 2016)

	AA	DCFTA	CA/PCA	Cotonou agreement	EPA
Country	In force	In negotiation	In force	In force	In negotiation
			SINCE		
Algeria	09/2005				
Bahrain			1989 (GCC-EU)		
Comoros				03/2000	02/2004
Djibouti				03/2000	02/2004
Egypt	06/2004	2013 (dialogue - on hold)			
Iraq			05/2012		
Jordan	05/2002	2013 (preparatory process)			
Kuwait			1989 (GCC-EU)		
Lebanon	04/2006				
Libya			2008-2011 PCA negotiations		
Mauritania				03/2000	06/2014 agreement initialized
Morocco	03/2000	2013 (negotiations) 2016 (negotiations suspended)			
Oman			1989 (GCC-EU)		
Occupied Palestinian Territories	07/1997 (IA) PAPs 01/2012				
Qatar			1989 (GCC-EU)		
Saudi Arabia			1989 (GCC-EU)		
Sudan				03/2000	02/2004
Syria	2004 and 2008 (agreement initialled) 2011 (negotiations suspended)				

(continued)

Table 3.1 (continued)

Country	AA In force	DCFTA In negotiation	CA/PCA In force	Cotonou agreement In force	EPA In negotiation
Tunisia	03/1998	2015 (negotiations)			
UAE			1989 (GCC-EU)		

AA Association Agreement
DCFTA Deep and Comprehensive Free Trade Area
CA Cooperation Agreement / PCA Partnership and Cooperation Agreement
EPA Economic Partnership Agreement

and partly overlapping groupings with Arab and/or African countries. Egypt and Morocco acceded together with Tunisia to SinSad, while Egypt became a member of COMESA too. In addition, Egypt has signed, similar to Palestine, an FTA with MERCOSUR.[2]

3.3.2 Hub-and-Spoke Agreements with the EU: Euro-Mediterranean Partnership

As illustrated in Table 3.1 Arab countries' trade-related contractual arrangements with the EU form part of various and significantly differing regional frameworks ranging from the Euro-Mediterranean Partnership in which the Arab Mediterranean Partner Countries are involved to the Cotonou framework covering African Arab countries such as Djibouti or Mauritania. In November 1995 the EMP was launched by the EU and twelve MPCs.[3] The Barcelona Declaration stated as broad objectives the establishment of a "common area of peace and stability", an "area of shared prosperity" and the promotion of "understanding between cultures and exchanges between civil societies" (European Commission 1996). The elementary basis on which relations were aimed to be built covered bilateral free trade or Association Agreements (AAs) between the EU and each MPC. As negotiation, signature and ratification of the AAs took much more time than anticipated the creation of the Euro-Mediterranean Free Trade Area (EMFTA) could not be realized as originally

[2] The Community of Sahelo-Saharan States (SinSad) is not included in Fig. 3.1.

[3] In 1995 the MPCs covered Egypt, Algeria, Jordan, Lebanon, Morocco, Syria, Tunisia and the Occupied Palestinian Territories besides Turkey, Cyprus, Malta and Israel. In 2004 Malta and Cyprus acceded to the EU while Turkey was granted accession candidate status. Albania and Mauretania became members of the EMP in 2007. Libya has been an EMP observer since 1999 and started negotiations on an FTA outside the EMP framework in 2008 which were suspended in February 2011. Iraq and Yemen are neither EMP nor ENP members; a cooperation agreement between the EU and Yemen was signed in 1998, while a Partnership and Cooperation Agreement between the EU and Iraq went into force in spring 2012 (European Commission 2016).

Table 3.2 Trade agreements between Arab countries and the United States (Source: Own compilation based on Ilias Akhtar, Bolle and Nelson (2013). U.S. Trade and Investment in the Middle East and North Africa, Table 2, p. 21; Zorob (2013), Table 11.2, p. 192)

	TIFA	BIT	Bilateral FTA		QIZ
Country	Year signed	Year entered into force	Negotiations	Year entered into force	Year entered into force
Algeria	2001				
Bahrain	2002 2012 (GCC-US)	2001	Concluded 05/2004	2006	
Djibouti					
Egypt	1999	1992	Put on hold in 2005		2005 (USA-Israel-Egypt)
Iraq	2005				
Jordan	1999	2003	Concluded 10/2000	2001	1998 (USA-Israel-Jordan)
Kuwait	2004 2012 (GCC-US)				
Lebanon	2006				
Libya	2010				
Morocco		1991		2006	
Oman	2004 2012 (GCC-US)		Concluded 10/2005	2009	
Qatar	2004 2012 (GCC-US)		(preliminary) put on hold in 2006		
Saudi Arabia	2003 2012 (GCC-US)				
Syria					
Tunisia	2002	1993			
UAE	2004 TIFA-plus 2007 2012 (GCC-US)		Put on hold in 2006		
West Bank / Gaza Strip					
Yemen	2004				

TIFA Trade and Investment Framework Agreement
BIT Bilateral Investment Treaty
FTA Free Trade Agreement
QIZ Qualifying Industrial Zone Agreement

planned by 2010. As illustrated in Table 3.1, bilateral FTAs have been signed with Algeria, Egypt, Jordan, Lebanon, Morocco, the Palestinian Authority and Tunisia.[4] Given the completion of a minimum 12-years transition period during which customs duties and quantitative restrictions were to be abolished on a gradual basis, fully implemented were, as of 2016, the treaties with Tunisia, Morocco and Jordan. Against the background of the EU enlargement in 2004, the EMP was, according to the European Commission's official definition, "complemented" by the European Neighbourhood Policy (ENP). The ENP aims at enhancing prosperity, security and stability in the countries bordering the EU and basically extends on existing contractual relations between the EU and its neighbours. Therefore, the ENP is addressed to the MPCs and selected non-EU-Eastern European and Caucasian countries or those that currently can't expect to become full members of the EU. The ENP is implemented primarily via so-called action plans (APs) which are expected to deliver 'tailor-made' agendas for reform and cooperation and which are negotiated by the EU and the ENP members bilaterally (see Zorob 2006b: 40–41). Finally, in 2008, the Barcelona Process has been 're-launched' in the form of the Union for the Mediterranean (UfM).[5]

Apart from provisions on competition rules and plans to introduce deeper integration measures, most AAs resemble rather 'shallow' FTAs. Although the 2003 Euro-Mediterranean Meeting of Trade Ministers approved the extension of free trade to services and investment and bilateral negotiations on those issues started in 2008, the negotiations reportedly have not achieved substantial progress so far.[6] As regards merchandise trade, the AAs call for, in essence, an asymmetrical opening-up of MPCs' markets to European competition because the MPCs enjoy duty-free access to EU member country markets for industrial goods since the 1970s. Accordingly, improved market access for MPCs industrial exports to the EU can only be expected if additional measures of 'deeper' integration aiming at relaxing barriers 'behind the border' materialized. Preparations for negotiations on sector-specific Agreements on Conformity Assessment and Acceptance of Industrial Products (ACAAs), however, are commencing only slowly. As regards agricultural goods, processed agricultural products and fisheries, the AAs offer concessions for selected items and call for future progressive gradual liberalization based on every three to five years newly negotiated protocols. Updated agricultural protocols were signed as follow-ups to the AAs so far with Jordan, Egypt and Morocco. In late 2011 the European Council authorized the Commission to open negotiations on Deep and Comprehensive Free Trade Areas (DCFTAs) with Egypt, Jordan, Morocco

[4] Syria and the EU initialed an AA for the first time in 2004 and again in 2008; although the European Council approved the treaty in October 2009, Syrian representatives ignored the date scheduled for the AA's official signature. In 2011 the EU enforced restrictive measures against the Syrian ruling elite. For details on the Syria-EU draft AA see Zorob 2006b.

[5] Members of the UfM are beyond EU members and MPCs, Bosnia and Herzegovina, Croatia, Monaco and Montenegro.

[6] Aside from the AAs with Jordan and Syria rights of establishment are mentioned only as a future target in the AAs with other MPCs although the treaties reconfirm the partners' GATS commitments (see Zorob 2006b: 68–69).

and Tunisia. With Morocco official negotiations have started in spring 2013 but were suspended in 2016 while negotiations on a DCFTA with Tunisia are ongoing since 2015. The EU and the GCC concluded a cooperation agreement in 1989. Negotiations on an FTA started as early as 1990 and constituted the first talks on a free trade agreement the GCC conducted jointly with an external power. Due to several stumbling blocks, however, the GCC representatives suspended the negotiations in late 2008 (see Lawson in this volume, Zorob 2013: 188 and Sect. 3.5.3.1).

3.3.3 Hub-and-Spoke Agreements with the United States: The MEFTA Initiative

In addition to their agreements with the EU, Jordan and Morocco concluded bilateral FTAs with the United States too. Although the Jordan-US FTA has been signed as early as 2000 in the framework of US initiatives to foster the Middle East peace process, it forms part of the MEFTA Initiative launched by the Bush Administration in 2003 US-Jordan FTA (n.d.). MEFTA was designed as a bottom-up approach based on which "willing" Middle Eastern countries could become members given that they fulfil a number of steps starting from WTO accession and reaching in the end a comprehensive FTA. It was planned that the bilateral FTAs with MENA countries would finally merge into a single arrangement – the MEFTA – by 2013 (Zorob 2013: 191–192).

Since the signature of the Oman-US FTA in early 2006, however, no significant measures have apparently been taken to sign additional FTAs with Arab countries (US-Oman FTA (n.d.). Negotiations with the UAE apparently stalled soon after their launch. While Nelson, Bolle and Ilias in their paper for the Congressional Research Service explained the suspension of the US-UAE FTA negotiations in a rather diplomatic way with "differing views on issues related to labor, market access for services and government procurement" (Nelson et al. 2012: 18) other sources saw a link to the Dubai Ports case which had sparked controversial debates about the rights of foreign investors in the United States in early 2006.

In 2011 president Obama announced the launch of a new "Trade and Investment Partnership with the Middle East and North Africa" which emphasized to support MENA countries' integration with US and European markets by building on existing trade agreements and a stronger coordination of policies with the EU. Supporting the doubts cast by experts about the feasibility or rather willingness of the US administration to negotiate agreements with other MENA countries the new initiative still waits to be packed with substance. US FTAs with Arab countries do follow more or less a similar structure and can be classified as 'deep' FTAs. The treaties cover liberalization of trade in services, rights of establishment, protection of intellectual property rights (IPR), modernization of customs procedures and rules for government procurement as well as provisions on labour and environmental protection. Moreover, reciprocal liberalization of trade in industrial goods promised to offer Arab partners enhanced access to the US market as they previously did not enjoy preferential treatment except in the framework of the Generalized System of Preferences (Khouri 2008, Lawrence 2007: 22). However, several limitations apply as regards 'sensitive' branches such as textiles. With respect to agricultural trade, the provisions call for a gradual liberalization according to rather complex country-specific schedules as well as quotas and/or entry-price restrictions for selected products reflecting fears concerning each other's expected competitive edge. Beyond an exceptionally long transition period, seasonal restrictions or a 'net exporter clause' for various processed agricultural products the US-Morocco FTA includes a 'preference clause' guaranteeing US wheat and other selected agricultural exports automatically the same preferential treatment that Morocco is going to extend to any other country in the future (US-Morocco FTA (n.d.): Annex IV). Against the background of the Middle East Peace Process in the 1990s the US administration sought to engage Qualifying Industrial Zones (QIZs) as another instrument for fostering 'economic normalization' between Israel and those countries in the region which are bound by peace treaties with the former (Khouri 2008: 4). The first QIZ agreement between Jordan, Israel and the United States entered into force in 1998, the second including Egypt, Israel and the US in 2005 (see Table 3.2).

3.4 Arab Countries' "Spaghetti-Bowl" of Trade Agreements with Regional Partners

3.4.1 Overview

In 1997 the Economic and Social Council (ESC) of the League of Arab States (LAS) approved the Executive Programme to establish the *Greater Arab Free Trade Area (GAFTA).* In addition to GAFTA, existing sub-regional groups such as the *Arab Maghreb Union* (AMU) and the *Gulf Cooperation Council* (GCC) were intended to be re-activated and/or deepened.[7] Moreover, a new sub-regional grouping saw the light of the day in the first half of the 2000s when Jordan, Egypt, Tunisia and Morocco signed the *Agadir Agreement* establishing the *Mediterranean Arab Free Trade Area* (MAFTA). Arab countries and in particular the Arab MPCs negotiated a new round of bilateral FTAs among themselves besides trade agreements with Turkey and Israel. The announcement of GAFTA reflected the aim of LAS

[7] The AMU was formed in 1989 between Algeria, Libya, Morocco, Mauritania and Tunisia. As the AMU did not succeed in approving the formal legal basis necessary for the establishment of an FTA, it will not be part of the analysis. One of the main problems affecting proper functioning of the AMU pertains to closed borders between Algeria and Morocco. For an overview about the multiple past efforts at regional integration in the Middle East and North Africa until the beginning of the 2000s including initiatives launched in the framework of the Middle East Peace Process see Laanatza et al. 2001).

members to give regionalization another chance. In addition, the new project was announced to be the Arab countries' 'answer' to regional and international developments. These developments included the decision of Arab MPCs to take part in the EMP. Accordingly, one of GAFTA's as well as the Agadir Agreement's main objectives is apparently to serve as a complementary strategy to integration with the EU.

3.4.2 Greater Arab Free Trade Area (GAFTA)

The GAFTA Executive Programme, and the *Agreement to Facilitate and Develop Inter-Arab Trade* of 1981 as its legal basis, has been signed by 18 Arab countries including all Arab MPCs (see Fig. 3.1). GAFTA constitutes a typical 'shallow' FTA. The Executive Programme calls for a gradual removal of customs duties and taxes of similar effect on all industrial as well as agricultural goods of Arab origin within a period of ten years (GAFTA Executive Programme 1997). After the transitional period was cut to eight years, the elimination of customs duties among the 14 GAFTA members which started to reduce tariffs as scheduled in 1998 was regarded as having been accomplished by 2005. Palestine, Yemen and Sudan signed the Executive Programme at a later date and are entitled to enjoy special treatment; Algeria joined GAFTA in 2009 while Syria's Arab League membership has been suspended in late 2011.[8] The Programme allows for exemptions of a limited proportion of industrial goods from the phase-out of tariffs and the application of seasonal restrictions on selected fresh fruits and vegetables on a temporary basis during the transition period. It also stipulates the removal of NTBs but lacks detailed regulations on how to achieve this end. The body supervising GAFTA implementation is the ESC (GAFTA Executive Programme, Zorob 2008: 174–176). In 2000 the ESC decided to extend liberalization of trade to services too. The hitherto eleven Arab WTO members agreed in 2003 on a separate Arab Agreement for the Liberalization of Trade in Services or 'Arab GATS' and started a year later to submit provisional lists with country-specific concessions to be discussed at sector meetings (LAS 2012a, b; LAS 2014b; AMF 2011, 2012, 2015).

3.4.3 Agadir Agreement

The GAFTA Executive Programme encourages the conclusion of additional trade agreements among two or more member countries though GAFTA commitments are to be regarded as minimum requirements. This provision seems to have provided the

[8] Whereas Yemen and Sudan were granted a longer time to phase out tariffs because of their status as least developed Arab countries, Palestinian goods shall benefit from free access to the markets of all GAFTA members without being obliged to offer the same treatment to partners (see LAS 2012a, b).

main justification for LAS representatives to welcome the signature of the Agadir Agreement between Jordan, Egypt, Tunisia and Morocco in 2004. The agreement to establish the MAFTA is open to accession by all GAFTA members given that they signed an FTA with the EU too. The body supervising implementation of the Agadir Agreement is the *Ministers of Foreign Trade Committee* while the *Ministers of Foreign Affairs Committee* shall support the Agadir process on the political level (Agadir Agreement 2004). After several delays in the process of the agreement's ratification it went formally into force in July 2006 while effective implementation did not start before spring 2007. Similar to the GAFTA Executive Programme, the provisions of the Agadir Agreement call for a removal of customs duties and charges of similar effect on all industrial and agricultural goods. With respect to antidumping, safeguards and the elimination of NTBs the Agadir Agreement refers to the GAFTA provisions and to WTO principles. As regards the removal of technical barriers the members agreed to negotiate on ACAAs among each other. Moreover, the provisions of the Agadir Agreement cover the protection of IPR and liberalization of trade in services. Liberalization of services, however, is limited to reconfirming GATS commitments (Agadir Agreement 2004, Layadi 2008: 319–323).

3.4.4 Bilateral Trade Agreements Among MPCs

Beyond GAFTA and the Agadir Agreement in particular the members of the latter built a complete network of bilateral FTAs among themselves (see Table 3.3). As indicated above, the GAFTA Programme encourages the conclusion of additional trade agreements given that they comply with or go beyond GAFTA commitments. The bilateral FTAs signed among Arab MPCs, however, do not satisfy these conditions. They have primarily been based on complex positive lists, included numerous exemptions and their period of implementation exceeded the GAFTA transition period (Zorob 2006b: 114–116). Against the background of the Middle East Peace Process, the region also witnessed the conclusion of the first Arab-Israeli trade and cooperation agreements. In 2004 Jordan and Israel signed a supplementary protocol which extends preferences granted in the 1995 trade agreement (State of Israel 2014). All Arab MPCs (AMPCs) except Algeria passed bilateral FTAs with Turkey (see Table 3.3). As Turkey has a customs union with the EU since 1996, it is in Turkey's interest to follow closely the EU's preferential trade policy with third countries. In other words, to prevent that goods originating in a country with which the EU has signed an FTA enter the Turkish territory via an EU member duty-free while Turkish exporters do not enjoy preferential access to the respective third country, the government of Turkey needs to conclude trade agreements with this country too. In contrast to the bilateral FTAs among Arab MPCs, the agreements between the latter and Turkey follow more closely the model of the AAs. As regards industrial goods Turkey grants duty-free access for goods originating in the AMPCs immediately with entry-into-force of the agreements while AMPCs enjoy a nine to twelve years transition period to phase out tariffs. Agricultural trade is covered by

Table 3.3 Bilateral trade agreements among MPCs (year signed/year entered into force) (Source: Own compilation based on World Bank (2008): *MENA Economic Developments and Prospects 2008;* various government websites)

	Algeria	Egypt	Jordan	Lebanon	Morocco	Palestine	Syria	Tunisia	Israel
Algeria									
Egypt	PTA								
Jordan	PTA1997/99	FTA 1998/99							
Lebanon	PTA	PTA1998/99	PTA1992/93						
Morocco	PTA	PTA1998/99	FTA 1998/99	–					
Palestine	–	PTA 1994/94	PTA1995/95	–	–				
Syria	PTA1997	PTA1991	PTA2001/02	PTA1998/99	–	–			
Tunisia	PTA	FTA 1998/99	FTA 1998/99	–	FTA 1999/99	–	PTA 2004/05		
Israel	–	–	PTA 1995/96	–	–	PTA 1994/95	–	–	
Turkey	–	FTA 2005/7	FTA 2009/11	FTA 2010	FTA 2004/06	IFTA 2004/04	FTA 2004/07 suspended 2011	FTA 2004/05	FTA 1996/97

FTA Free Trade Agreement
PTA Preferential Trade and Cooperation Agreement (tariff preferences for selected goods)

reciprocal preferences for selected goods as part of separate agricultural protocols. The treaties also include rules on competition and IPR (Republic of Turkey 2014).

3.4.5 Gulf Cooperation Council (GCC)

Although the creation of the GCC in 1981 was primarily motivated by security concerns, the GCC members swiftly approved the Unified Economic Agreement (UEA) which spelled out, among others, the target to establish an FTA. By early 1983, customs duties on trade among the GCC members had officially been abolished though problems remained in actual implementation (see Lawson in this volume). Almost twenty years later the GCC members made public their decision to establish a Customs Union (CU) based on a revision of the UEA including a timetable for the introduction of a CET. Initially the CU had been scheduled to be completed by 2005. Although the GCC member countries managed to approve a common customs law and to align their tariff regimes with a CET of five percent across more than 85 percent of all tariff lines with most of the rest to be exempted from duties) the practical implementation of the CU, however, continued to face numerous obstacles. Despite these problems, the Gulf leaders declared in 2007 that the GCC common market should come into force as scheduled at the beginning of 2008 while full completion of the CU has later been announced to be reached by 2015 (for more details see Zorob 2013: 186–188, World Bank 2010).

3.5 Hub-and-Spokes Bilateralism and Trade Integration Among Arab Countries

3.5.1 Rules of Origin in Arab Countries' FTAs with the EU and the United States

US and EU rules of origin systems have one thing in common: Both are said to be complex and restrictive. The systems differ considerably in their regime-wide rules such as provisions on cumulation and certification methods besides their product-specific criteria. Moreover, EU and US ROO systems may differ even among the FTAs each of them has signed with third countries. The EU, however, made large efforts to harmonize its ROO regimes with the introduction of on a "single list" of product-specific rules (Cadot and de Melo 2008: 79, Estevadeordal and Suominen 2006: 76–77). The Pan-European System of Cumulation was launched in 1997 between the EU, the EFTA countries, the Central and Eastern European Countries (CEEC) and the Baltic States. In 1999, the System has been extended to Slovenia and Turkey. In 2003 the MPCs were invited to join the System when the third meeting of the Euro-Mediterranean Ministers of Trade decided to establish the *Euro-Mediterranean System of Cumulation of Origin*. To become members of the

Pan-Euro-Med System MPCs are required to conclude FTAs with all other partners of the system and adopt the Pan-Euro-Med ROO Protocol as part of theses treaties. As it soon became clear that such a process would take years to materialize, the Euro-Med Ministers of Trade decided in 2007 to draft a single Regional Convention which has been approved and opened for signature by the members in 2011. The Regional Convention shall replace the network of some 60 ROO protocols inside the System covering in addition to the above mentioned members the partners in the EU's Stabilization and Association Process. The signature and ratification of the Regional Convention as well as the following insertion into the trade agreements among the partners seem to proceed only slowly too, at least as regards the MPCs.[9]

The Pan-Euro-Med Protocol includes a long list of product-specific rules which define for each good on the six-digit HS level one or several different criteria. The list-rules are regarded by many as being complex and restrictive. This applies in particular to sectors in which MPCs enjoy a comparative advantage such as textiles and apparel or processed agricultural goods. For many goods product-specific criteria require double transformation (double transformation from yarn to fabric and from fabric to clothing) in manufacturing processes and/or a local value added ranging between 40 and 60 percent or higher. Rules of this kind are considered hard to fulfil for developing countries lacking the necessary deep production and supply chains as well as countries with lower wages. In case producers of clothing, for example, are heavily dependent on imports of textiles, European ROOs may force these countries to source textiles in the EU despite often higher prices (see, for instance, Ghoneim 2003; Estevadeordal and Suominen 2006; Cadot and de Melo 2008). Major regime-wide rules cover provisions on diagonal cumulation, no duty drawback, de minimis and tolerance rules. All members of the System are allowed to make use of partial cumulation for trade between each other and the EU. The countries belonging to the European Economic Area (EEA) comprising the EU, Iceland, Liechtenstein and Norway enjoy the benefit of full cumulation while Algeria, Morocco and Tunisia have been granted this right too. Duty drawback is prohibited in diagonal trade while it is allowed for the MPCs except Israel in bilateral trade with the EU. In 2014/2015 MPCs were still allowed to apply a partial drawback in diagonal trade too but on a temporary basis until the end of the transition period (European Commission 2014; Council of the European Union 2010). Apart from the Pan-Euro-Med System of Cumulation the European Commission had started in 2003 also a discussion on a more general reform and simplification of ROOs. In a 2005 Communication the Commission suggested, among others, a single, across-the-board value added criterion besides changes in the system of certification (European Communities 2005). Unfortunately, this initiative seems not to have produced significant progress so far as the new Regional Convention still includes a multitude of different product-specific criteria.

[9] Although all MPCs except Morocco and Syria ratified the Regional Convention, as of early 2017 only Egypt and Palestine started to apply diagonal cumulation (or rather fulfil the legal prerequisites to do so) based on the Regional Convention and only in their trade relations with the EU (see European Commission 2017).

In contrast to the Pan-Euro-Med Protocol, ROO systems as part of the bilateral US-Arab FTAs are not in line with each other. Although all ROO protocols include a general local content rule requiring 35 percent of the appraised value of a good to be processed in one or both parties to the FTA for a majority of goods, they include differing product-specific rules for selected goods. The latter cover in particular textiles and apparel. While in the US-Jordan FTA origin requirements for textiles are primarily based on the "four-operations"- rule, the others include "yarn-forward" or "fiber-forward" rules which constrict sourcing of inputs in third countries even more heavily than in case of the "four-operations"- rule. Accordingly and taking into account that all four Arab countries are heavily reliant on imports of inputs from third countries, product-specific rules for textiles and apparel seem to have been primarily designed to protect the US market. Although Oman, Morocco and Bahrain were granted Tariff Preference Levels (TPLs) enabling companies to export textile products duty-free to the US market that do not fully comply with the ROO requirements, the TPLs are limited to a period of ten years after entry into force of the agreements (Malkawi 2011). The Bush Administration seems to have been considering, at least initially, to allow for sub-regional cooperation via granting Morocco, for example, the right to cumulate inputs originating in neighbouring North African countries, or Bahrain to use inputs originating in other Gulf countries (Bolle 2006: 8). However, a system of diagonal cumulation similar to the Pan-Euro-Med System does not seem to have emerged although the US-Jordan and the US-Oman FTAs called for the start of discussions on the possibility of cumulation within six months after the agreements' entry into force (US-Jordan FTA (n.d.), US-Oman FTA (n.d.)). Compared to the US-Arab FTAs the ROOs as part of the QIZ agreements seem to be more flexible or even 'force' cumulation. To be eligible for duty-free access to the US market a good is required to be imported directly from a QIZ or the West Bank/Gaza Strip. In addition, the product needs to go through a process of substantial transformation and 35 percent of the value added must be delivered in a QIZ. Finally, of the 35 percent local content, 20 percent are required to be sourced in Israel and Jordan (no less than 8 percent from Israel) or Egypt (no less than 10.5 percent from Israel) while the remaining 15 percent may come from the United States, Israel, the West Bank and Gaza and/or Jordan or Egypt depending on which QIZ programme is concerned (Bolle, Prados and Sharp 2006: 2).

3.5.2 Rules of Origin in Arab Countries' FTAs with Regional Partners

The GAFTA Executive Programme addresses the issue of ROOs in a very short form only. The relevant paragraph calls for the application of "temporary" ROOs approved by the ESC in a separate decision (GAFTA Executive Programme 1997; Arab Rules of Origin 1997). These rules have to be applied by the GAFTA member countries until final and detailed ROOs are defined by the League's *Rules* *of Origin Committee*. As of late 2016, almost 20 years after the signature of the GAFTA Executive Programme, the final GAFTA ROOs remained to be fully defined and agreed upon (LAS 2016). The temporary GAFTA ROOs differentiate between two basic criteria to confer status of origin. Goods achieve Arab origin if they are wholly obtained in one of the GAFTA member countries. Sufficient working or processing of a product is fulfilled if the local value added is no less than 40 percent. In addition, the temporary GAFTA ROOs allow for partial cumulation while the general criteria for the formulation of detailed GAFTA ROOs call for an alignment with those applied in agreements of GAFTA members with other countries. In line with the latter aim, the GAFTA provisions require in contrast to all earlier trade agreements signed under the auspices of LAS the design of numerous product-specific criteria (Arab Rules of Origin 1997; LAS 1998). The Agadir Agreement, in contrast, adopted the Pan-Euro-Med Rules of Origin Protocol. The same applies to the bilateral FTAs signed between Turkey and Arab MPCs as well as to the Jordan-Israel trade agreement (State of Israel 2014, Republic of Turkey 2014, Agadir Agreement). Finally, the ROO criteria of the GCC-FTA require a minimum of 40 percent local value added and that the plant producing a good for intra-GCC trade shall be owned by a GCC citizen (51 percent minimum share) (World Bank 2010: 6).

Summing up, the ‘point of departure’ at the beginning of the 2000s and after the start of GAFTA implementation presented itself as follows. As outlined in Sect. 3.5.3.2, most of the Arab MPCs had signed AAs with the EU. The right to diagonal cumulation of origin as part of these agreements and the official establishment of the Pan-Euro-Med System of Cumulation in 2003 pushed these countries to become members. As Baldwin noted, it fostered a “domino-like effect … not in terms of tariffs … but rather in terms of ROO/cumulation protection” (Baldwin 2011: 73) as remaining outside of the Pan-Euro-Med System could have been understood as risking investment diversion (see Sect. 3.2.1). Although negotiations of GAFTA detailed ROOs had started already with the proclaimed aim of “harmonization” of rules of origin, Morocco in 2001 reportedly came up with the initiative to negotiate a separate MAFTA leading in the end to the signature of the Agadir Agreement in 2004 (see Sect. 3.4.3). The EU supported the latter’s signature and implementation technically as well as financially while at the same time refusing to accept the GAFTA Executive Programme as a regional free trade agreement (Zorob 2008: 180). Moreover, the EU-GCC negotiations on an FTA witnessed a major acceleration while some Arab countries signed or negotiated FTAs with the USA. Against this background the question arises how these different agreements and their commitments may have affected the process of GAFTA-internal negotiations on detailed rules of origin.[10]

[10] The question if and how the bilateral FTAs signed by the USA with both Bahrain and Oman may have affected implementation of the GCC customs union was explored by the author in an earlier publication (see Zorob 2013: 196–199).

3.5.3 Pan-Euro-Med Rules of Origin: A Tool to Promote Intra-MENA Integration?

3.5.3.1 The Complicated Process of Adopting GAFTA Rules of Origin

As explained in Sect. 3.2.4 the design of ROOs as part of Hub-and-spoke agreements and the accompanying provisions on cumulation may constrain the spokes' *policy space* of negotiating trade liberalization among them. Given that they allow for diagonal cumulation as in the case of the AAs signed between the EU and the MPCs the spokes are granted the right to cumulate inputs sourced from each other. For being able to do so, however, the EU requires them to adopt the Pan-Euro-Med ROOs in their South-South FTAs too. With the Agadir Agreement and the decision to apply the Pan-Euro-Med ROOs also on intraregional trade the four Arab MPCs covering Morocco, Tunisia, Egypt and Jordan, however, did not only abandon *policy space* in negotiating regulation of trade among themselves. Keeping in mind that at the beginning of the 2000s Arab MPCs formed only a minority of GAFTA members, a situation that hasn't changed much since, and thus the right to cumulate inputs has been limited to the MPCs, one may argue, in addition, that they risked fragmentation of established intraregional frameworks.

Looking at this situation from another perspective the EU apparently tried to impose her own *concept of regionness* on the MPCs. In line with this argument De Lombaerde and Schulz, among others, emphasized that the target to establish the Euro-Med FTA mainly reflected a "European Initiative introduced independently from existing regional initiatives" (De Lombaerde and Schulz 2009: 288). If the European Commission wanted to put into practice what other authors portrayed as the EU's genuine strategy of "engaging in interregional arrangements" and, as part of this, to negotiate FTAs "with existing regional groups" (Langenhove and Costea 2007: 72, 78) it could have offered linking the EMP with the EU-GCC free trade negotiations and to extend diagonal cumulation beyond Arab MPCs to the GCC countries and probably also to other GAFTA members (see also Brenton and Manchin 2003: 14–16, Neugart and Schumacher 2004: 187–188). However, the *EU Strategic Partnership with the Mediterranean and the Middle East* approved in 2004 declined on offering an "Euro-Middle East Partnership" which could have overcome the "compartmentalisation" of the EU's policies towards the Middle East and North Africa (Neugart and Schumacher 2004: 182, 185).

A look on the forces behind the establishment of the Pan-European System of Cumulation and its extension to the MPCs may provide an explanation. According to Baldwin, the increasing "unbundling" of manufacturing processes and "offshoring from the EU" to countries such as CEECs and MPCs encouraged European companies which were previously protected by the spaghetti bowl of different ROOs to lobby for harmonization and diagonal cumulation (Baldwin 2011: 70–73). Relations between the EU and the Arab Gulf countries, however, are apparently rather different. European heavy industries' opposition against duty-free imports of Gulf petrochemicals and aluminium products long featured as one of the main stumbling blocks in EU-GCC FTA negotiations (Luciani 2008: 119). In addition, European lobbyists' more recent calls for 'restriction-free access to raw materials as a necessity for maintaining the complete value chain inside the EU' formed the basis for the 2008 EU Raw Materials Strategy. As part of this strategy the European Commission started to include a clause proscribing export duties into the trade agreements in negotiation. This clause apparently presented the last in a row of alternating 'stumbling blocks' which according to GCC officials would have been tabled anew by the European Commission in each and every round of negotiations and which pushed the GCC members finally to suspend the negotiations in late 2008 (Zorob 2009). Accordingly, it is rather difficult to imagine that the EU will reverse her strategy of 'compartmentalising' MENA any time soon and by doing so 'sacrifice' her own, and so to say 'traditional' concept of regionness in this area, that of a *Mediterranean Region*.

Beyond the question of WHO would be in the end allowed to cumulate inputs from WHERE in trade with the EU and WHAT Arab countries could have expected in this regard at the beginning of the 2000s the question arises IF the signatories of the Agadir Agreement perceived fragmentation as a risk? In other words did they care for or try to avert undermining GAFTA or rather grasped the opportunity to ask for more restrictive ROOs also in the context of intraregional trade? What were the interests of the other GAFTA members and could MAFTA's adoption of the Pan-Euro-Med ROOs be hold accountable for the slow progress in GAFTA-internal negotiations on final and detailed rules of origin? As mentioned above the general criteria for the formulation of detailed GAFTA ROOs call for an alignment with those included in the agreements of its members with other countries. In line with this principle regional experts recommended a 'harmonization' with the Pan-Euro-Med ROOs mainly by referring to its potential in reducing inconsistencies and costs in practical implementation of overlapping FTAs (see al-Megharbal 2001: 71, Afifi 2007). The first draft on detailed ROOs presented in 2000 was said to have been mainly but not exclusively guided by European ROOs and included product-specific criteria for a large number of goods. Regime-wide rules covered partial cumulation and a prohibition of duty-drawback (Zorob 2006b: 217–218). In the following years the Rules of Origin Committee made up of ministerial experts of GAFTA member countries met regularly two or more times a year to discuss draft criteria and submit rules agreed on for adoption by the ESC. After the European Commission suggested an extension of the Pan-European System to the MPCs, Arab MPCs apparently strengthened their pressure on the Rules of Origin Committee to seek conformity with European rules (Layadi 2008: 314). The overwhelming reliance on European criteria, however, soon sparked controversy between the Arab MPCs and other GAFTA members. According to the latters' view, European ROOs would neither be appropriate for fostering development and joint production among Arab countries nor take duly into account competitiveness of Arab industries (Said 2011: 179). More generally, two groups emerged, one consisting of the majority of Gulf countries besides Jordan and Lebanon who advocated 'softer' or more 'liberal' rules. The second group covering countries like Morocco, Tunisia, Egypt and Syria called for 'stronger' criteria in terms of higher local content and/or technical requirements aimed at protecting domestic industries or, in ‘official language’ to prevent third country imports from flooding Arab markets (Zorob 2006b: 218–219).

By end of 2007 the ESC had approved product-specific criteria for around half of all goods. GAFTA members were asked to apply those ROOs commencing in mid-2008. Simultaneously, a new origin certificate was adopted. Nevertheless, problems with implementing the new decisions soon emerged (LAS 2008). In addition, negotiations on the remaining detailed rules proved to become even more difficult. In the regular meetings of the Rules of Origin Committee opinions of GAFTA members on product-specific criteria drafted jointly by the newly established Saudi-Moroccan Expert Group reflected in some cases strongly diverging interests. Taking into account that Saudi-Arabia has been viewed in recent years as the most protectionist country in intraregional trade (see, inter alia, Hoekman and Zarrouk 2009: 13) and Morocco (only some ranks behind Saudi Arabia) apparently having been the main driver behind the Agadir Agreement, probably even regarding it, at least initially, as a potential way out of GAFTA, their assignment of drafting the remaining product-specific criteria could easily be interpreted as putting the fox in charge of the hen-house. Moreover, dissent among GAFTA members persisted with respect to some regime-wide rules. Although the ESC undertook several steps during the 2000s to facilitate and simplify mutual recognition of ROO certificates, the issue resurfaced time and again as one of the hot topics in the discussions of the Rules of Origin Committee (see, for instance, LAS 2011a, b; LAS 2012a). One of the reasons behind may have been that Morocco and in part also other Agadir members reportedly stopped to accept the GAFTA ROO certificate after the Agadir agreement had gone into force (Said 2011: 276; Layadi 2008). Consequently, around the turn of the decade and well into the 2010s the negotiations on the final GAFTA ROOs reportedly came near to a deadlock. To re-start the negotiations and to put the proposals submitted by the Saudi-Moroccan expert group back on track, a decision approved at the Doha Arab League Summit 2013 called for a switch to the principle of majority rule. While some countries, among them the Agadir members Egypt, Tunisia and Morocco, raised reservations against this principle, at that time the number of broad HS goods categories waiting for an agreement on product-specific criteria still covered more than 200 categories primarily in textiles and apparel, processed foodstuffs, chemical products as well as machines, vehicles and appliances (AMF 2016: 251; LAS 2013, 2014a). The outcome were two large lists, the first covering those goods categories for which a majority of at least 80% of members agreed on the proposed product-specific criteria and a second list of goods which either did not meet the majority approval or for which the expert group has not been able to come forward with a common proposal. Apparently in an endeavour to heighten the pressure the ESC decided to lift the negotiations on a higher level when in the following year ESC senior representatives met five times with members of the Rules of Origin Committee to discuss these lists. However, and despite some progress, the 5th and last meeting in 2015 ended again with two (although smaller) lists of goods categories for which no final agreement could be reached. In its 98th ordinary meeting in September 2016 the ESC then authorized the Economic Department of the General Secretariat to carve out new negotiation proposals for the remaining goods categories in cooperation with the Arab Organization for Agricultural Development and the Arab Industrial Development and Mining Organization. In addition, the ESC asked the General Secretariat to prepare together with the specialized organizations an analysis on the effects of the suggested ROO criteria on the GAFTA member countries (LAS 2015, 2016).

In sum, the general aim of 'harmonizing' GAFTA ROOs with those covered by FTAs with external partners and, in particular, the Pan-Euro-Med ROOs have apparently contributed to complicate intra-GAFTA ROO negotiations. At least the Agadir Agreement's adoption of the Pan-Euro-Med ROOs provided these countries with an additional justification to pressure for restrictive product-specific criteria in the framework of GAFTA and thus helped to open the door for protectionist capture. In addition, any efforts towards harmonization of ROO systems were and are most probably doomed to fail simply because ROOs as part of bilateral FTAs with the EU, USA and other partners differ among each other, as explained in detail in Sect. 3.5.1, to a substantial degree. Accordingly, even if Arab countries wished to achieve this goal it would not be in their hands to do so as it hinges on the will of the hubs to agree on a common set of ROOs. The negotiations on the *Transatlantic Trade and Investment Partnership (TTIP)* could have provided, in theory, a chance that the EU and USA agree on a common set of rules of origin. Inserting those common rules into their FTAs with third countries would certainly have represented a great leap forward in 'taming' the spaghetti bowl of overlapping FTAs and making sure that "Mega-regionals" do not hollow out the multilateral system even any further (see, inter alia, Lawrence 2014: 42). Ideas of this kind, however, seem not to have featured prominently in TTIP negotiations before their suspension in the beginning of 2017.

The decision taken as early as 1997 to design product-specific criteria could nevertheless also easily point at GAFTA members having grasped the idea of how to use ROOs as tools to protect local industries and specifically as the GAFTA Executive Programme prescribed the elimination of import prohibitions and other NTBs. In addition, one should not forget the purely intergovernmental approach of bargaining and linked to it the general lack of power in terms of decision-making on the part of LAS organs which surely has contributed its part to prolonging negotiations on GAFTA ROOs. The ROO negotiations are apparently not the first and will most probably not be the last 'project' seeking to bridge legal gaps in LAS treaties that ends up in an infinite loop of negotiations on the level of the ESC and its numerous committees while 'keeping busy' a huge bureaucratic apparatus on the part of the General Secretariat and the ministries in charge in the Arab League member countries. Even if the GAFTA members reached agreement on the remaining list rules any time soon one may ask if the years-long negotiations were worth the effort? If product-specific GAFTA ROOs are even more or less restrictive than Pan-Euro-Med list rules only future studies on their particular content and impact on intra-Arab trade will be able to find out. This being said, they are in a similar manner complex and therefore must be expected to confront companies and customs authorities in Arab countries with potentially high costs of compliance. Finally, and though temporary rules had been in force since the beginning of the GAFTA transition period, the prolonged process of negotiations on detailed ROOs constituted one of the major obstacles impeding proper implementation of GAFTA.

3.5.3.2 The Rules of Origin Issue and Other Stumbling Blocks of Intra-Arab Trade

In case harmonization of rules of origin of overlapping FTAs is out of reach, the member countries have to cope with at least two different ROO systems and associated red tape in trade among each other depending on the final destination of their exports. This will lead almost inevitably to controversies such as those mentioned in the preceding section with respect to the recognition of ROO certificates in intraregional trade. Beyond that, however, some countries may have used the procrastination of ROO negotiations as a pretext to evade proper implementation of tariff reductions. In conjunction with the above mentioned opportunity to exempt goods from the phase-out of tariffs during the GAFTA transition period, as part of which Morocco, for example, suspended tariff reductions for more than 800 products, some countries tried to delay their removal by conditioning the latter on the approval of detailed GAFTA ROOs (Zorob 2006b: 121–124). They started to ask for a prior request for customs exemption or, in other words, import permission to be issued by competent ministries under the pretext of "statistical reasons". Those requests were reportedly approved only when accompanied by a certificate confirming the compliance with product-specific ROOs (Layadi 2008: 178). By 2007 the GAFTA members applying exemptions had finally 'notified' the LAS Secretariat about the elimination of the exemptions lists. Apart from the question whether 'notifying' actually translated into an effective removal of trade barriers (see also Afifi 2007) the exemptions lists and agricultural calendars probably still form part of the bilateral FTAs although the ESC asked GAFTA members to delete the lists.

Coming back to the issue of documents certifying the compliance with ROOs, various surveys conducted among Arab companies by the General Union of Chambers of Commerce, Industry and Agriculture for Arab Countries (GUCCIAAC) and other regional or international organizations show that towards the end of the 2000s firms still faced serious problems. However, lacking acceptance and disputes over authentication of ROO certificates was one type among various barriers. In addition, they would have hampered trade particularly in sectors such as textiles, apparel and foodstuffs that were the goods for which product-specific rules had mainly not been approved in the years 2011/2012.[11] Nevertheless they apparently remained an important issue in MAFTA members' trade with rest of GAFTA. While, for instance, MAFTA member customs authorities were often reported to reject the GAFTA ROO certificate their counterparts in other GAFTA countries would have

[11] The survey results do not reveal information about the magnitude of costs of compliance in the production of goods. Those costs might induce companies to prefer paying tariffs instead of fulfilling ROOs when exporting to Arab neighbours.

refused to accept MAFTA member companies' cumulation of origin (Hoekman and Zarrouk 2009: 12–14, GUCCIAAC 2010, 2012). According to company surveys conducted by the International Trade Centre (ITC) in Egypt, Morocco and Tunisia problems with rules of origin still featured as the most important barrier impeding exports to other Arab countries at the beginning of the 2010s and specifically in trade with manufactures (see ITC 2012: 8–11).

Beyond ROOs, Morocco's fear of being swamped with agricultural goods has been made responsible for the numerous delays in the Agadir Agreement's signature and ratification. Initially Morocco apparently sought to exclude liberalization of agricultural trade. When the other members disagreed, the Moroccan administration tried to include a long list of exemptions but in the end had to accept the inclusion of the GAFTA provisions on liberalization of agricultural trade into the final text of the Agadir Agreement (Layadi 2008: 326–228). With the US-Morocco FTA "preference clause", however, a new factor emerged which prevented the Moroccan side from ratifying the agreement for the following two or three years. According to this clause Morocco is obliged to grant US exporters the same preferential treatment it offers to other partners for a range of agricultural goods including wheat, corn, poultry and soybeans as well as goods produced thereof (US-Morocco FTA: Annex IV). To prevent this clause from becoming a "death penalty for the Moroccan agriculture" the Ministry of Agriculture introduced a "net-exporter clause" which allows for duty-free access to the Moroccan market only if the FTA partner country is a net exporter of the goods concerned. As the Moroccan Ministry of Agriculture was certain that the other Agadir members would not be in the position to be or to become net-exporters of those products any time soon, the way was cleared for Morocco to ratify the Agadir Agreement in June 2006 (LA VIEéco 2006, Layadi 2008: 330–333). This issue, however, left a lot of question marks behind liberalization of agricultural trade in the framework of GAFTA and a future enlargement of the Agadir Agreement to other members.

The many other barriers hampering trade among Arab countries and proper implementation of GAFTA during the 2000s included charges and taxes of similar effect. In addition, the elimination of NTBs turned out to be a difficult task and all the more as many GAFTA members apparently sought to substitute tariffs with different sorts of NTBs so as to maintain protection of domestic markets (see Chauffour 2011: 13–15; LAS 2011c, 2012a). Similarly to the bumpy track record of ROO negotiations the slow progress in abolishing NTBs discovers one of the 'traditional' stumbling blocks of intra-Arab integration: The intergovernmental approach of bargaining and the ESC's poor competencies in sanctioning violations of treaties as a result of Arab governments refusal to assign power to supranational bodies (see, inter alia, Fawzy 2003, Hoekman and Sekkat 2010: 29–30). A survey among Arab companies in 2008 ranked transport costs covering road and maritime transport besides domestic taxes and problems encountered in customs clearance and inspection procedures as the most important impediments (Hoekman and Zarrouk 2009: 10–12). High transport costs featured also as one of the major impediments in the surveys of the General Union of Arab Chambers (GUCCIAAC 2010, 2011, 2012). In addition, companies frequently complained about problems and lengthy procedures in procuring an entry visa besides different sorts of other administrative and, in particular, technical barriers to trade such as stringent application of standards and related inspection and confirmation procedures. EU and US officials keep emphasizing that harmonization with their regulations could offer positive spill-over effects for integration among the spokes by importing best practice rules. However, and similar to the rules of origin systems, EU and US standards differ to a substantial degree confronting countries having signed FTAs with both hubs with tough decisions which "hegemonic harmonization" they should follow (Hoekman and Sekkat 2010: 27–28). Moreover, the GCC members are working since years on common standards while GAFTA members were asked to apply 'Arab' standards approved by one of the LAS specialized organizations besides international standards for goods for which there are no unified Arab standards yet (LAS 2011c, d; Hoekman and Sekkat 2010: 22–23). Beyond different sorts of NTBs, high transport costs and other barriers one must finally not forget the state of war, destruction and backslide into authoritarian rule the region is witnessing since the rather short-lived 'Arab Spring' has given way to another 'Arab Winter'.

3.5.3.3 Harmonizing 'Arab' with Pan-Euro-Med Rules of Origin?

A harmonization of GAFTA with MAFTA rules of origin via adoption of Pan-Euro-Med ROOs could have spared companies and customs authorities in Arab countries the need to distinguish between different ROO systems and thus help to mitigate at least some of the above mentioned problems in intraregional trade. However, and recalling that a simple 'adoption' of rather restrictive Hub-and-spoke ROOs could turn out to be counter-productive what would have been the 'price' of harmonization and what diagonal cumulation could really have offered to mitigate restrictiveness of ROOs? Moreover and much more important than speculating about what could have happened during the last ten to fifteen years: Is harmonization as requested by the EU indeed necessary? Regional experts warned from the beginning that restrictive product-specific criteria as those covered by the Pan-Euro-Med System which primarily respond to the requirements of European industry must be expected to hamper rather than promote intra-Arab trade (see, inter alia, Inama and Jachia 2000: 24). Besides constraining competition among the members of both MAFTA and GAFTA they were expected to severely limit the prospects for enhanced trade and thus their potential to enhance efficiency and specialization. In other words, adopting the Pan-Euro-Med ROOs would have risked compromising the role of GAFTA and MAFTA in complementing integration with the EU even further. Both agreements' potential to fulfil this role has been rather limited from the outset not least because they were implemented simultaneously with the AAs. In other words, they came too late for being able to support Arab MPCs companies in preparing for enhanced competition or to provide them with the level of bargaining power needed to jointly request better market access conditions (for more details see Zorob 2006a, b, 2008).[12] With respect to feasibility and expected benefits of cumulation among MPCs, regional experts were also rather sceptical. Even in the years after 2007 trade between the four Agadir members remained limited as a share of their total trade ranging from less than 1 percent of total imports in case of Egypt to around 4 percent in the Jordanian case. Whereas both Jordan and Egypt sourced a relatively larger share of their imports in other GAFTA members, the main markets of Morocco and Tunisia remained outside the region and strongly concentrated on the EU. Inside GAFTA and in contrast to GAFTA members' overall trade almost one half of merchandise trade was made up of manufactured goods in recent years (AMF 2011, 2012, 2014, 2015). Accordingly, an extension of diagonal cumulation to rest of GAFTA members would at least offer a somewhat larger potential but seems, as mentioned above, out of discussion.

Beyond the issue of how many goods could be sourced in neighbouring countries the question remains if diagonal cumulation indeed helps to reduce restrictiveness of product-specific criteria as often stipulated by European Commission representatives? First of all, effects of diagonal cumulation and associated convergence of ROOs remain "completely under-researched" (Estevadeordal and Suominen 2009: 204). A study sponsored by the European Commission found out that the introduction of the Pan-European System raised trade among the participating spokes which covered at that time the CEECs (Augier et al. 2005). In a second study the same authors discovered positive effects of cumulation in different industries and in particular those that suffered from stiff ROOs. Cumulation, however, would not be a policy option which is easy to put into practice (Gasiorek et al. 2009). Apart from that, can diagonal cumulation be expected to deliver the same allegedly positive effects if applied among MPCs and other Pan-Euro-Med spokes? Moreover, as indicated in Sect. 3.2.4, exporting companies are probably burdened with providing additional information about the sources and use of inputs. Finally, MPCs might simply prefer bilateral cumulation with the EU to be able to make use of their right of duty drawback at the expense of splitting production processes among MPCs? As a consequence, there are many questions which can only be answered by future research on the effects and costs of Pan-Euro-Med ROOs.

[12] The same applies to their potential to counter diversion of investment to the hub (see Sect. 5.2). First, firms located in the EU can source tariff-free imports from and enjoy tariff-free access to many other countries than the MPCs due to the EU's huge network of FTAs with spokes around the world. Second, most MPCs' MFN tariffs on imports from third countries are still higher than the EU's, a factor aggravated by the prohibition of duty-draw-back. Even a lowering of MFN duties may remain ineffective as long as the use of those imported inputs is restricted by stiff product specific criteria. In addition, as outlined in 5.5.3.1, Arab MPCs use of duty-free imports from other GAFTA members is limited because they can't be cumulated as local content and their sourcing of inputs in other Pan-Euro-Med spokes covers goods originating in these countries only. Finally, when the investor plans to serve the EU market, he is induced to locate there to be able to evade compliance with ROOs. What remains is the hope to benefit from diagonal partial cumulation as a tool to expand joint production of intermediate goods to be exported to the EU and other partners of the Pan-Euro-Med System.

Finally, is ‘adoption’ of ROOs into South-South FTAs as requested by the EU indeed a necessity or could it be ‘waved’ or somewhat softened allowing spokes to cumulate inputs sourced in neighbouring countries without stifling intraregional trade? According to authors like Brenton and Manchin the right to cumulate inputs could be granted without aligning the ROOs pointing at the General System of Preferences (GSP) in which the EU would have allowed for cumulation on a limited regional basis without asking for harmonization (see ibid. 2003: 14).[13] Gasiorek, Augier and Lai-Tong propose to apply what they call the “preferential partner principle” enabling spokes to cumulate inputs from each other even without having signed a spoke-spoke FTA given that they follow the ROOs anchored in their agreements with the EU (ibid. 2009: 172–174).[14] Estevadeordal et al. more recently and in the context of the discussion about TTIP and global value chains also scrutinized the necessity or rather adequacy of ROO harmonization as it would be rather hard to imagine that identical ROOs inside a “cumulation triangle” are “optimal for any two agreements”. They propose instead to concentrate on harmonizing the methods of calculating local value added and the procedures for certifying the origin of goods (Estevadeordal et al. 2013: 52–53). A strategy such as the latter could arguably have contributed a lot in tackling the problems described in this chapter with respect to certification of origin and disputes over authentication of ROO certificates among GAFTA and MAFTA member countries. Moreover, it might have helped to prevent what happened to GAFTA-internal negotiations on rules of origin and their protectionist capture paradoxically justified by the aim to ‘harmonize’ ROO systems. One should not forget, however, that even an alignment of procedures for certifying origin necessitates first of all the political willingness on the part of all parties involved to reach this goal.

In the debate about GAFTA regional experts had advocated from the beginning for more liberal ROOs including a switch from partial to full cumulation to be applied on intraregional trade to provide Arab producers with the necessary incentives to exchange goods and re-allocate production along the lines of competitive advantages (see, inter alia, Inama and Jachia 2000: 24–25). Hoekman and Sekkat proposed later in the 2000s against the bumpy track record of ROO negotiations that it might have been a better choice for Arab countries to stick to the temporary GAFTA ROOs with an across-the-board local content requirement of 40 percent (Hoekman and Sekkat 2010: 19). Arab countries could have followed the example of the ASEAN Free Trade Area (AFTA) and the ASEAN-China FTA (see Chen in

[13] In contrast to the Agadir Agreement, Jordan and Israel, opted in their bilateral agreement to work with two different sets of ROOs, the Pan-Euro-Med for cumulation purposes and a more simple system for purely bilateral trade; the 2004 supplementary protocol to the Israel-Jordan FTA stipulates an across-the-board local content rule of 35 percent for bilateral trade between Jordan and Israel (State of Israel 2014).

[14] Alternatively, the authors suggest making European ROOs more “development-friendly” in general via a more wide-spread use of the local content requirement as the essential product-specific rule combined with “a value-added tariff rule” and full cumulation (see Gasiorek et al. 2009: 174–176).

this volume). Both FTAs opted for a much less stringent approach than the EU and the United States in their trade agreements. For achieving sufficient processing FTA members are allowed to choose between a single 40 percent local content rule or, as an alternative for a range of goods where this rule is hard to fulfil, a change of tariff classification or specific process criteria. In addition, AFTA rules of origin provide although not 'on paper' but in effect for full cumulation. With this model AFTA member countries were also able to prevent interest groups from trying to lobby for stiff product-specific ROOs (Cadot and de Melo 2008: 90–91). As explained in the preceding sections, however, GAFTA members have forgone this opportunity. Instead they opted for carving out their own complex system of multiple product-specific rules inspired mainly by the Pan-Euro-Med System without being allowed to make use of diagonal cumulation in the EMP framework. The associated problems and costs of complying with these rules including time-consuming procedures for certification and authentication of documents add to the many other barriers impeding intra-Arab trade raising transaction costs in trade among Arab countries instead of enabling the members to take full advantage of the elimination of tariffs through GAFTA. This, in turn, may also seriously compromise the agreement's theoretical potential in contributing to improve Arab countries ability to attract export-oriented FDI and in particular those destined to serve regional markets.

3.6 Conclusion

This chapter explored the impact of bilateral Hub-and-spoke FTAs Arab countries have signed since the 1990s with the EU and the United States on efforts at intraregional trade liberalization with a focus on the Greater Arab Free Trade Area and the Agadir Agreement. The analytical framework applied here assumes that rules of origin as part of Hub-and-spoke agreements and specifically the provisions on cumulation of origin do not only decide about the extent to which spokes are able to benefit from trade liberalization among each other in their trade with the hub. They also heavily constrain the spokes' policy space of negotiating and their capability of implementing trade liberalization among themselves depending on their specific configuration of cumulation provisions, the overall restrictiveness of ROOs as well as the status of the spoke-spoke FTAs. Besides tracing how the bilateral arrangements affected the latter's negotiation and implementation the analysis tried to find out if 'harmonization' of rules of origin with those anchored in the Hub-and-spoke FTAs is a feasible option.

The results suggest that although the bilateral FTAs with the EU allow for diagonal cumulation within the Pan-Euro-Med System, its introduction seems, in the specific case looked at here, to have rather complicated efforts at regional integration instead of 'taming' the spaghetti bowl of overlapping FTAs. With this system the EU imposed its own concept of regionness on the MPCs which, however, excludes the Arab Gulf economies and other non-MPC members of GAFTA. The FTAs covered by the US-sponsored Middle East Free Trade Area Initiative are limited to bilateral cumulation and include product-specific rules sharply different from those anchored in the FTAs with the EU. Accordingly, both ROO systems are apparently designed in ways which foster fragmentation. Moreover, their dissimilarity makes ‘harmonization’ of rules of origin inside GAFTA simply impossible or at least nothing which GAFTA members can accomplish by themselves as it hinges on the will of the hubs to first agree on a common set of rules. Moreover, ‘adopting’ Hub-and-spoke ROOs into spoke-spoke agreements could turn out to be ‘counter-productive’ if their restrictiveness constrains intraregional trade. In addition, by adopting the Pan-Euro-Med Protocol the EU-supported Agadir Agreement apparently contributed to the distortion of negotiations on final GAFTA ROOs and the agreement’s proper implementation. More precisely, it paved the way, at least in part, to open GAFTA-internal negotiations for protectionist capture. One should, of course, not try to blame the bumpy track record of both GAFTA and the Agadir Agreement, solely on the ‘systemic implications’ of the bilateral Hub-and-spoke FTAs as there are many other barriers impeding intra-Arab trade beyond rules of origin and disputes about ‘overlapping’ procedures for certifying origin. The rather tragic plot of this story is that a *harmonization* of inter- and intraregional ROOs might, at least in such a manner as requested by the EU, simply not be necessary according to the oppinion of some leading experts. How complex and constraining final GAFTA ROOs are in practice and whether diagonal partial cumulation as part of the Pan-Euro-Med System is indeed able to substantially mitigate the restrictiveness of European product-specific ROOs remain important topics for further research.

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Chapter 4
The Greater Mekong Subregion (GMS) – Infrastructure Development and the Prospects for the Emergence of a Security Community

Timotheus Krahl and Jörn Dosch

Region: East Asia

4.1 Introduction

The new structural opportunities for cooperation that emerged on the horizon in the immediate aftermath of the Cold War resulted in a strong push for collaboration within sub-regions. The incentives aimed at mitigating the problems of larger regional or trans-regional schemes such as the Association of Southeast Asian Nations (ASEAN) or the Asia Pacific Economic Cooperation Forum (APEC); guarding against what many saw at that point as a possible failure of the Uruguay Round of trade negotiations; and easing potential disadvantages arising from the strengthening of trading blocs such as the EU and the North American Free Trade Agreement (NAFTA). The appearance of sub-regional schemes was itself a manifestation of the intensified intraregional investment flows and the accompanying trade flows in the Asia Pacific region (Chia and Lee 1993: 226). In the 1990s the idea of sub-regional cooperation in Asia was closely associated with the concept of "growth triangles", a term first used in the late 1980s by Singaporean deputy prime minister Goh Chok Tong to paraphrase economic cooperation among Singapore, the

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Malaysian state of Johor, and the Indonesian province of Riau, a triangle that was officially proposed in December 1989 as a new type of cooperation in Southeast Asia, through investment rather than through trade (ibid). In the following years, the term “growth triangle” was applied to other existing sub-regional schemes within ASEAN as well as to new ones. The literature offers congruous analyses of what a growth triangle, also known as a “subregional cooperation scheme” (the two terms are often used synonymously), characterizes. The most basic definition is that of “a few neighboring provinces of different countries interlinked closely through trade, investment, and personal movement across national borders” (Yamazawa 1994: 262). So-called special economic zones within state borders, city states, and free ports, are also subsumed by the concept (Chen 1995). For Kenichi Ohmae, these economic zones, or what he calls “region-states”, “may or may not fall within the borders of a particular nation. Whether they do is purely an accident of history” (Ohmae ibid. 1995: 81;). According to the Asian Development Bank (ADB), the growth triangle concept refers to the “exploitation of complementarity among geographically contiguous countries to help them gain greater competitive advantages in export promotion. Growth triangles help solve the practical problems of regional integration among countries at different stages of economic development, and sometimes, even with different social and economic systems” (Krongkaew 2004: 979). Sub-regionalism can also serve as “a preparatory ground for merging into larger groupings as it is often indicative of the members’ willingness to act in a cooperative framework with their neighbours and a readiness to join larger groupings in the region that go beyond these members” (Batra 2011: 6).

In recent years the Greater Mekong Subregion (GMS) has emerged as one of the most effective schemes in terms of facilitating cooperation among states that had previously been prevented from engaging in meaningful economic and political exchanges – in this case as the result of the confrontational structures of the Cold War. The Mekong River is the world’s twelfth-largest river and Southeast Asia’s longest waterway. It originates in Tibet and flows through the Chinese province of Yunnan before continuing southwards, touching the territories of six countries (China, Cambodia, Lao PDR, Myanmar, Thailand and Vietnam) and ending in the South China Sea. The sub-region covers some 2.3 million square kilometers and contains a population of about 245 million people. With the end of the East-West divide, a window of opportunity opened to bring peace and reconciliation to the Cold War conflicts in this area which had been characterized by intense rivalry and confrontation, for example between China and Vietnam. More than a quarter of a century ago, in 1992, the ADB took the initiative to establish a new forum of regional cooperation to revive a sense of community within the formerly war-torn sub-region as defined as the combined territory of the six Mekong states. China was represented by Yunnan Province and later Guangxi Autonomous Region also joined the GMS.

The GMS Program has the ultimate objective of promoting the development of GMS markets and the movement of goods and people across the common borders. Its key specific objectives include: (1) facilitating sub-regional trade and investment, (2) facilitating sub-regional development opportunities, particularly for energy and tourism, (3) facilitating the resolution of trans-border issues such as contagious diseases and environmental degradation, and (4) meeting common resource or other needs. However, while the general institutional structures of the GMS, the economic dividends of sub-regional cooperation, particularly in the field of hydropower, and also achievements and challenges with regards to environmental sustainability are well covered in the existing academic literature (for one of the most comprehensive studies on the GMS see Hensengerth 2010), less emphasis has been given to infrastructure development. In early 2011, the governments of Laos and Thailand announced their intention to sign a major contract with China to boast the development of high-speed railway infrastructure within the sub-region. However, ongoing political change in Thailand resulted in delay of implementation and constant re-design of concepts. The plan to strengthen the transport infrastructure of the Mekong riparian countries is not new. A major step forward in developing the railway infrastructure of the GMS countries, namely Cambodia, China (PRC), Laos, Myanmar, Thailand and Vietnam, was a plan adopted in August 2010 in Hanoi (AFP 2010). It is envisioned that by 2020 the six GMS countries will be linked through an integrated railway system, which however is only a part of a much bigger goal to enhance the infrastructure linkages within the sub-region.

This chapter looks at the extent to which the development of infrastructure in the GMS supports the emergence of a pluralistic community in the sense of Karl W. Deutsch. The brief theoretical discussion is followed by an analysis of the GMS infrastructure projects which focuses on the development of roads and railways with particular emphasis on the concept of sub-regional economic corridors. We argue that the volume of cross-border transactions has increased significantly over time which has created a strong basis for the emergence of a security community, which however, is still in its nascent phase.

4.2 The Security Community Concept

While the initial Deutschian concept, a child of the post-World War II years, focused primarily on the North Atlantic area, for the past three decades it has mainly been applied to East Asia, and especially ASEAN (Deutsch et al. 1968). Definitions of ASEAN as a security community were first proposed in the second half of the 1980s, with Acharya (2009) being the major proponent of the idea during the 1990s and 2000s (see also Peou 2001: 123–124, for a revision of the literature). A security community is defined as a community “in which there is real assurance that the members [...] will not fight each other physically, but will settle their disputes in some other way”, i.e. through peaceful change (Deutsch et al. 1968: 5). Capie and Evans (2002: 198) list three “requirements” for the emergence of a security community: the total absence of armed conflicts among members, absence of competitive military build-up, and the existence of institutions and procedures to safeguard peace and to solve conflicts. Social constructivists have emphasized the importance of interaction, communication and the emergence of common norms, values and identity as defining criteria for the emergence of security communities, thereby distinguishing them from other security agreements, such as military alliances (see Acharya 2009: 19–23).

The concept developed by Deutsch et al., differentiates between two different types of security communities: the first, the so called Pluralistic Security Community (or Non-Amalgamated), and the second, the so called Amalgamated Security Community. The difference between them lies in the degree of integration. The pluralistic form is less integrated than the amalgamated security community, which is a “merger of two or more previously independent units into a single larger unit” (Deutsch et al. 1968: 6). In the case of the GMS the concept of an amalgamated security community does not apply; therefore the following will focus on the type of a pluralistic security community. In a major further development of Deutsch’s work, Adler and Barnett (1998) distinguish between loosely and tightly coupled security communities. A loosely-coupled security community is thereby defined as a region of “sovereign states whose people maintain dependable expectations of peaceful change” (Adler and Barnett 1998: 30). By comparison a tightly coupled security community represents a group of states with a high degree of integration which, however, have not yet reached the level of a unified nation state. Yet, the general defining criteria given by Deutsch (1988: 281) for a pluralistic security community are still present in Adler and Barnett’s work: the participating states agree on major political values, have the ability and willingness to understand each other and respond quickly and adequately “to one another’s messages, needs, and actions” without the use of military power.

An important value added of Alder and Barnett’s approach is their introduction of a three-phase-model in the process of building a pluralistic security community, namely “nascent”, “ascendant” and “mature” (ibid. 1998: 48). The nascent phase is best described as the point in time where the states become acquainted with each other and thereby develop a concept of cooperation and investigate how they could increase their mutual security. The reasons and motivations are very often manifold and can be of an internal or external nature (Adler and Barnett 1998: 37–38). During the nascent phase most actors do not yet have a clear idea about the direction in which the cooperation will develop, and if success is at all guaranteed. But if there are signs of closer linkages, the participants start to create the first low level institutions (Capie and Evans 2002: 199). This is the ascendant phase, which can be referred to as the boom period of institutionalization. At the stage the community develops strong institutionalized ties with explicit links to security matters (Adler and Barnett 1998: 54). The last step in this evolutionary process, and thereby the ultimate goal, is described as the mature phase. The community members have now reached the stage where “dependable expectation of peaceful change” is the case (Capie and Evans 2002: 200). They have crossed the line where the preparation for war seems highly unlikely.

Deutsch brought forward several indicators to assess the emergence of a (new) community. Based on his transactionalist approach he proposed that a sense of community would develop through transaction and interaction among the peoples and governments of the participating states. Therefore, he tried to quantify his observation through measuring the flow of goods and people across borders. Deutsch's transactionist view centres on "social communication" in a broad sense, comprising a great variety of economic, political, and societal spheres. Crucially, transactions and communications are also "associated with rewards and expectations of gain" (Dougherty and Pfaltzgraff. 1990: 437) or what Axelrod and Keohane (1985) later termed "shadow of the future". While Deutsch has been criticized for relying too heavily on quantitative indicators and neglecting "institutions, norms and the inter-subjective process of identity building" (Acharya 2009: 23), transactionism is still a valid and useful approach. Regional identity building can only progress if people have the opportunity to communicate and cross-border exchanges take place in a substantial way. Consequently, the development of a regional infrastructure for such political, economic and social transactions is the pre-condition for the emergence of regional norms and institutions. Identity building does not happen in a vacuum, its facilitation requires a physical infrastructure. Focusing on infrastructure development in the GMS is therefore the basis for any assessment of the possibilities and probabilities for the emergence of a sub-regional pluralistic security community.

4.3 Infrastructure Development

The GMS was established with the aim to overcome the economic parallelization of the Cold War in Indochina, and to strengthen the economic linkages of the area. The ADB and the GMS member countries thereby opted for a market driven approach with the development of infrastructure at its heart (Schmeier 2009: 46). Over the last two decades the concept has seen some alteration while the core approach has remained untouched. The current vision for the GMS is defined as "a GMS that is more integrated, prosperous, and harmonious" (ADB 2011a), with a strategic focus on the so called 'Three Cs': Connectivity, Competitiveness and Community. Furthermore, the GMS has identified nine key sectors of development: transport, energy, telecommunication, agriculture, environment, tourism, human resources development, trade and investment (ADB 2011a).

The concept of "Economic Corridors", which is at the centre of infrastructure development, has been implemented since 1998 as the result of a reassessment of sub-regional cooperation after the Asian Financial Crisis of 1997–98 (Masviriyakul 2004: 304). There are currently three Economic Corridors: the North-South Economic Corridor (NSEC), the East-West Economic Corridor (EWEC) and the Southern Economic Corridor (SEC) (Fig. 4.1). Infrastructure development is focused along these economic corridors as the approach allows for a more streamlined and integrated development and the ADB expects spillover effects to the micro-regional level. The GMS is loosely organized: the ADB functions as the secretariat, and the meeting of Prime Ministers, which takes place every 3 years, is the highest body of decision making. The GMS Summit, a meeting of all Heads of Governments also approves the Greater Mekong Sub-Region Framework, and the

Fig. 4.1 North-South transport corridor (Source: ADB (2010c): Toward sustainable and balanced development, p. vi.)

most recent one was adopted at the 4th GMS Summit in Nay Pyi Taw in 2011 (ADB 2012). Other decision-making bodies include the yearly Ministerial Conferences and Working Groups. In the following we will take a closer look at the three main corridors. The analysis below will refer to the main branches of each corridor as they were identified at the begining of the current decade. Furthermore, it is to note that corridor development in Mynamar is lagging behind and therefore will not be accounted for in most of the analysis.

4.3.1 The North-South Transport Corridor

Initially the NSEC was designed as a more or less straight connection between Kunming and Bangkok but later on was split up into three sub-corridors (ADB 2010c: 5): the Western Sub-corridor, containing the initial route, offering different alternatives (crossing from the PRC into Thailand through Myanmar or Laos, and a second route between Chiang Rai and Nakhon Sawan within Thailand). The Central Sub-corridor connects Yunnan with northern Vietnam and thereby the cities of Kunming and Hanoi. Finally, the Eastern Sub-corridor offers two different routes from Nanning to Hanoi.Today furhter branches have been added, including links to Myanmar and to connect Thailand and Vietnam (Fig. 4.1).

According to Stone et al. (2010: 17) the NSEC and especially the route between Kunming and Bangkok are the most developed within the GMS. The action plan (ADB 2010c) demonstrates that the majority of projects should have been completed by now, with the main target to upgrade the routes “from class or grade 2 or 3 to class 1”.[1] Especially Myanmar has to catch up in terms of infrastructure development, which is not only the case for the NESC. Once all construction projects are completed and a fully paved all-weather road link between Bangkok and Kunming will be in place, the transit time will be reduced significantly (Banomyong 2007: 12, Fujimura 2008: 33). A recent assessment highlights that 81.2% of the road projects along the NSEC are completed (ADB 2015: 14). A major milestone was the opening of the 4th Mekong International Bridge - between Lao and Thailand - in December 2013 (Thai PBS 2013). Furthermore, all countries have participated in different activities to make the Mekong more navigable and developed the port infrastructure.

[1] Class 1—an expressway that is sealed completely from pedestrians with concrete barriers on both sides of the road; class 2—a three-lane highway with unsealed sides and no middle dividers with a speed limit of 80 km per hour; class 3—a two-lane narrow and winding road with a speed limit of 60 km per hour (ADB 2010c: 76).

4.3.2 East-West-Economic Corridor (EWEC)

The EWEC crosses four countries, and its length from coast-to-coast (Mawlamyine to Dong Ha) is 1293 km. On the western shores of Southeast Asia its starting-point was initially at Mawlamyine (Myanmar), from there it crosses into Thailand at Myawaddy-Mae Sot and continuous towards the East and into Laos at the border checkpoint Mukdahan-Savannakhet. Within Lao it creates a West-East link, between Thailand and Vietnam, as the route makes its way into Vietnam at Dansavanh-Lao Bao. As soon as the route reaches the coast of the South China Sea, it continues southward towards Da Nang (ADB 2010: 6). Latest reviews of the corridor include its extension to Yangoon (Myanmar) and possibly Pathein (Myanmar) (Fig. 4.1).

According to an assessment from 2015 all road infrastructure projects are completed (ADB 2015). A very important step in the process was the completion of the Second Friendship Bridge between Thailand and Lao, which was opened in December 2006, and the upgrading of highways. However, while most roads in Thailand are now four-lane highways, the section in Vietnam has just been upgraded to a Class III highway. Further goals are especially the improvement to the interconnectivity of sea routes on both sides of the EWEC to enhance the forwarding of goods shipped in and out of Southeast Asia (ADB 2010:11) (Fig. 4.1).

4.3.3 Southern-Economic-Corridor (SEC)

The SEC is a parallel corridor to the EWEC but is situated further to the South and spreads out along the Gulf of Thailand and the South China Sea. The main routes form a 90 degree shifted Y, starting off at the port of Dawei (Myanmar), going straight through Thailand and thereby passing by Bangkok, before splitting up just behind the Thai-Cambodian border. From there, on the northern string, it passes by Siem Reap and finally ends in the seaside town of Quy Nhon in Vietnam. The southern string, on the other hand, connects to Phnom Penh and Ho Chi Minh City before reaching its final destination in Vung Tau. Therefore, the latter is considered one of the main routes within the whole of the GMS as it connects three capitals (Fig. 4.1).

With regards to infrastructure development the case of the SEC is similar to the EWEC. Most important is the development of “all season roads” and river crossings. Thus far, the roads on the Thai side are all in good condition (ADB 2010b: 25). Particularly the routes which are known as the Southern Coastal Corridor have been upgraded during the last decade. A flagship project was the 1.9 km toll bridge across the Kah Bpow River. Another important river crossing on the Mekong is the one at Neak Loueng (Cambodia) where construction started early in 2011 and was completed in 2015 (AKP 2011; ADB 2015: 16). The bridge eliminated one of the bottlenecks on the route from Bangkok to Ho Chi Minh City via Phnom Penh. At the same time the southern tip of Vietnam as well as the whole of Laos and Cambodia, still face manifold challenges in the process of improving their infrastructure and are thereby dependent on international donors. Another important task for the region is the upgrading of the port infrastructures, which include port facilities and the access roads and highways (Bangkok-Laem Chabang in Thailand; Phnom Penh-Sihanoukville in Cambodia; and Ho Chi Minh City-Vungau in Vietnam). Furthermore, Laos needs to upgrade its airports to improve accessibility (ADB 2010b: 28).

4.4 Railway Development

The Chinese government in cooperation with Southeast Asian states tries to develop a pan-Asian railway network. Such a regional railway network is expected to be beneficial for the region not only in terms of boosting trade but also due to its potential to enhance the connectivity and exchanges among the peoples of Southeast Asia. Currently, Thailand has a well-established network of 4000 km of rail track, which connects Bangkok with northern, north-eastern, eastern and southern provinces and links to Malaysia and Singapore (ADB 2010c: 81). However, most of the network is single tracked, using a 1000 mm gauge and thus far has only one rail link to a neighbouring GMS country at the Nong Khai border crossing. The case for China is different, which traditionally has a good established railway network and has invested heavily in further improving it. For the two Chinese member regions in the GMS integration in the national network is spatial, with Guangxi being fully integrated and Yunnan only caught up recently. It is at the bordering regions of Vietnam and China where the different gauges split the continent, an example is the Kunming (PRC)-Hekou (Vietnam) railway, which has 1000 mm gauge, in contrast to the rest of China which has the standard gauge (ADB 2010c: 79). 1726 km of Vietnam's 2600 km long network are part of the Hanoi-Ho Chi Minh City route (VNR 2011). Most of the tracks are 1000 mm gauge, and only 178 km have the standard gauge and 253 km dual gauge. Cambodia has two main tracks, the so called Northern Line (386 km) and Southern Line (264 km) which both start off in Phnom Penh. As a cause of the civil war, the rail network in Cambodia is not fully operational (ADB 2010b: 26–27).

Overall, the quality of the existing network is weak and upgrading and creating interconnectivity ranks high on the list of political priorities in the GMS. The major goal, in addition to the upgrading of the respective national rail networks is the establishment of a Singapore-Kunming Rail Link (SKRL). The starting point for this venture would be Bangkok, as a link to the South is already established, with four different routes currently discussed (Canrail Consultants Inc. 2011: 14):

Route 1 Bangkok-Phnom Penh-Ho Chi Minh City-Hanoi-Kunming-Nanning
Route 2 Bangkok-Vientiane-Kunming (via Boten/Mohan)-Nanning-Hanoi/Ho Chi Minh City
Route 3 Bangkok-Vientiane-Hanoi/Ho Chi Minh City-(via Tha Khaek-Mu Gia-Vung Anh)-Kunming-Nanning
Route 4 Bangkok-Kunming (via Chiang Rai-Boten-Mohan)-Nanning-Hanoi/Ho Chi Minh City

All alternative routes are based on the objective of using as much infrastructure as possible that is already in place. Only Route 2 and 4 would need a substantial amount of new tracks to create a direct connection from Thailand to Yunnan through Laos.

Furthermore, China has been promoting the project of a high speed railway network connecting its southern province with mainland Southeast Asia and – in the future – also with the Malay Peninsula, which should serve three goals: to establish the SKRL, even if does not completely match with the broader regional framework of GMS and ASEAN + 1 (Montlake 2011), to establish a 'back door' to the Indian Ocean and hence access to new markets (Kuhn 2011) and finally to support Chinese companies and their endeavor for global markets (Manila Bulletin 2010). An important step forward for China is to develop the tracks up to the border crossings. The first and already completed project is the Menghzi-Hekou route, the link with Vietnam (Railway Gazette 2014). The second one, Dali-Ruili, will connect to Myanmar and is currently under construction (Railway Gazette 2011). Another route is Yuxi-Mohan and thereby the link to Laos (ADB 2011c: 10). Myanmar is in the process of extending its existing network of 6942 km by another 2000 km and aims to connect its network with China and Thailand (ADB 2011c: 10). All Burmese projects are funded by China and are the most advanced among those in Southeast Asia. The Chinese goal is to connect Myanmar to Yunnan, and thereby develop several critical routes, namely to the Kyaukpyu, a new port at the western shores of Myanmar, to Yangon and further south to Dawei, and a third route linking China to northern Thailand through Myanmar (McCartan 2011). Laos has de facto no railway network, except the link from Thailand which terminates just behind the border. Yet, a high-speed railway, financed by China, that will connect Kunming with Vientiane has been under construction since late 2015 (Railway Gatzette 2015). Other considered routes are links to Vietnam, China, and two more southern ones, which cross the country and thereby connect Thailand and Vietnam (ADB 2011c: 9). The railway network in Vietnam is currently undergoing a major upgrade with the main focus on the track between Hanoi and Ho Chi Minh City and the links to its GMS neighbor countries. The program in Vietnam is not only limited to the upgrading of tracks but also includes the implementation of new technologies, as well as a modernization of the rolling stock. Furthermore, the government conducts studies in regard of a high speed link between Hanoi and Ho Chi Minh City.

4.5 Assessing the Level of Transactions

So far the chapter has tried to provide a stock-taking of the current state of infrastructure development. It can be concluded that, first, the building and upgrading of roads and bridges had made significant progress and most projects are completed. The development of a GMS rail infrastructure lags behind but the sub-region is not short of specific plans and visions that have a good chance of implementation as long as China takes an active interest and, above all, provides the bulk of funding.

Table 4.1 Time and cost savings

Corridor	Route	Cost savings	Time savings	
Central Corridor	Vientiane–Laem Chabang[a]	40%	43%	(Stone & Strutt 2010, p. 170; referring to Nathan Associates 2007)
EWEC	Bangkok-Hanoi		34%	Isono (2010, p. 344)
EWEC	Danang–Mukdaharn[b]	50%	42%	(Stone & Strutt 2010, p. 170; referring to Nathan Associates 2007)
EWEC	Dansavanh-Lao Bao (border crossing clearance)		66%	ADB (2009, p. 89)
EWEC	Route within Lao PDR Route within Vietnam (NR9 / highway 1)		75% 25%	ADB (2008a, p. 19)
SEC	Phnom Penh-Bavet (similar for Vietnam)		30%	ADB (2008a, b, p. 15)

[a]Cost Saving: USD 1362 vs. the norm of *USD 820 and* 18.5 days vs. the norm of *10.5 days*
[b]Cost Saving: USD 1625 vs. the norm of *USD 825 and* 12 days vs. the norm of *7 days*

Table 4.2 Trends in the Hai Phong-Kunming corridor

Hai Phong-Kunming	USD per ton	Transit time
Year 2000	105	85 h
Year 2006	87	58 h
Year 2015	43	26.5 h

Source: Banomyong (2007): Logistics development study of the GMS North-South Economic Corridor, p. 14.

An important question in this context is how quickly it will be possible to implement corridor development in Myanmar, which was always considered in the region's development but did not materialize due to its political isolation. However, beyond the visions the more interesting question is as to what extent has community-building in the GMS achieved tangible outcomes.

It is often stated that "cross-border road infrastructure in the GMS has had a discernible positive effect on regional trade and is considered a critical part of a broader effort to encourage regional integration to benefit GMS economies" (Fujimura 2008: 30). Table 4.1 gives an overview of cost and time savings for the transport of goods in the case of each corridor.

Table 4.2 provides an overview of the development of the Hai Phong-Kunming corridor and the expected reduction in time and cost until the year 2015, which shows that infrastructure development within the GMS has already had an impact on the cost and time factors of this corridor.

Minor et al. (2008) explain to which extent trade and transport facilitation has an impact on economic growth. They estimate that the economic gains of reducing the time to export and import will be around 25 percent. This will add approximately USD 800 million to the regions GDP (Minor et al. 2008: 13). While such projections are speculative, hard empirical evidence exist for the significant increase of trade within the GMS which has grown faster than the trade of GMS countries with extra-regional economies. According to the United Nations Comtrade database, trade among the GMS countries increased overall by 500 percent, while trade with the outside world only grew overall by 380 percent from to 2000 to 2008 (CIE 2010: 8). Thereby it is important to not draw a hasty conclusion and credit those numbers solely to infrastructure development in the region, domestic policies and economic development as well as a changing regional framework as it is described by, inter alia, Chen in this volume, also have contributed to the economic advancement and integration. However, the GMS and its infrastructure development are an important pillar for the region to move ahead.

On-going sub-regional integration is also confirmed by figures provided by the ADB (2007) according to which there has been a marked increase of traffic along the route connecting Mukdahan, Savannaketh, Khe Sanh and Dong Ha, the Asian Highway 16 or GMS Route 2 (referred to as Road 9 in Laos). The number of international buses on that route has also increased significantly. Data for border movements at Lao Bao (Vietnam) in both directions between Laos and Vietnam for 2000–2007 shows that the number of passengers increased markedly after the construction work on Road 9 had been accomplished by the end of the second quarter in 2005. Passenger numbers went up from 143,000 (2005) to 263,000 (2007) while they had only been 90,000 border crossings in 2002 (ADB 2007: 32–33; Luanglatbandith (2007: 8).

4.6 Conclusion

The sine qua none for a fully established security community is the absence of war and the assurance that members will resolve their conflicts in a peaceful way. In case of the GMS border disputes (for example between Thailand and Cambodia) are still a matter of fact, while the military continues to be a strong political actor in several member-countries. At the same time, however, the GMS has made significant progress towards community-building and offers realistic potential to facilitate peace and stability. There is strong empirical evidence to assume that the GMS provides a widening and deepening structural framework for growing gross-border economic exchanges which, in turn, contributes to the emergence of a sub-regional pluralistic security community.

In evaluating the transactions across the GMS we found that the volume of cross-border exchanges has increased significantly over time, mainly due to the ADB-supported infrastructure development in the GMS along the concept of the three economic corridors. These corridors have markedly strengthened the connectivity among the GMS members and thereby contributed to economic and political cooperation within the sub-region. An important factor which is likely to stimulate further transactions within the GMS is the full completion of dozens of road and river crossing projects, accomplished around 2015, and the establishment of a connected railway network, which is promoted by both the ADB and China. The argument proposed by social constructivist that the amount and volume of transactions is not an indicator of community-building needs to be revisited. A certain volume of transactions does not equal the existence of a security community but it is indicative of the existence of a suitable basis for such a community-building process. As we noted in the introduction, identity building does not happen in a vacuum, its facilitation requires a physical infrastructure. And this is exactly what can be observed in the GMS. Equally important, transactions are not confined to already existing levels of border crossings or trans-border trade and investments. Thereby, expectations of future growth and gains – the "shadow of the future" based on existing accomplishments and agreements – are as crucial as the status quo. Or according to the slightly reworded liberal peace argument: states that expect to increase trade with each other are less likely to go to war with each other. The GMS is a strong empirical case in this regard as the achievements in infrastructure development over the past 25 years are not only impressive, they have also created very vivid and realistic expectations as to how the sub-region could look like in a decade's time or so. Overall, however, the GMS has not yet emerged beyond the "nascent" stage of a pluralistic security community, the point at which states become acquainted with each other and start to develop a concept of cooperation that might increase their mutual security. The GMS is still at a low level of institutionalization but reaching the "ascendant" phase of the security community is within the realms of possibility if infrastructure development and the increase in transactions continue at the current pace.

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Chapter 5
Institutional Development and Institutional Interplay Within the Global Financial Regime Complex – The IMF and Regional Financial Cooperation in East Asia

Howard Loewen

Region: East Asia

5.1 Introduction

When the Japanese Ministry of Finance proposed the creation of an Asian Monetary Fund in September 1997 at the height of the Asian financial crisis it was harshly rejected by the International Monetary Fund (IMF), the United States and China. While this specific plan vanished – to the disappointment of the member states of the Association of Southeast Asian Nations (ASEAN) and Korea – the idea of a common regional fund on which East Asian governments might draw in times of financial turmoil survived. The plan began to materialize in 1997, when the ASEAN as well as China, Korea and Japan decided to build a new regional institution, ASEAN+3. Within that context it was soon thereafter decided to create a *self-managed* network of bilateral swap arrangements called the *Chiang Mai Initiative* (CMI) in order to cope with balance-of-payment problems of the member states. In May 2009 the ASEAN+3 decided to create a *collectively managed* regional fund, known as *Chiang Mai Multilateralization* (CMIM) that was signed in December 2009 and took effect in March 2010. The current total size of CMIM is 240 billion dollars with the contribution portion between ASEAN and the plus three countries at 20 percent versus 80 percent. Yet, until now, only 30 percent of emergency funds can be withdrawn in a financial crisis *without IMF conditionality*. Moreover, the lending facility and surveillance function, the latter being performed by the

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ASEAN+3 Macroeconomic Research Office (AMRO), are similar to the respective cooperation principles of the IMF. Taking into account that it was IMF conditionality that was harshly criticized by most of the Asian states in the aftermath of the Asian crisis it would have been plausible that a somehow "genuine" Asian Monetary Fund with its own rules and principles was in the making. *Why is this not the case until now?*

The argument of this paper is that regional financial institutions such as the Chiang Mai Initiative can be understood as part of larger regime complexes, such as the global financial regime complex. Within these complexes instances of institutional interplay occur, such as the one between the IMF and financial cooperation schemes in East Asia. These linkages exert significant influence on the establishment, dynamics and effectiveness of institutions within that complex. It is further argued that ASEAN+3 states seem to avoid overdependence on the IMF while at the same time maintaining cooperative relations with it. It is thus shown that the Chiang Mai initiative has typical features of institutional interplay within a regime complex: The CMI was a) designed to enhance forum shopping possibilities, b) was not build on a clean slate (path dependency), c, is marked by legal inconsistencies at its boundaries and is d) dominated by politics of implementation.

The first part of this chapter deals with the conceptual foundations focusing on institutional development and the concept of regime complexes (Sect. 5.2). The second part addresses the global financial regime complex, the Asian Crisis and the evolution of the Chiang Mai initiative and the corresponding negotiation processes until 2012 (Sect. 5.3). In the last part hypotheses of institutional development based on liberal theories and institutional interplay within the global financial regime complex are put to a test (Sect. 5.4).[1]

5.2 Theoretical Foundations

5.2.1 International Institutions and Regime Development

A widely accepted conceptualization of international institutions defines them as "persistent and connected set of formal and informal rules that prescribe behavioural roles, constrain activity, and shape expectations" (Keohane 1989: 3). This definition suits the purpose of this chapter since it emphasizes the variety of international institutions which is a basic feature of the global governance system. International Institutions or systems of rules may surface spontaneously but in most cases they are created by states through negotiations (Keohane 1993) in order to manage cooperation and collaboration problems within the system of global governance.

[1] This chapter draws heavily on my previous article "Institutional Interplay between the Chiang Mai Initiative and the International Monetary Fund" in *European Journal of East Asian Studies*, 13:1, pp. 50–67.

International Institutions may assume the following three forms: Formal international organizations, international regimes, and conventions. International organizations are the most formalized institutions. They are set up on purpose and designed by states. They are bureaucratic organizations with explicit rules and specific assignments of rules to individuals and groups, thus being able to enter into legal contracts. Examples include the United Nations, the World Trade Organization (WTO), the World Bank, the North Atlantic Treaty Organization (NATO), the International Maritime Organization (IMO) the European Union (EU) and so on. At the intermediate level of formality international regimes are to be found. International regimes may be built on one or several international treaties and are capable of providing procedural decision-making structures that are based on specific communication processes. By doing so they are an issue-specific answer to the ever growing demand for international cooperation. Put differently: States use regimes as flexible and dynamic means to manage interdependence. Examples include the international trade and monetary regimes established at Bretton Woods in 1944, the Law of the Sea regime set up through the United Nations sponsored negotiations during the 1970s, and the Strategic Arms Limitation Talks Agreements initiated between the United States and the former Soviet Union. Thus, bilateral or plurilateral free trade or financial agreements can also be conceived of as international regimes or institutions. Conventions are informal institutions, with implicit rules and understandings that shape the expectations of actors and help them to coordinate their behavior.[2] They show the tendency to arise spontaneously and include for instance traditional diplomatic immunity (before it was codified in the 1960s), reciprocity, and sovereignty (Keohane 1989: 3–4).

Especially regimes and formal organization qualify as international institutions allowing international governance which may be defined as "negotiated systems of norms and related decision-making processes" (Oberthür and Gehring 2006a: 23). Both manifestations of international cooperation thus are appropriate units for the analysis of interaction within different issue areas and on different levels of the global governance system.

What are the variables proposed by regime theory relevant for the formation of international institutions? The sets of relevant mechanisms proposed in regime theory may vary in their specific manifestations but can be roughly grouped into three perspectives labelled interest, power, and knowledge (Hasenclever et al. 1997). In this chapter I will mainly focus on interest-based explanations of institutional or regime development with the exception of one knowledge-bases factor, that is "shared values and causal beliefs". The following factors will be considered as relevant for the creation of new international institutions (Young and Osherenko 1993: 11–21):

[2] In contrast to Keohane's definition who uses the term „convention"in the sociological sense, this paper mainly refers to examples like the *Law of the Sea Convention* and the *Vienna Convention for the Protection of the Ozone Layer* that are formal multilateral treaties according to international law.

Exogenous Shocks or Crises An external shock can make it more likely that efforts to form a regime are successful. The added sense of urgency gives states extra incentives to come to an agreement quickly, a motivating factor in whose absence states do not tend to be in a particular hurry.

Participation of All Concerned States It is conducive to the success of an agreement if all stakeholders are at the negotiation table. If not all those who are affected by the handling of a competitive/cooperative or mixed motive interaction are parties to the debate, they might feel inclined to refuse to join or even sabotage any agreement that ignores their interests, leading to a failure to achieve a lasting settlement.

Potential Zone of Contract / Possible Gains from Cooperation For a regime to come into existence it is necessary that a potential contract zone or zone of agreement exists. Self-interested parties will only converge on a solution if they can reap joint gains. However, a zone of contract is only a necessary, not a sufficient condition for participants to reach closure on the terms of a mutually acceptable agreement.

Veil of Uncertainty and Prominence of Integrative Bargaining The bargaining is more likely to result in a positive outcome if the participating states work under a veil of uncertainty. The smaller the extent to which exact payoffs are known, the more probable is it that states will bargain in contractarian terms, considering the negotiations an integrative exercise rather than a competitive vying for relative gains. The term "veil of uncertainty" summarizes all factors that inhibit the participant's abilities to predict the influence of the institutional arrangements on their interests in the future.

Mutually Equitable Solution, Equity over Efficiency The participating states, most likely differing in power and capabilities, are more open to an agreement if the solution is equitable, according them the status they think to deserve rather than only seeing institutional efficiency as the main objective.

Existence of a Short, Salient Solution It is of utmost importance that a short, salient solution can be found around which expectations can converge. In negotiations operating under a consensus rule it can be a focal point increasing the probability of success. Its very saliency and simplicity allow it to be easily understood while being probably somewhat ambiguous or uncertain, contributing to the veil of uncertainty but also leaving issues unresolved that might need to be taken up later.

Availability of an Effective Compliance Mechanism The existence or at least possibility of instituting an effective compliance mechanism contributes to the potential success of regime formation. It assures states that one of the major problems of interstate negotiations, other state's non-compliance, can be solved in this specific case.

Shared Values and Causal Beliefs For a certain problem-solving regime to be founded, it is of major importance that the participating states share the same understanding of the problem, its causes and the possible solutions, a consensus most often provided by specific epistemic communities or scientific ideas in general.

5.2.2 Regime Complexes

International institutions increasingly influence each other's development, maintenance and effectiveness. The increasing density of institutions also gives rise to nested and overlapping relations between international agreements in different issue-areas. East Asia is a highly interesting region regarding regime interaction, especially since regional institutions or fora are steadily and at times spontaneously evolving in issue areas such as trade, finance, development and security. Moreover, emergent regional institutions in this region overlap with their respective global counterparts. Overlapping regimes exist when multiple institutions have authority over an issue, where each regime can create authoritative rules and interpretations. These clusters of overlapping institutions constitute specific governance systems in which its elements influence and feedback on each other over time (Oberthür and Gehring 2006b: 29–30). Kal Raustalia and David Victor call these clusters regime complexes and define them as an "array of partially overlapping institutions governing a particular issue-area. Regime complexes are marked by the existence of several agreements that are created and maintained in distinct fora with participation of different sets of actors. The rules in these elemental regimes functionally overlap, yet there is no agreed upon hierarchy for resolving conflicts between rules. We contend that regime complexes evolve in ways that are distinct from decomposable single regimes" (Raustiala and Victor 2014: 7). They propose four ways how the existence and the dynamics of a regime complex matter for institutional interaction within its systemic boundaries': The lack of a clean slate, forum shopping, legal inconsistencies and the politics of implementation (ibid: 8–10):

Hypotheses on institutional interplay in regime complexes

1. *Previously created arrangements limit and direct the process of establishing new rules or institutions*. In contrast to existing regime literature, in which regimes are thought to be negotiated on a basically clean slate, negotiations in international regime complexes take place within an array of *prior rules* developed in other institutions. Existing and developing institutions within regime complexes are not only influenced by past experiences but also by the norms of related and larger institutional structures.
2. *Forum shopping* is a consequence or function of institutional density and thus institutional choice in a regime complex. Actors choose to set up or join institutions that suit their interests best. They can thus realize their preferences without having to succeed in any particular negotiation. The extent of forum shopping is a function of barriers of entry, membership, and linkages between issues. Forum shopping has a significant effect on the evolution of new norms and rules within a given regime complex.
3. An increasingly institutional density within regime complexes gives rise to legal inconsistencies. Standard regime theory states that institutional establishment or development is driven by political contestation over some central rules and norms. In regime complexes institutional evolution is significantly influenced by *inconsistencies emerging at the blurred boundaries between elemental regimes*. It is anticipated that negotiators or states will set up procedures such as savings

Regime complex consists of elemental institutions ⇓ Institutional interplay between them is influenced by ⇓			
No clean slate	**Forum shopping**	**Legal inconsistencies**	**Politics of Implementation**
Regimes are negotiated in an array of prior rules developed in other institutions (i.e. IMF)	*Actors choose to set up or join institutions that suit their interest best. Depends on barriers of entry, membership and issue-linkages*	*Legal inconsistencies emerge at the blurred boundaries between the elemental regimes of a regime complex. Numerous negotiations*	*Multiple and overlapping rules, norms and agreements lead to politics of implementation and interpretation of new institutions*

Fig. 5.1 Regime Complex Model (Source: Author's compilation)

clauses[3] that help to define boundaries between regimes and untie events in different institutions. Moreover, there is no general negotiation process. Instead, *numerous negotiations are dominated by different international and domestic actors*.

4. Due to legal inconsistencies, i.e. multiple and overlapping rules, norms and agreements, negotiators put an emphasis on the *politics of implementation and interpretation of new institutions*. They do so by adopting broad rules and delegating rule-interpretation and rule-implementation to later stages or phases of institutional development.

The evolution of the Chiang Mai Initiative will be evaluated in two steps. Firstly, variables explaining the regime emergence will be tested with reference to the CMI to account for its formation in South East Asia. Following this, it will be evaluated how institutional interplay within the financial regime complex shaped the CMI. It will be argued that the four factors mentioned above play a major role in the CMI's evolution and interactions within the financial regime complex. These factors are summarized in Fig. 5.1 above.

5.3 Financial Regime Complex and Financial Cooperation in East Asia

5.3.1 Financial Regime Complex

The establishment of the International Monetary Fund and the World Bank in 1944 laid the foundations for the current global financial regime complex. While the IMF provided short-term loans to member-countries with balance-of-payments

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[3] Special clause which regulates the applicability of the remaining clauses of a contract when some clauses become ineffective.

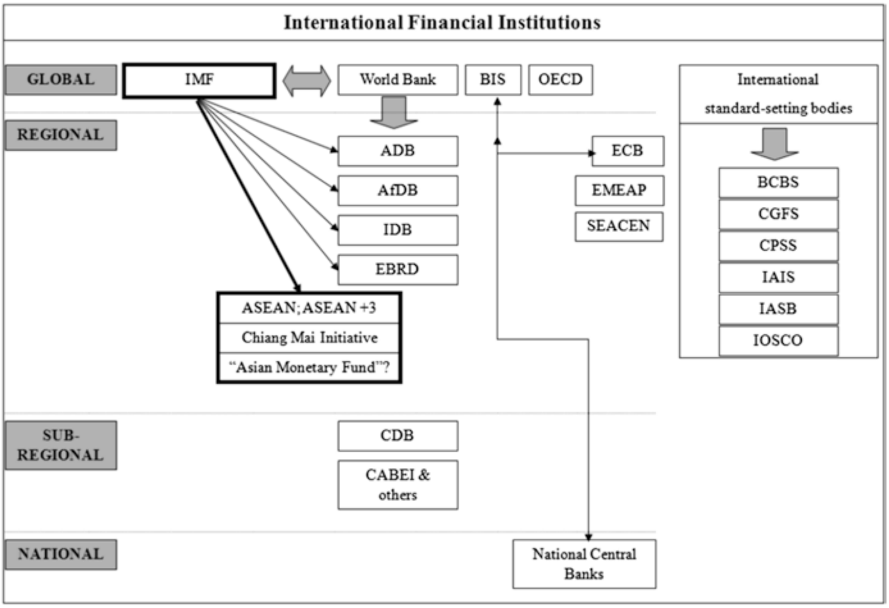

Fig. 5.2 International Financial Institutions (Source: Author's compilation)

difficulties and surveys of member's economies, the World Bank offered long-term loans to developing countries. Today the IMF has to share its` tasks with other international financial institutions, especially with those on the regional level. Such are the EU Commission, the EU Balance of Payment Facility, the European Financial Stability Mechanism, the European Financial Stability Facility, ASEAN+3 ERPD, the Asian Development Bank, the Arab Monetary Fund, the Latin American Reserve Fund and the North American Framework Agreement. Nevertheless, IMF surveillance and especially its funding capacities are unmatched. Yet, institutional linkages and the respective interplay between regional and global financial regimes are increasingly significant for the establishment, maintenance and effectiveness of regimes as will be shown in the course of this analysis. Global Institutions that matter most for regional financial cooperation are the International Monetary Fund, the World Bank, the International Bank for Development and Reconstruction (IBDR), the Bank for International Settlements (BIS), the Organization for Cooperation and Development (OECD) and the Financial Stability Forum (FSF).

The chart below illustrates financial institutions as elements of the respective financial regime complex with a focus on the global and regional level. Furthermore, it displays linkages between the institutions and highlights the main issue of this chapter - that is the existing and potential interplay between the International Monetary Fund and regional institutions such as the Chiang Mai Initiative (Fig. 5.2).

5.3.2 Asian Financial Crisis and the IMF

The Asian Crisis hit the region in 1997, led to a temporary financial and economic crisis of the countries involved and – due to its global implications – can be viewed as an international financial crisis. In Indonesia the economic slump even caused social upheaval and eventually political transformation. Empirical evidence suggests that the Asian financial crisis was caused by internal as well as external factors.

There are two views on the causes of the Asian Financial Crisis. One states that it was a natural reaction of markets towards internal structural weaknesses of Asian economies. The other explanation points to the dynamics of global finance which allow for the uncontrolled flow of short-term capital and thus enhances speculative attacks against currencies. A case in point is Thailand, the first country to be affected. Although macroeconomic indicators suggested a sound overall economic situation, lack of transparency, especially in the Thai banking sector, led to uncontrolled credit lending and spurred a real-estate-bubble. Furthermore the Thai currency (*baht*) was pegged to the US dollar which allowed for initial speculations whether the exchange rate realistically reflected the countries` economic potential. Consequent hints that the Thai currency was under pressure to devaluate led to massive speculation against the baht and to the large scale withdrawal of private capital. Finally the national reserve bank of Thailand had to uncouple the Baht from the US Dollar. The consequences were disastrous: the exchange loss of the Thai currency in the period from July to September 1998 amounts to 36.7 percent of its former value. In the following months speculative attacks against dollar-fixed exchange rates led to significant devaluations of the respective currencies in Indonesia, Malaysia, the Philippines and South Korea. It is noteworthy that none of the latter economies that were hit by contagion had any economic connection to the Thai-property bubble. The currency crisis turned into a stock market and then into an economic crisis, which not only hit Asia but also Brazil and Russia one year later. Therefore we may conceive of the Asian crisis as a crisis of globalization (OECD 1999: 9, Lee 2000: 39, Krugman and Obstfeld 2003: 698).

5.3.3 Role of the IMF

In terms of crisis management the global community relied almost entirely on the IMF. There are doubts about the adequacy of IMF conditionality that accompanied IMF loans which were granted to Thailand, Indonesia and South Korea. In the case of the Philippines an already existing program was modified. Some countries, e.g. Malaysia, which did not ask for or even refused IMF loans seemed to recover faster from the Asian Crisis.[4] In total the IMF granted loans of USD 120 billion to the

[4] It has to be noted, however, that Malaysia implemented strict controls of short-term capital inflows to avoid speculative attacks on its currency, the Ringgit.

above mentioned three countries. The International Monetary Fund provided 31 percent of the total loans granted to Indonesia, Thailand and South Korea. Moreover, it was key to acquiring more money from other lenders as without the IMF's involvement, they would most probably have been reluctant to accept the risks associated with providing these loans. In the end, the remaining 69 percent were covered by grants from the World Bank, the Asian Development Bank and other bilateral donors (Dieter 1999: 77).

In the case of Thailand USD 4 billion were approved in August 1997, distributed over a period of 34 months. The IMF imposed strict conditionalities: It demanded a restructuring of the financial sector and the closure of weak banks as well as a strengthening of the equity base of all other banks. The Thai government raised the value added tax from 7 percent to 10 percent and a new framework for monetary and exchange rate policies was instituted together with a managed float system for the Baht. In addition, structural political measures were taken. The Thai economy was directed towards exports, higher importance was put on the private sector, the public sector was reformed and efforts were made to attract more foreign capital (IMF 1999).

Indonesia received USD 10 billion distributed over a period of 36 months. The respective conditionalities included, as in the case of Thailand, a restructuring of the financial sector: Weak banks were closed, state-owned banks merged and the judicial and institutional framework of the financial sector improved. Structural reforms of the economy included a liberalization of foreign trade and the regulation of foreign direct investment and a divesture of monopolies coupled with a strong privatization policy. In order to free funds for these efforts infrastructure projects were prolonged and many government subsidies were cut. Further modifications of the program took place as the crisis proceeded (IMF 1999).

The above cases exemplify that IMF loan packages come with conditions attached. In general the IMF insists on a combination of tight macroeconomic policies. These policies include austerity measures such as cuts in public spending, higher interest rates and a tight monetary policy. Moreover, the IMF pushes for deregulation of sectors which were formerly protected from foreign competition, privatization of former state-owned assets and improved financial reporting from the banking sector. This set of policies came under harsh criticism by many observers. One main argument here is that the IMF's "one-size-fits-all" approach to macroeconomic policy is simply inappropriate for many countries (Hill 2009: 375).

5.3.4 Japan's Proposal to establish an Asian Monetary Fund in 1997 and the Implications

After the United States had made it clear they would not join the Thai rescue programme proposed by Japan, the Japanese government decided to initiate a debate at the IMF meeting in August 1997 about the establishment of an Asian Monetary Fund without any link to the International Monetary Fund. The plan, meant to create a pool of US 100 billion in a central reserve to lend to countries in financial distress, was circulated to officials in central banks in Korea, China and Southeast Asia. While Korea and the Southeast Asian states were supportive, even Michael Camdessus who only objected to the name of the fund, China refused to support the proposal, almost rejecting it completely. Similarly, the US Treasury Department was against it and successfully managed to sink the proposal during meetings taking place at the annual meeting of World Bank and IMF in Hong Kong. The events surrounding the Japanese proposals allow for several observations (Higgott 2000: 256).

East Asian officials, feeling particularly vulnerable due to the crisis in Thailand, were enraged because the US refused to back a plan that would have cast doubt on the future role of the IMF in the region. Comparing it to the quick and generous response to Mexico's crisis only a few years earlier left them with the lasting impression that the US would not treat East Asia as it treats Latin America. The reason for China's refusal to agree to the Asian Monetary Fund cannot be explained by worries about the IMF's position or the belief that strict conditionality needs to be imposed on the states embroiled in the crisis. Instead, they simply considered the quick approval expected by the Japanese to be unrealistic and inappropriate and were wary of an association with the Japanese proposal. China changed its position when two years later the Chinese foreign minister expressed his support for regional financial cooperation to the ASEAN+3 finance ministers.

Even though the US rejected the idea of an Asian Monetary Fund, they offered in return for abandoning the proposal to deal with the crisis seriously, to contribute to "second lines of defense" (bilateral loans flowing largely parallel with IMF lending) and to institute the Manila Framework, a transient regional dialogue with financial officials on crises management and regional surveillance. This seems to show that concessions can be extracted from multilateral institutions and the US by threatening with regional cooperation. All in all, however, the MFA's benefits to the region were limited (Henning 2002: 64). The United States' domestic politics has been a source of worries for the East Asians when it comes to the question of American support in international financial institutions. The imposition of limits on the use of Exchange Stabilization Funds after the Mexican crisis by congress led to the reluctance of the US Treasury to support the Thai rescue package in 1997. Quota increases had been increasingly politicised by Republicans and Democrats alike. Even in the middle of the crisis, congress did not act quickly to raise the quota and institute the New Arrangement to Borrow. Only with the Russian state's bankruptcy looming, congress finally made the decision. The attempt by the IMF to institute a policy of selling gold in order to finance lending to highly indebted countries was undercut by a coalition of companies with gold interests which managed to scuttle the proposal. The Bush Administration opposed further quota increases and bilateral lines of credit while congress' support for the IMF is far from certain.

5.3.5 Chiang Mai Initiative

East Asian governments responded in different ways to the financial crisis of 1997–98. Despite specific policy reforms that were initiated in the aftermath of the crisis the states of the region followed three broad strategies in order to prevent and to be able to respond adequately to future financial crisis: The first strategy included the *unilateral accumulation of foreign exchange reserves* in order to restore confidence in financial markets and to be able to finance significant balance of payment deficits. The second strategy was multilateral and advocated a *reform of the global financial architecture* in general and the International Monetary Fund and its perceived lack of responsiveness in particular. The third strategy was a regional plan to establish a *network of bilateral swap arrangements*, called the *Chiang Mai Initiative* (CMI).

The Chiang Mai Initiative was created in 2000 by the ASEAN+3 states to provide liquidity for member countries should they get into short-term balance of payments deficits. The aim was to prevent regional contagion effects emanating from a systemic economic breakdown in a member country, such as Thailand in 1997. Since 2001, 16 bilateral currency swap arrangements have been negotiated and concluded among the central banks of the ASEAN+3 countries. Central to the institutional design of the CMI in the first period of its existence from 2000 until 2009 is its *self-managed feature* with no collective decision-making body. Until 2005 the size of the CMI mounted up to USD 36.5 billion. Each agreement granted member states access to the equivalent of USD 1–3 billion in foreign exchange reserves from their partner's central banks. The swap arrangements are effective for exactly 90 days and renewable for a maximum of two years. The primary amounts of USD 36.5 billion provided by CMI seem undersized and thus insufficient for avoiding speculative attacks. This assessment is underlined by the fact that the ASEAN+3 group has a combined GDP of USD 3.6 trillion as of February 2009, and thus holds more than half of the worlds currency exchange reserves (Jakarta Post, 23.02.09 (2009)). Given the fact that Thailand requested USD 17.2 billion in the wake of the financial crisis in 1997 it was clear from the start that the CMI would have to be supplemented by the IMF in the event of another crisis.

Bearing in mind this structural weakness of the CMI, in 2005 East Asian countries resolved to double the amount of emergency funds to be granted to affected countries to USD 80 billion, marking the second stage of the CMI. In accordance with the objective to increase emergency resources, Singapore and Japan signed a USD 4 billion currency swap arrangement in November 2005. Equally, Japan and South Korea agreed on a USD 15 billion currency swap arrangement in February 2006. Similarly, China also doubled its already existing currency swap deal with Indonesia from USD 2 billion to USD 4 billion in May 2006. As of May 2006, the size of the CMI already amounted to USD 75 billion. The decisions to increase the size of the CMI clearly show that the common interest of East Asian countries to reduce the dependence on an IMF or US-determined solution to financial crisis in the region. By doing so East Asia follows a regional strategy as well as keeping up the already existing IMF-backed financial firewalls to set up a broad defence line against possible speculative attacks.

In May 2009 the ASEAN+3 countries decided to erect the Chiang Mai Initiative Multilateralization (CMIM) in order to deepen and broaden the CMI. With Myanmar, Brunei, Cambodia, Laos and Vietnam joining the Initiative, all ASEAN-state had become member countries. The existing network of bilateral swap-agreements was replaced by a multilateral currency-swap agreement. In instances of short-term liquidity difficulties and after a collective decision has been taken the CMIM allows for the exchange of member countries` currencies into US-Dollar provided by the central banks of other members. The regional liquidity reserve was increased to USD 120 billion. The successful implementation of the CMIM was very much dependent on a common understanding of China and Japan on the peculiars of financial cooperation.

Ever since the agreement to proceed with multilateralization was reached in 2005 the CMIM has faced difficulties in reaching a decision about contribution levels. This problem was political and pertains to the role of Japan and China in the process of establishing the CMIM. The main problem was that Japan wanted to be the biggest single contributor to the collectively managed regional fund. China preferred equal distribution of contributions between the two powers. The dispute did not escalate and led to a compromise that made the generous financial endowment of the CMIM possible: Japan will contribute 32 percent of the total to the CMIM, or USD 38.4 billion of the USD 120 billion pool. China will contribute USD 38.4 billion in total: USD 34.2 billion from the mainland and USD 4.2 billion from Hong Kong. If one adds South Korea's contribution to the equation, Northeast Asia provides for 80 percent of the liquidity pool, while ASEAN countries contribute only USD 24 billion or 20 percent. Then again ASEAN states are entitled to draw an unproportional part of the fund amounting to USD 63.1 billion. This imparity between contributions and drawing rights has been thoroughly planned and reflects the idea that currency reserves giants such as China, Japan and Korea support smaller and vulnerable Southeast Asian countries (Loewen and Hilpert 2010).

Apart from boosting the scope of the fund, ASEAN+3 states decided in 2009 to establish an independent surveillance unit. In February 2012 the ASEAN+3 Macroeconomic Research Office (AMRO) was established. AMRO is the surveillance mechanism of the CMIM and has the function to monitor and analyse regional economies, detection of risks, swift implementation of remedial actions and to contribute to CMIM's decision making (ASEAN+3, Chairman's statement 2009, Point 9). AMRO for the moment is a private entity under Singaporean law that will be transformed into an international governmental organization soon.[5]

In 2012 ASEAN+3 Finance ministers and central bank governors decided to double the size of the CMIM from USD 120 to 240 billion. The deputy governor of the Philippine central bank (BSP), Amando M. Tetangco, said that if there was a need to again modify the fund size there would be a willingness of the ASEAN+3 members to support such a move (*BusinessWorld* online 2012). In addition a further option to delink the fund from the IMF has been considered. The amount that can be disbursed without IMF consent increased from 20 to 30 percent. A further increase

[5] Interview with an AMRO executive on the 19th of March 2012 at the AMRO office in Singapore.

to 40 percent in 2014 was envisaged. Moreover the "crisis prevention" lending line, also called CMIM Precautionary line, was introduced in order to take pressure from the main credit line, the CMIM that was designed to help member countries to overcome liquidity crises (ASEAN+3 FMM, Chairman's statement 2012).

One of the basic norms of the CMI and the CMIM is their task to "supplement the existing international financial arrangements", namely the International Monetary Fund. This is quite surprising as the Chiang Mai Initiative evolved as an Asian attempt to substitute the IMF in the region. Eventually, East Asian countries approved the linkage of the CMI to the IMF as a provisional arrangement *until a formal surveillance mechanism* is established. How can this be explained?

Firstly, the IMF possesses better institutionalized surveillance mechanisms than the ASEAN+3 countries. Moreover, the IMF carries out annual reviews of member country economies through Article 4 consultations and evaluations of financial sector vulnerability through the Financial Sector Assessment Program. Furthermore, some East Asian countries, especially the big creditor countries like China, Japan and South Korea have a very functional and thus supportive attitude towards lending funds to countries whose operations are under this type of regular surveillance. Thus, linking the CMI to the IMF can safeguard that loans have a better chance of being repaid, even if ASEAN+3 remained critical of IMF conditionality per se. *Secondly*, East Asian states tried to position themselves with regard to dominant powers in the financial regime complex such as the United States and the European Union. They feared that especially the US-treasury would oppose a new Asian financial framework which lacks any IMF linkage as in the case of the aborted Asian Monetary Fund plan in 1997. Given the limited, albeit growing, political power of East Asian grouping vis-à-vis the US and EU, East Asian countries needed to water down the independent nature of the CMI at the initial stage of regional financial integration. At the May 2001 ASEAN+3 Finance Ministers Meeting in Honolulu, member countries agreed to review the issues of the IMF linkage with the CMI after three years had passed, leaving room for a possible revision of the linkage requirement. In May 2005, the finance ministers of East Asian governments agreed to double the amount of emergency funds that could be withdrawn without IMF conditionality from 10 percent to 20 percent (Sohn 2007). In 2012 this amount was increased to 30 with the prospect of raising to 40% percent.

This revision represents the gradual approach taken by East Asian countries in loosening their adherence to the IMF conditionality. Whether or not the CMI eliminates its IMF linkage in the near future, such a regional liquidity fund clearly intends to complement the role of the IMF in crisis management in the long term. At the moment, the IMF linkage made the CMI look more inclusive, thereby helping to deflect suspicions and criticism from non-Asian economic powers. In this sense, the CMI reflects *East Asia's strategic behaviour to counter the risk of its overdependence on the IMF even as it maintains collaborative relations with the IMF and other G-7centered global financial institutions*.

5.4 Assessment of Hypotheses

5.4.1 Regime Development

Let us again take a look at the proposed hypotheses with regard to the evolution of financial cooperation in general and the Chiang Mai Initiative in particular. Of the factors mentioned in the theoretical discussion, all seem to play a role in the formation of the Chiang Mai Initiative.

Exogenous Shock The outbreak of the Asian financial crisis and the largely failed IMF policies to protect the regional economies contributed to the insight that reliable help from outside the region cannot be expected while the currently existing regional institutions were not strong enough to cope with the problem (Fort and Webber 2006: 109). From this the South East Asian states received a good deal of the motivation that led to the institution of the Chiang Mai Initiative.

Shared Values and Causal Beliefs For the exogenous shock to provide the required impetus it was necessary for the crisis to be perceived in the same way by all relevant parties. This was certainly the case as all of them tended to attribute their economic woes to the failed policies of the IMF, providing a shared causal belief that can be directly linked to the institution of the CMI. In addition, building on other cooperation, particularly inside ASEAN, shared values and trust had developed which contributed to the easiness with which an agreement could be found (Nabers 2003: 122, Stubbs 2002: 443–444).

Participation of All Concerned States Due to the contagion effect it would be extremely dangerous if some states inside the region would stay out of a potential cooperation scheme as one state's economic problems can easily spread to others if not quickly dealt with. Recognising this, all states concerned (ASEAN+3) are participating in the Chiang Mai Initiative. The American tacit consent can be conceived as agreement (Henning 2002: 6).

Potential Zone of Contract and Collective Benefits There are clearly collective gains available by avoiding a future crisis that can only be avoided by cooperation. Small states are vulnerable due to the small size of their financial markets while big states are still constrained by their small IMF quotas which limit their borrowing capacity. An additional benefit is the faster decision-making that can be expected from a regional institution, another major problem states in the region have with the IMF. In the terms of regime complex theory, the states are creating themselves additional opportunities for forum shopping.

Veil of Uncertainty and Integrative Bargaining While states can reasonably expect that at some point in the future a crises is bound to occur, they do not know when it will take place nor who will be particularly affected, giving them good reasons to find an equitable solution. Similarly, in the agreement as it is as the moment, many potentially contentious questions are left open, making agreement on principles easier as states do not know how they will be resolved in the future. For once, it is still unclear how the voting rights in the CMI will be distributed. Additionally, it was similarly left open how surveillance will take place in the future and whether the IMF link will be sustained, a fact that for example induced Singapore to agree to the CMI. The US as a potential veto actors also tacitly consented because they do not quite know how the CMI will develop. As a result of all these factors, the veil of uncertainty was strong and integrative bargaining dominated the negotiations. Another result is that, as regime complex theory predicts, we are like to witness a lot of "politics of implementation" to close the gaps left open by the agreement.

Mutually Equitable Solution Despite strong reservations the participating states consented to Malaysia's demand that 30 percent of the reserves should be accessible even without IMF agreement (IMF link). A mutually equitable solution was prioritised over a more streamlined, potentially safer and more efficient solution.

Availability of a Salient Solution The CMI is organised in a manner very similar to the IMF. This is not surprising as the IMF is certainly the easiest, salient solution all participating states are aware of. The availability of the IMF as a template saved time and effort and was hence the model of choice for all involved. This also confirms the argument brought forward by regime complex theory that the creation of institutions cannot be understood when considered outside the regime complex they are part of. The fact that there is "no clean slate" strongly contributed to the final form of the CMI.

Compliance Mechanism Finding an efficient compliance mechanism is often one of the most difficult parts when debating about how to set-up an international institution. However, in the case of the CMI the fact that one was already available strongly contributed to the easiness of agreement. The IMF, while disputed, is time-tested and hence the logical choice. As in the case of the IMF as salient solution, it is clear that the absence of a "clean slate" contributed to the agreement and moulded its outcomes.

5.4.2 Regime Complex

<u>*No Clean Slate*</u>: European monetary integration and especially the functions of the International Monetary Fund are taken as models for the development of regional financial institutions. Examples are (a) the discussion on the implementation of an Asian Currency Unit and (b) the lending and surveillance functions of the CMIM. Thus, rules developed in other institutions of the financial regime complex matter for the evolution of a new regional institutional arrangement. However, it was lack of trust in IMF policies which actually set in motion regional financial or crisis-management cooperation in East Asia at a certain point in time.

Forum Shopping The discredited IMF led Asian states to focus on already existing regional institutions like ASEAN that was broadened with regard to issue-areas and membership. The resultant ASEAN+3 process (ASEAN + China, Japan, Korea) gave rise to a financial regime agenda, that in turn set in motion the establishment of the CMI and the CMIM. Forum shopping possibilities went hand in hand with the establishment of these new institutions, yet only theoretically. Practically not a single swap arrangement has been utilized until now. Since only up to 30 percent of emergency funds can be withdrawn in a financial crisis without IMF conditionality, forum shopping is not a real option yet. This underlines the assumption that forum shopping possibilities are being created during the process of regional financial cooperation in East Asia. At the same time "pure" forum shopping would not fit into the counterweight strategy of the ASEAN+3-states which avoids overdependence on the IMF while maintaining cooperative relations with the IMF and the dominant states within the complex.

Legal Inconsistencies There is no clear division of labour between the Chiang Mai Initiative and the IMF. There are no criteria for evaluating this linkage with regard to the interaction of both institutions. In contrast, within the global trade regime complex the compatibility between the World Trade Organization (WTO) and regional free trade agreements is assessed by a set of criteria which are established in Art. XXIV of the GATT and Art. 5 of the General Agreements on Trade in Services (GATS). For the time being the Chiang Mai initiative supplements the existing financial facilities made available by the International Monetary Fund.

Regime Development through Implementation As in the case of FTAs, regional financial instruments were and are being initiated swiftly in contrast to lengthy multilateral negotiations. This again implies an emphasis on the implementation and interpretation phase where some of the open question regarding the Chiang Mai Initiative (surveillance, conditionality) still have to be tackled in order to put the institution in operation.

State of the Regime Complex, Dominant States and Regime Development Systemic crises like the Asian crisis of 1997/98 and the current global financial crisis are strong incentives for states to embark on regional financial projects like the Chiang Mai Initiative. Yet, the multilateral financial regime is not abandoned. East Asian governments supplement their multilateral strategy with regional and unilateral options. East Asian states were dissatisfied especially with three aspects: a) behaviour of the dominant states in the regime complex, b) policies of the IMF, and c) their institutional standing in the organization. Regional powers like China and Japan also play a significant role regarding the establishment and effectiveness of this initiative.

5.5 Conclusion

The decision of the ASEAN+3 states to put up the Chiang Mai Initiative in 2000 was clearly a reaction to IMF conditionalities imposed after the Asian financial crisis of 1997/98 that led to the shared belief among all the concerned states of

Northeast and Southeast Asia that a regional financial cooperation without any western interference in order to realize collective benefits had to be advanced. While the smaller ASEAN states had an interest to access the currency reserves of China, Japan and Korea, the latter were keen on improving their borrowing capacity within an Asian fund. At the same time, many contentious questions were left open, making it easier to agree on cooperation principles behind the veil of uncertainty. A mutually equitable, although not uncontested, solution is the decision of the Chiang Mai member states that only 30 percent of the total reserves should be accessible without IMF conditionality. The fact that the Chiang Mai Initiative's institutional design is very similar to the IMF underlines that the latter offers the most salient institutional solution to regional financial cooperation problems. Although negotiations about compliance mechanisms are often difficult, in the case of the CMI it could be avoided or postponed by simply using the already existing, time-tested mechanism of the IMF.

It is indeed puzzling that the members of the Chiang Mai Initiative decided to outsource conditionality by restricting the reserves that can be accessed by member states without an IMF linkage to 30 percent. This would appear to nullify the very purpose of the arrangement which is to free Asia from IMF conditionality and the dominance of US and other western states in this global institution. Why is this so? Regime complex theory assumes that the CMI/CMIM has to be seen as one elemental regime in the global financial regime complex, dominated by the International Monetary Fund. Institutional Interplay within this complex is influenced by the fact that regimes are negotiated in an array of prior rules developed in the IMF. This is certainly true for the interaction between the CMI and the IMF. Principles of cooperation, conditionality and institutional form clearly resemble each other. Moreover, conditionality is still directly linked to the IMF. Forum shopping seems to be a decisive factor that explains why and how ASEAN+3 states set up the CMI. In the course of regime development it became clear that the inclusion of IMF conditionality is primarily a function of the interests of big creditor countries like Japan, China and Korea that want assurances for currency reserves they provide. Other features of the CMI-IMF interplay are legal inconsistencies and the lack of division of labour between them. For the time being the CMIM is merely supplementing the IMF. Yet, the initiation of the AMRO surveillance mechanism and the political interest Questions of surveillance and conditionality have to be tackled in the near future.

East Asia's strategic behaviour aims at countering the risk of its overdependence on the IMF by slowly reducing this link, yet maintaining collaborative relations with the IMF and the dominant states behind it (USA, Europe). Combined with the interests of the big creditor countries such as China, Japan and Korea the IMF-link can be regarded as a vital supplement to regional financial cooperation in the medium term. Regional powers such as China and Japan play a vital role if it comes to resources being allocated within the CMIM.

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Chapter 6
Shanghai Cooperation Organization: China, Russia, and Regionalism in Central Asia

Ishtiaq Ahmad

Region: East and Central Asia

6.1 Introduction

Since its establishment in June 2001, the Shanghai Cooperation Organization (SCO) has emerged as a viable regionalism institution in Central Asia. It comprises China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, India and Pakistan as full members, with Iran and Mongolia, as observers. The organization is a successor to the Shanghai Five founded in April 1996 when China, Russia and three Central Asian states – Kazakhstan, Kyrgyzstan and Tajikistan – agreed to a number of confidence building measures aimed at avoiding conflict among the five countries. It was at the June 2001 Shanghai summit that the Shanghai Five grouping was renamed as SCO while Uzbekistan joined as its sixth member. In July 2015 India and Pakistan were accepted as full members too. Iran and Mongolia are observers of the SCO while Sri Lanka is a dialogue partner. Afghanistan and the SCO are linked by a joint contact group. The original motivation behind the establishment of the organization was to collectively combat the regional security threat all of its members felt from the so-called three evils, namely: terrorism, extremism and separatism (Aris 2009). Overtime cooperation has expanded to economic, social and cultural spheres too. In the post-Cold War period, regionalism in Central Asia has also involved other initiatives such as the Economic Cooperation Organization (ECO) and Commonwealth of Independent States (CIS). However, the SCO seems to have

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proven its comparative distinctiveness by serving the objective national needs and interests of its members in an era of globalization and terrorism.

This chapter discusses the origin and evolution of the SCO, the content and scope of its cooperative activities in security, economic and political domains, and their future outcomes in view of the challenges confronting the organization. Joint military exercises by SCO members and the organization's role in balancing Russian and Chinese interests in the region have grabbed considerable negative attention among Western policy makers and scholars. Much of the previously published work on the subject had for the same reason focused on the nature of security cooperation within the SCO and its implications for US or Western interests in Central Asia (Germanovich 2008; Weitz 2006). Some authors (Kleveman 2002; Atal 2005) viewed the emergence and evolution of the SCO within the context of the 'New Great Game' among international and regional powers over Central Asian hydrocarbon resources. Consequently, relatively less attention was paid to the organization's economic and political roles. However, more recently, a new body of literature (Aris 2011; Boland 2011) has started to critically assess the SCO's performance in its entirety.

While building upon this new discourse on the organization, the chapter attempts to answer some crucial questions regarding its diversified agenda for regional cooperation: How has the SCO made a difference in Central Asian regionalism? What roles have China and Russia as great powers played in setting its agenda? How much importance do Central Asian member states attach to the SCO? How far has the organization succeeded in assuaging US/Western perceptions about its potential confrontation capacity? And, what more does the SCO need to do structurally and practically to overcome its remaining challenges?

The chapter argues that within a relatively short span of over a decade, the SCO has succeeded in institutionalising credible cooperation among its members in the security and political fields. Unlike its counterparts in the region, the SCO is able to create mechanisms to mitigate security threats, particularly terrorism, and create cohesion among its members. While the organization has also made remarkable progress in improving its external image, economic cooperation remained limited to the initialization of some major plans and initiatives. Like other regional organizations in their formative phase, the SCO continues to face institutional and financial constraints concerning its ability to foster and deepen cooperation. With economic issues gaining greater salience in its summit agendas however, the SCO may overtime be able to tackle what is by far the most formidable challenge for its member-states. The chapter is structured as follows. Section 6.2 delivers an outline on the evolution of the SCO and discusses how this has been theoretically contextualized in the literature. Section 6.3 elaborates on the main achievements of the SCO with a focus on the internal political relations among its members and the development of SCO's external image. Building upon Sect. 6.3, the following section explores the 'competitive edge' of the organization as well as its major challenges. Section 6.5 concludes.

6.2 Evolution of the SCO and Its Theoretical Contextualization

The SCO covers one of the largest geographical areas of any regional organization, from Kaliningrad to Vladivostok and from the White Sea to the South China Sea. With the inclusion of India and Pakistan as full members, and Iran as observer and Sri Lanka as dialogue partner, it reaches the Indian Ocean and the Middle East as well. Its members and observers collectively possess 17.5 percent of the world's proven oil reserves, 47–50 percent of known natural gas reserves and some 45 percent of the world's population (Bailes and Dunay 2007: 3–4). The organization is a successor to the Shanghai Five which was established in April 1996 when the leaders of China, Russia and three Central Asian states - Kazakhstan, Kyrgyzstan and Tajikistan - signed the "Agreement on Strengthening Military Confidence in Border Areas". The agreement aimed at achieving demilitarization and delimitation of international borders in Central Asia, and included a number of confidence-building measures (CBMs) to avoid conflict among the five countries. At the Moscow summit held in 1997 the Shanghai Five leaders agreed to place their troops deployed in border areas in defensive positions, not to use forces or threaten to use force when disputes arise and not to seek unilateral military superiority over each other (Mahmud 2001–02: 6). The Shanghai Five agenda was subsequently broadened to cover issues of regional security and stability such as the fight against international terrorism, organized crime, arms smuggling, trafficking in drugs and other transnational activities.

At the June 2001 Shanghai summit the "Shanghai Five" were transformed into the Shanghai Cooperation Organization with the inclusion of Uzbekistan as its sixth member. The declaration on its establishment and the Charter of the Shanghai Cooperation Organization laid out a much broader agenda for the SCO. The Declaration identified a number of founding goals or purposes of the SCO including "strengthening mutual trust and good-neighbourly friendship among member states; encouraging effective cooperation among the member states in political, economic and trade, scientific and technological, cultural, educational, energy, communications, environment and other fields". In addition, it obliged member states to "cooperate closely to implement the Shanghai Convention on Combating Terrorism, Separatism and Extremism, including setting-up an Anti-terrorist Center of the SCO in Bishkek". The Declaration also required member states to draw up a "long-term, multilateral economic and trade cooperation" (Declaration on Establishment of SCO).

The emergence and evolution of the SCO has to be seen within the context of globalization and regional integration as its by-product or response, in post-Soviet Central Asia. There is a reason why neorealist perspectives initially appeared to dominate the largely Western scholarly discourse on the subject. China, Russia and Central Asian members of the SCO have authoritarian political systems, and their views of international relations often differ from those of the United States and the Western countries. Central Asia as a region was additionally aloof to the phenomenon of regionalism, and a few organizations that existed were driven essentially by security needs. However, by initially resolving border conflicts, then undertaking credible security cooperation, and finally trying to extend cooperation to economic, political and social spheres, the SCO has proven to be no different from other regional bodies. Its emergence and evolution conforms to the trend towards regionalism and regionalization outside of the West. Building upon this assumption, neoliberal approaches, especially strands of constructivist theory explaining Asian or Central Asian regionalism, as articulated by Acharya (2011) and Gorshkov (2006), offer a more convincing explanation of how two major non-Western powers perceive and seek to develop a framework for regional cooperation in Central Asia, in which the region's smaller states are willing participants.

In particular, the 'New Great Game' approach seems to have little relevance to the reality of regionalism in Central Asia, where in many ways the objective security and economic interests of the SCO member-states are not incompatible with those of the US and other Western powers. For instance, there is hardly any incompatibility in their respective policies on combating international terrorism and drug trafficking. Russia and China being contiguous to Central Asia should naturally have greater clout over Uzbekistan, Kyrgyzstan, Tajikistan, and Kazakhstan, but this factor has not prevented these countries from pursuing long-term cooperation with the US and Europe. The SCO is a product of a constructive approach based on objective interests of its member-states - including China's pursuit of 'new regionalism,' Russia's quest for the 'near-abroad,' and Central Asian states' desire to benefit from strategic wealth. According to Gorshkov, "Central Asian regional actors have asserted their mutual 'inherent' compatibility on the basis of 'organic' geo-strategic objectives, such as natural resources, economic development, and regional stability, coupled with aggrandized geopolitical strategy. The multilateral regional framework - the SCO - has allowed regional parties to engage on an equilateral basis" (Gorshkov 2006: 43). There are, of course, competitive interests within the members of the group. These interests are, however, eclipsed by the motivations driving the cooperation among the SCO members.

6.3 The SCO's Main Achievements

6.3.1 Expanding Security Cooperation

Over the course of time, the SCO has attempted to realize the goals set in the Shanghai Declaration by creating appropriate institutional mechanisms and undertaking various cooperative steps. Its original agenda has not fundamentally changed; rather, its focus has expanded over time. The organization has so far achieved considerable progress mainly in four areas: establishing mechanisms to deal with security issues, harmonizing ties between its member-states, enhancing its international image and initializing efforts at promoting economic cooperation.

First, the SCO has achieved notable success on the security front. The SCO has conducted multilateral security exercises and developed its counter-terrorism and counter narcotics coordination efforts. Terrorism remains a high priority issue on the SCO agenda, as the "perceived potential danger of Islamist militants is the main threat that binds regional security strategies of the SCO countries together" (Yom 2002). China is concerned about Uygur extremism in Xinjiang, Russia has experienced terrorism in Chechnya and elsewhere, the Uzbek government has faced a potent security threat posed by the Islamic Movement of Uzbekistan (IMU) since the 1990s, and Tajikistan has confronted years of Muslim militancy. Hizb-ut-Tahrir represents a common threat to Central Asian security. SCO member states have long perceived religious extremism spilling over from Afghanistan as a principal security concern. During the time of the Shanghai Five and for half a year after the creation of the SCO, Afghanistan was under the Taliban regime, which allegedly exported religious extremism into Central Asia, Russia and China. Taliban-led insurgency amid the international war effort in Afghanistan since 2001 has continuously concerned SCO member states. For China, Russia and Central Asian states, the SCO is the principal regional platform to counter the threat of religious extremism and terrorism simultaneously.

The organization's main institution for the purposes of security is the Regional Anti-Terrorist Structure (RATS), which was established during the June 2004 SCO summit in Tashkent, Uzbekistan. Its functions include collection and analysis of information about terrorist organizations, exchange of relevant information and experience among the SCO members, study of different forms of terrorism, monitoring the anti-terrorist struggle of the SCO members and searching for new approaches and methods of anti-terrorism campaign (Tolipov 2004). The RATS claims to have been responsible for successful criminal interdictions, arrests and advance warnings to other SCO states. It has reportedly assisted with security matters during the Beijing Olympics in 2008, the 2010 World Expo and the 2011 Asian Winter Games (Boland 2011: 13).

The SCO has also conducted several anti-terrorism exercises to enhance its capability to tackle the terrorist threat. For instance, in 2002, China and Kyrgyzstan held counter-terrorism manoeuvres, which were followed by a joint SCO command-post exercise called "Cooperation 2003" (Allison 2004). In March 2006, the security forces of SCO members conducted a similar exercise in Uzbekistan. The SCO's Contact Group with Afghanistan is geared towards managing non-traditional threats like the smuggling of arms, narcotics and illegal migration. Since 2003, the organization has conducted annual joint anti-drug trafficking exercises to help its Central Asian members overcome these problems (Maksutov 2006: 11, 17). The SCO has also organized several joint military exercises to foster defence cooperation among its members, including one in 2003, the Peace Missions in 2005 and 2007. In 2008–2009, the SCO expanded its exercise cooperation to include corporate partners. The Peace Mission-2010, hosted by Kazakhstan, also represented several advancements for the SCO's conduct of security exercises (Boland 2011: 11–12). Military cooperation has gained further momentum in subsequent years.

6.3.2 Strengthening Political Ties

Another success on the part of the SCO pertains to the strengthening of political ties among its member states. The organization provides a platform for the leaders of its member states, observers and facilitates dialogue between partners such that they can interact more regularly and try to build a consensus on issues of competing or conflicting interests. Consequently even major players such as Russia and China, which have had serious issues of mutual conflict during the Cold War, have become regional partners. While Sino-Russian ties have been improving since the early 1990s, a breakthrough was made in October 2004 when Russia and China resolved their main border dispute through a comprehensive agreement. The SCO has helped them to come closer and mutually benefit from bilateral and multilateral initiatives under the organization's umbrella.

The SCO has also helped create a mechanism for foreign policy coordination amongst member states. The SCO Charter had envisaged common viewpoints on foreign policy issues of mutual interest. Hence, starting from the 2002 St. Petersburg Declaration, the declarations issued by SCO heads of states at their successive summits have always stressed the need to coordinate the member states' foreign policies on problem areas in Central Asia. The SCO-level cooperation has generated a spirit of dialogue among Central Asian states. Annual summits of SCO leaders and regular ministerial level interaction between its member states have built confidence among them and brought stability to the region. No surprise that a number of border tensions, such as issues over Uzbek-Kyrgyz and Uzbek-Tajik borders, have been resolved amicably. Central Asian states seem to attach increasing importance to the SCO, since no other extra-regional player or regional initiative has been so prompt in tackling the region's security and economic problems. Being landlocked and resource-rich, Central Asian states need an outlet for economic development. This outlet is being provided by China and Russia, which have their respective interests in benefiting from the region's hydrocarbon resource potential. It is therefore the complementarity of economic interests that has paved the way for greater harmonization of ties among SCO member states.

6.3.3 Improving the International Standing of the SCO

Another accomplishment of the SCO regards the improvement of its international standing and image. Because the relations between the US, China and Russia were strained during the 1990s, the creation of the Shanghai Five has initially been associated with criticism and mistrust. At that time, the organization was perceived as a Sino-Russian alliance to curb US influence in Central Asia (Huasheng 2006). Such concerns have subsided to a considerable degree because of the improvement in Sino-Russian ties with the United States, and the emergence of the SCO as an important regional organization whose security and economic agendas do not clash with US/Western interests in Central Asia. Additionally, the SCO is not a military bloc like NATO. From time to time, its leaders do express concern about US-NATO's security ambitions in Central Asia. The prospect of the US establishing a permanent military foothold in Afghanistan as well as the deployment of any missile defence systems by the US in the region have been a source of major concern for both China and Russia. Indeed, the June 2011 SCO summit in Astana dealt with Russia's repeated criticism of the planned NATO missile defence system in Europe and its implications for Central Asia (Winnie 2011). However, even while expressing concern about the "prolonged presence of foreign forces in the region", the SCO has supported the US-led war in Afghanistan.

The SCO also reached out to other countries and even multilateral organizations. It has been granted observer status to the United Nations General Assembly in 2004. In 2010 the SCO Secretariat signed a Joint Declaration on Cooperation with the UN. In April 2005, it agreed on a Memorandum of Understanding with the Commonwealth of Independent States (CIS) to cooperate in areas of trade, anti-terrorism and social contacts, and an agreement with the Association of South East Asian Nations (ASEAN) for cooperation in economic, finance, tourism, environmental protection, use of natural resources, social development, energy and the fight against transnational crime (Tao 2005: 25). The SCO continues to develop links with the European Union (EU) and the Organization for Security and Cooperation in Europe (OSCE). For example, it attends EU and OSCE forums, particularly on Central Asian security issues (Boland 2011: 10).

Another factor enhancing the SCO's international standing and its legitimacy as a viable regionalism venture is the establishment of permanent institutional structures such as the Secretariat and the Regional Anti-Terrorist Structure (RATS). Its highest decision making body is the Council of Heads of State, followed respectively by the Councils of Heads of Government, the Foreign Ministers and the National Coordinators. There are other formal set ups, including Ministerial Meetings, the Commission of Senior Officials, Working Groups, the Business Council, and the Inter-Bank Consortium. The Shanghai-based Secretariat of the SCO manages its administrative and functional matters. Headed by a Secretary General, it has four Deputy Secretary Generals who respectively head the Political Section, Economic and Cultural Section, Information and Analysis Section and Administrative Section. Each section is assigned several relevant tasks. As for the RATS, it has a Council, an Executive Committee and Permanent Representatives. A Treaty of Long-Term Neighbourliness, Friendship and Cooperation, ratified in Bishkek in August 2007, solidified the organization's legal foundation.

6.3.4 Initializing Economic Cooperation

Finally, the SCO has always tried to step up efforts to foster cooperation in the economic field, even though many of its stated goals for greater economic and trade cooperation are yet to be realized. The SCO has undertaken several initiatives to harness the economic potential of its member states, raise their level of economic development and trade, and to develop communication links between them.

In September 2001, SCO leaders signed a "Memorandum of Regional Economic Cooperation" which emphasized the need for creating favourable conditions for economic cooperation among SCO members, including the development of communication corridors and a reduction of tariffs (Zhuangzhi 2004: 603). At the September 2003 SCO meeting, a Framework Agreement for multilateral economic and trade cooperation was signed which formulated a macro program for the promotion of regional economic integration and a free flow of commodities, capital, skills and services among member states over the next 20 years (Tao 2005: 21). At the 2006 SCO summit, 10 agreements were signed and on the eve of the summit, business worth USD 2 billion was transacted. The summit decided to set up a Business Council and an Inter-Bank Association. The summit identified 127 cooperative projects for the SCO pertaining to quality identification, customhouse, investment, tele-commerce, telecommunication, traffic and transport, energy and other fields (Dwivedi 2006). Subsequent SCO summits have identified additional projects.

Sino-Russian economic preferences within the SCO vary. Moscow is keen on developing plans for an SCO Energy Club to cover half of the world's natural gas reserves and almost a quarter of its oil reserves upon Iran's inclusion into the initiative (Blagov 2007). Beijing, on the other hand, is interested in fostering communication and transportation linkages with Central Asian states. China signed a bilateral agreement with Tajikistan for the construction of a 410 km motorway along the Tajik border to enhance transport and communication links and maintain effective control of border zones in Central Asia. The SCO has also facilitated bilateral economic cooperation between member states. For instance, China has signed an energy agreement with Uzbekistan worth USD 600 million. At the 2006 SCO summit, Kazakhstan and Russia decided to establish the Eurasian Bank to help financial enterprises in the region (Maksutov 2006: 18). Kyrgyzstan's North Western Talas province has announced plans to sign a memorandum of economic partnership with Russia's Altai province under the SCO's umbrella (Boland 2011: 14).

Efforts at fostering economic cooperation under the SCO were accompanied by a higher level of bilateral trade. Trade between China and Central Asian countries totalled USD 50 billion in 2014, up from USD 527 million in 1992 (Wang and Yampolsky 2015). This makes China as the region's largest trading partner. Annual trade between China and Russia has also grown considerably reaching USD 79.25 billion in 2012. The two countries share a goal of further increasing bilateral trade up to USD 200 billion in 2020 (Blagov 2012). Until now, however, cooperation on microeconomic projects within the SCO framework has made relatively less progress. This is largely due to concerns among Central Asian members that their economies will not be able to compete with the strength of the Chinese economy, especially in the trade sphere (Bailes and Dunay 2007).

6.4 SCO's 'Comparative Edge'

Russia and the Central Asian states, with the exception of China, have been members of several regional initiatives other than the SCO. However, these initiatives failed to be as effective as the SCO. Three of them, the Commonwealth of Independent States (CIS), the Central Asian Cooperation Organization (CACO), and the Economic Cooperation Organization (ECO) are worth considering for comparison with SCO. CIS was established in the immediate aftermath of Soviet disintegration primarily on Russia's initiative. It consisted of all of the former Soviet republics excluding the Baltic States. The security aspect of CIS inherited from the 1992 Tashkent Collective Security Treaty (CST) (Allison 2004: 469). In April 2003, CST was expanded and renamed as the Collective Security Treaty Organization (CSTO). The CSTO aimed to foster greater defence cooperation among its members by acting as a rapid reaction force for Central Asia, a common air defence system and coordinated foreign, security and defence policy (Nikitin 2007). In addition, Russia offered many incentives to CSTO members, such as subsidizing training costs for CSTO members' military officers provided by the Russian Ministry of Defence. It also granted CSTO members the option to purchase Russian defence equipment at the same price as paid by the Russian military (Weitz 2006).

However, the interests and priorities of the CSTO members frequently differed. Moreover, overlapping membership of CSTO and SCO resulted in fluctuating priority that the members placed in one or the other organization at different times. Cooperation among the members varied. Rutland explained in this context that "the level of rapport among the members of the CIS Collective Security Treaty often depends on Moscow's willingness to open its wallet" (Rutland 2003). Consequently, the CSTO has failed to emerge as a viable regional security mechanism in Central Asia. The Russian bid to promote economic cooperation among the CIS members, such as the establishment of the Eurasian Economic Community (EEC) has likewise failed to transform the CIS into an effective regional body. The Russian-led regionalism in Central Asia has not worked since the Central Asian states were weary of Russia's dominant attitude and "did not wish to be relegated to a client-state status"(Mahmud 2001–02: 11) in addition to a limited Russian potential to offer any substantial economic support.

The Central Asian Cooperation Organization (CACO) was created by the Central Asian states to essentially reduce Russian influence in the region. In 1994, Uzbekistan, Kazakhstan and Kyrgyzstan established the Central Asian Union (CAU) to address their common problems and to prevent marginalisation in a 'new post-Soviet order'. The CAU aimed to create a single economic region with a reduction in tariffs among member states. In 1998, it was renamed as the Central Asian Economic Union, and a Central Asian Bank for Cooperation and Development was created. In 1999, Tajikistan also joined the Union. In 2001, it was again renamed as the Central Asian Cooperation Organization. However, Bohr (2004) points out that, like the EEC, CACO has achieved little more than issuing resolutions of a declaratory nature.

ECO is the third major regional initiative in Central Asia which has not proved as effective as the SCO. Since 1992, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan have all been members of the ECO, which also includes Turkey, Iran, Pakistan and Afghanistan. ECO aims to develop economic and technical infrastructure and transportation systems in the region along with improving cultural ties among its members. It evolved out of a previous regional alliance between Iran, Pakistan and Turkey called the Regional Cooperation for Development and was revived to its present form in 1985 by Iran. The ECO initiated several developmental projects none of which have been implemented yet due to the shortage of funds, the region's security predicament, and other bureaucratic and political hindrances. It has however succeeded in facilitating bilateral contacts between the member states.

Some of the problems facing the SCO such as tension among its Central Asian member states, overlapping membership and shortage of funds are the same as those confronted by the CIS, the CACO and the ECO. However, the SCO has made a difference in achieving what these regional initiatives have not as it is illustrated by its accomplishments. Unlike the SCO, other initiatives of regionalism in Central Asia were not truly comprehensive in their approach. In addition, SCO's relative success can be attributed to its membership, primarily that of China and Russia. The organization provides China with a security protection mechanism, and a platform for China to cooperate with Central Asia comprehensively (Weinstein 2005). China can contribute more to Central Asia's development than any other external actor due to its geographical proximity and also because of the vast economic and technological capacity which is not matched by other regional actors. As for Russia, its influence in Central Asia may have eroded in the post-Soviet period, but it is still an important power in Central Asia, with profound political, economic, military and cultural ties with its countries. In the post-Soviet era, Russia shifted to a more placatory policy towards Central Asia. Hence, Russian and Chinese interests, along with Central Asian states' interests, can be achieved within the diversified agenda and unique membership of the SCO. Even otherwise, the SCO does not perceive other regionalism initiatives in Central Asia to be hostile towards its interests. Besides signing a memorandum of understanding with CIS in April 2006, it concluded an agreement with the Collective Security Treaty Organization to broaden cooperation on issues such as security, crime, and drug trafficking. The 2011 SCO summit at Astana decided to link its Regional Anti-Terrorist Structure with the CSTO (Contessi 2011).

6.5 SCO's Current and Future Challenges

The SCO has achieved major successes in a relatively short period and its 'comparative edge' over other regional initiatives in Central Asia is quite clear. However, the organization still confronts several challenges which it has to overcome to gain greater regional and international credibility. These challenges include a lack of cohesion among member states and lingering institutional issues as well as continuing economic woes and image problems.

First, the SCO's success in harmonizing ties among its member states is still rather limited. These ties have not become cohesive enough to trigger full-scale, state-to-state cooperation, or to allow civil society of the member states to make the required input in the regionalism process. There is an inherent tension between the SCO states' desire for regional stability and the organization's mandate for non-interference in other nations' domestic affairs. The members also have to manage divergent national goals and bilateral tensions that threaten the group's goal of consensus-based actions. And the SCO is still slowly developing its bureaucratic structures and mechanisms for cooperation. Indeed, maintaining progress on joint activities in any multi-actor realm may be a more challenging hurdle than the initial decision to work together (Boland 2011: 17).

China and Russia, as overwhelmingly stronger members, coupled with the unstable Central Asian members, represents a situation of unequal membership. Moreover, the interests of the SCO member states continue to conflict with each other in some areas. Kazakhstan and Kyrgyzstan have serious reservations about the policies of Uzbekistan (Blank 2005). The conflict of interests among the SCO members is more pronounced in the energy sector. For instance, the Russians are interested in promoting the Trans-Siberian railway as a main connecting link between Asia and Europe. The Chinese are said to prefer the southern route to Europe across Central Asia-Trans Caucasus-Turkey to the Mediterranean coast. This route, argues Bakshi (2002), provides China's western region with "a new geo-strategic importance."

Traditional division of labour within the SCO is reflected in Russia's security agenda, and in China's economic sphere. However, according to Kizekova (2012), this division is undergoing a readjustment, where the two larger member states generate initiatives in economic and security areas. The SCO's mechanisms provide a flexible framework for their evolving Central Asian policies, minimizing the necessity to compete in these spheres, especially since China has become Russia's major trading partner. Moreover, as Trenin (2004) argues, the SCO is already a framework in which Russia and China have reached certain compromises on potentially prickly issues. The progression of the SCO agenda has been interpreted as a tacit agreement between Moscow and Beijing, whereby Russia maintains its central role in the security and political spheres in Central Asia and China takes the lead in economic development.

Central Asian states also perceive their interests and the role of the SCO differently. Uzbekistan and Kazakhstan want to play an important role in the region and consider the SCO's prestige as helpful in enhancing their own prestige. Kyrgyzstan and Tajikistan, on the other hand, consider their participation in the SCO as a tool for resolving domestic issues of economy and stability. According to Zhuangzhi (2004), Kyrgyzstan particularly co-relates its "domestic stability with security cooperation within the SCO framework". Such perceptual differences do influence the level of participation and interest of member states in the organization. Different mechanisms have been agreed upon but not yet finalized. Central Asian states also need to find a balance between their foreign policies and the process of regional cooperation as the tilt towards either of them can affect cohesion of the organization. Until the recent past, Central Asian states' short-term security priorities did not match with SCO's long-term developmental strategy. Gradually, however, they have started to express greater interest in the latter.

Central Asian states' internal politics also has had serious implications for the SCO-led regionalism in Central Asia, which has so far been a state-centric process without the involvement of civil society. Regional dynamics are being defined by interactions between "highly personalized regimes" rather than civil societies. Central Asian leaders do not seem to be fully committed to the agendas of any regional organization that may affect their 'ability to act unilaterally" (Bohr 2004: 498). Bailes and Dunay consider the SCO's record as "weakest or downright negative in respect to good governance and democracy building: and this may also be its Achilles heel in practical terms, since reliance on repressive methods, including attempts to block outside influence, will make Central Asian societies and regimes more rather than less fragile" (Bailes and Dunay 2007: 28).

The SCO's second challenge is economic. Despite being resource-rich, all of the Central Asian states are economically under-developed. Consequently, they expect China and Russia to provide for their economic development (Zhuangzhi 2004). However, China and Russia can spare limited financial and economic resources. Steps, such as a Chinese proposal in 2010 to supply USD 8 billion of the Development Fund's suggested USD 10 billion price tag (Zhao 2010), are nevertheless being taken to follow up on financing projects with an emphasis on funding transit proposals across the region. Chufrin (2007) mentions additional bottlenecks. In the energy sector Central Asian states have focused on import-substitution rather than regional trade. Limited land, rail and air links within Central Asia are also a major constraint on intraregional trade.

However, according to Knyazev (2012), neither the political/military nor economic potentials of cooperation in the SCO framework have been fully unlocked so far. Several factors could trigger 'seamless' economic integration within the SCO. The group's mechanisms of integration in the spheres of politics and security should serve as solid guarantees of shared economic success. The SCO's economies are in various regards complementary and structurally open to an efficient division of labour. The SCO as a whole sits on exceptional energy reserves. Finally, the SCO countries have considerable research and development, and industrial capacities along with skilled and relatively cheap labour.

The third challenge facing the SCO is institutional, as the organization still needs to create viable mechanisms for dealing with issues like dispute settlement and, to some extent, membership. There is no permanent body to settle disputes among the SCO member states. Article 22 of the SCO Charter stipulates no alternatives for dispute settlement other than negotiations and consultations (Al-Qahtani 2006). Likewise, the SCO does not have any institutional mechanism for crisis management. Whilst the democratic upsurge of 2005 affected its Central Asian members, the organization could not do play any role in managing the ensuing crisis due to its principle of non-interference in the domestic affairs of its members.

Moreover, for almost a decade, the SCO Charter did not have any provision for accepting new members. Its four observer states were admitted under the regulations for SCO observers approved at the 2004 Tashkent summit. It was at the June 2010 SCO summit in Tashkent that the rules on accepting new member states were finally approved. The membership criteria set by these rules request that SCO's new members are Eurasian nations, have diplomatic relations with all of its member states, and have either observer or dialogue partner status. The rules also stipulate that would-be member countries must not be subject to UN sanctions, or be involved in any armed conflict. These conditions effectively ruled out membership for India and Pakistan due to their lingering dispute over Kashmir. As SCO observer they had long desired full membership. However, in November 2011, Russia and China voiced support for the SCO membership of both nations (Blagov 2011). The organization's two major powers were hence prepared to forego institutional constraints for the purpose of expanding the scope of SCO activities to South Asia. India and Pakistan were finally accepted as full members at the SCO summit in Ufa, Russia, in July 2015. Aside from geopolitical considerations, argues Contessi (2011), such membership enlargement could offer the organisation significant leverage to promote regional influence and stabilization.

Finally, repeated assurances by the SCO's leaders that their organization is not an anti-US/West security alliance may have contributed to assuage US/Western fears about its future role in Central Asia in some form or another, but not fully. According to Kizekova (2012) when assessing the future of the SCO and who is in the driver's seat observers often infer that it is an anti-US and anti-NATO organization. Such conclusions, however, disregard the fact that both the United Nations and the United States recognize the role of SCO in assisting with a spectrum of security issues in Eurasia including the greater Black Sea region and Central Asia. As Collins and Wohlforth (2003) argue, although elements of rivalry and competition shadow some relationships, shared strategic interests dominate the concrete actions of the major powers to a remarkable degree. Sustaining this state of affairs, however, may require consistent effort on the part of the SCO leadership to reassure the US-led West, that the organization is geared only towards achieving greater security and economic development of Central Asia. In other words, the SCO's image needs to evolve more closely with the organization's political principles and agenda. This should not be a difficult task because the era of globalization and terrorism has seen growing compatibility in the interests of great powers. For both Russia and China, maintaining friendly ties with the United States are economically quite crucial. The same applies to the United States, which has credible stakes in its investment in China. China and Russia attach as much importance to countering terrorism as does the United States. So do the Central Asian states, which are free to foster bilateral ties with extra regional powers such as the United States and NATO. Moreover, if the SCO-level cooperation leads to regional trade liberalization, why should it bother the United States or the European Union?

6.6 Conclusion

Contrary to Western apprehensions, the SCO has not become a dominant regional powerhouse. Instead, it has carved out a significant role for itself as a forum for regional cooperation on specific issues. The SCO has no doubt reinforced an enhanced level of understanding among the member states that a multitude of problems they face can only be solved through mutually beneficial regional cooperation. It is therefore no surprise that, within a relatively short span of time, the SCO succeeded in creating basic structural and legal foundations for regional cooperation, enhancing security and defence ties, especially to counter terrorism, strengthening economic, trade, communication and transportation links, harmonizing political relations between the member states and enhancing the organization's regional scope and international standing.

Despite a multitude of challenges facing the SCO, the prospects of enhanced regional economic cooperation in Central Asia under its auspices are bright for pragmatic reasons. The economically impoverished and landlocked but resource-rich Central Asian countries need an outlet for economic development. This outlet is being provided by China and Russia, which have their respective strategic interests in benefiting from the region's hydrocarbon resource potential and increasing their global economic and political clout. It is therefore mutual compatibility of economic interests that has paved the way for harmonization of political relations and foreign policy priorities among SCO member states. India and Pakistan are new entrants, but the SCO offers a chance to them to resolve their lingering disputes for the sake of benefitting from Central Asian regionalism.

The great power status of Russia and China notwithstanding, the decision-making process within the regional bloc has been mostly consensual. The SCO actively sought partnership with other international groups, and did not pursue a rigid trajectory in its evolution and a zero-sum approach in its thinking. Thus, its portrayal as an anti-Western bloc operating within the context of the 'new great game' in Central Asia is questionable. The SCO model of regional economic cooperation emphasizes the commonality of context, approach and political system among the member members, different from those shared by Western liberal democracies. Since this denotes the importance of creating a regional institution in line with the nature of the nation states and values specific to a region, the SCO is more relevant to the regional economic cooperation process in the developing world. The internally consensual character, flexible trajectory, and externally transparent outlook and welcoming approach of the SCO may enable it to build upon its previous successes and overcome current challenges. The organization's growing attractiveness for countries outside Central Asia, vying for direct affiliation or closer collaboration with SCO, is testament to its future viability and growth as a regional organization.

Though the SCO has a lot to accomplish in the foreseeable future it needs to settle institutional issues pertaining particularly to dispute settlement and crisis management. The SCO members have to compromise on the remaining areas of conflict between them, and give greater priority to the organization's collective developmental goals over their specific national interests. Perhaps the greatest challenge facing the SCO concerns the economic sector. Several economic cooperative projects have been identified, but without a follow-up agreement. Many agreements remain to be implemented. The SCO needs to move beyond pronouncements to concrete action and funding in the economic arena. Moreover, the geopolitics of Central Asia revolving around regional conflicts such as Afghanistan necessitate the SCO leadership's sustained image-building campaign. In sum, the SCO has to tackle all of these challenges in order to enhance its international standing as a more credible and viable setup of formal regional integration in Central Asia and beyond.

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Chapter 7
China's Rising Power in Southeast Asia and Its Impact on Regional Institution-Building: Who Is Leading Whom?

Marco Bünte

Region: Southeast Asia, China

7.1 Introduction[1]

China's rise is generally seen to be the most important event of the early twenty-first century. It has profound global and regional implications. China is expected to overtake the United States economically in 20–30 years' time. China already has a leading role in world affairs, signified inter alia by its permanent seat in the United Nations Security Council and the role in the G20 and G77. The world increasingly looks to Beijing's factual or potential leadership to solve world problems such as climate change, financial crises and violent conflicts. But how will China use its capabilities and growing leverage in world politics? What impact will this have on regional institution building?

This article will try to answer these questions using Southeast Asia as a test case. In Southeast Asia, China's growing power is already a reality. The region has often been viewed as China's backyard due to its geographic proximity and cultural affinity. The region has also a long history of Chinese dominance. Southeast Asian

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countries lived in the shadow of the middle kingdom for centuries with China acting as a tributary power (Stuart-Fox 2003). Some scholars believe that Asia's past will also be its future, since China is repositioning itself as the central actor in the region with consequences for both the US as the main external power and the whole regional political architecture. David Sutter links China's rise to the potential emergence of an "inside-out" model of regional governance, which might be displacing the past half century's "outside-in" model of the United States through its regional allies" (Sutter 2008). Others see the Association of Southeast Asian Nations (ASEAN 2012) still in the driver's seat in moderating great power relations in East Asia (Acharya 1999). In this article I argue that China increasingly sets the rules in this world region. Competing with Japan and the US over regional Leadership China forges strategic links to Southeast Asian neighbours in terms of investments, trade relations and aid. China also increasingly engages in multilateral cooperation and sets up respective initiatives to manage international problems. This should not be taken as a preference for multilateralism per se, but has to be seen in the light of China's core interests of regional stability and resource seeking. The ASEAN states make room for a rising China as they benefit from increasing trade and stability. Due to the different interests of ASEAN, China's rise brings also the potential for greater conflict in inner-ASEAN relations. The argument is developed by linking theories of regional powers, leadership and regionalism.

7.2 Regional Powers, Regional Leadership and Regionalism

World regions play a larger role in International Politics and increasingly define the international system (Buzan and Weaver 2003; Godehard and Nabers 2011). Consequently, the topic of regionalism has become an increasingly studied one in International Political Economy and International Relations. Regionalism is also a contested concept with different meanings in the discourses of Economics and International Relations. In this short section it is therefore imperative to outline the conceptual underpinnings of the concept of regionalism and connect it to the term regional leadership, which also has come to prominence in recent years. I follow the broad definition used by Chris Dent who understands regionalism as "the structures, processes and arrangements that are working towards greater coherence within a specific international region in terms of economic, political, security, socio-cultural and other kinds of linkages" (Dent 2008: 7). Dent further distinguishes between regionalisation, defined as concentration of movements from below, which are private or driven by society, and regionalism as public policy initiatives undertaken by states. The latter is termed "political regionalism", that is 'integral formations of transnational policy-networks, the expression of shared political interests among the region's leaders, advancements in policy co-ordination and common policy enterprises, and the creation of regional level institutions to manage any common political sphere" (Dent 2008: 7).

This form of regionalism, however, has to be linked to agency, which means that states have to be willing to create or engage in such international fora or institutions. This requires leadership, which helps to set the rules and organize these institutions. The interplay between regional leadership and regionalism has hardly been looked at. According to Hurrell, "International institutions are not just concerned with liberal purposes of solving common problems or sharing shared values. They are also sites of power and reflect and entrench power hierarchies and the interests of powerful states" (Hurrell 2004). There are two ways to analyze the link between a state's foreign policy and regionalism: materialist and constructivist. The materialist school developed hegemonic stability theory as a way to link power distribution with the creation and stability of international institutions (e.g. Kraser 1985; Strange 1983) and be able to connect to the idea of leadership in international relations. According to this approach, international institutions are usually created or prevented by dominant powers during periods of hegemony. It would be rational for a hegemon to use his power in the interest of the system as a whole, because his immense power only exists relative to the system context, in which it is embedded. According to hegemonic-stability theory, a (regional or global) hegemon can keep up peace and stability of the international system and make available other public goods, e.g. in the international economy (Gilpin 1981; Keohane 1989). According to this view, there are three requirements for long-term hegemony: the willingness to gain military power and the readiness to use military force to solve international conflicts: the support for the institutionalisation of a regional and/or global free trade system and the provision of a stable and liquid reserve currency for foreign market participants; and the willingness to act as lender of last resort in financial crisis. However, attempts at assessing the hegemon's importance for the provision of public goods have brought no support for hegemonic-stability theory (Keohane 1984; Mansfield 1994; Russett and Oneal 2001). Hegemony might be periodically effective in providing public goods, but in the long term it characterizes an international system that is inherently unstable and highly vulnerable. It is thus one aim of this chapter to shed light on China's willingness and role in providing public goods such as free trade and security in Southeast Asia.

In a similar vein, power transition theory gives us important insights. The theory makes three basic arguments (Organski 1968; Organski and Kugler 1980; Kugler and Lemke 2000; Lemke 2002): Firstly, the development of the prosperity of nations has important consequences for international politics; second, the international system is characterized by hierarchy rather than anarchy; and, thirdly, relative power and evaluations of the international *status quo* are important determinants of interstate wars. What sets power-transition theory apart from realist thinking is the emphasis on the international implications of domestic growth (Bussman and Oneal 2004: 5). Especially the realist version outlined by Kenneth Waltz takes a much more static view of the power of states, accentuating instead the structure of the international system and treating states as black boxes. Another difference arises from the concept of order in the international system. Whereas neorealism points to the negative impact of anarchy on the degree of international coordination, power transition theory maintains that the international system is hierarchically organized since the leading state "orders, adjusts and allocates" (Siverson and Miller 1995: 59). The theory also argues that there are regional sub-hierarchies, located within the global hierarchical structure (Lemke 2002). The actions of regional powers are constrained by the requirements of the regional hierarchy as well as the actions of global leaders and global major powers. In contrast to the theory of hegemonic stability, power transition theory stresses that hegemonic states gain from their predominant position and that they distribute private goods to their allies to secure their support for the institutions they have established. Power transition asserts that the dominant state maintains its compelling power above all through the allocation of private benefits to its allies, not through the provision of public goods – military stability, liberal trade, etc. – available to all states (Bussman and Oneal 2004: 3). Hegemonic stability theory and power transition theory agree that superior capabilities are the best way to assure peace and prosperity, but they disagree whether the leading state seeks the help of others by creating public goods or distributing private benefits.

Both theories ignore the mechanisms of transforming material capabilities into political outcome, the exchange of ideas and socialisation. Oran Young introduced the concept of leadership from a behavioural perspective, differentiating between three forms of leadership – structural leadership, entrepreneurial leadership and intellectual leadership. Young makes three basic claims: First, leadership is essentially relational which means that leaders have also to find followers who are willing to follow. Structural leadership aims at translating power capabilities into bargaining leverage by making material threats and promises. Second, a leader will be able to act as agenda setter, showing innovative solutions to overcome deadlocks. Third, leadership is a reflective process, which involves the exchange of arguments. It implies the "power of ideas to shape the intellectual capital available to those in institutional bargaining" (Young 1991: 300). To integrate other sources of leadership into the model developed here, one has to ask how material sources are turned into power. There are two ways to exercise leadership. The first refers to material incentives, falling in the range from economic sanction to military strikes on the negative end and promises of reward on the positive end. These methods aim at reversing the costs and benefits of potential followers in pursuing alternative policies. The second means of showing leadership relies on the modification of basic belief systems in other nations (Ikenberry and Kupchan 1990: 285). The two ways of articulating leadership are interrelated and reinforce each other in the political process.

In sum, two facets of leadership that will guide the following empirical investigation may be summarized at this point: First, material capabilities (wealth, population, economic growth, military strength) are possible sources of power. Regional leaders can either distribute public goods among their followers (military stability, a liberal trading system) or private benefits (financial contributions, development aid, FDI etc.) to influence other actors' ideas. The first aspect stresses the significance of material capabilities, while acknowledging the relational and political character of international relations. The second illustrates that leadership is often disputed and constituted by shared ideas about self, other, and the world, relying on the intersubjective internalisation of ideas, norms, and identities. Leadership must therefore not be conflated with dominance. Leadership also involves persuasion, exchange and transformation. It is a form of power, but it implies mutuality. To quote Burns: "Leadership over human beings is exercised when persons with certain motives and purposes mobilize, in competition or conflict with others, institutional, political, psychological, and other resources so as to arouse, engage, and satisfy the motives of followers. This is done in order to realize goals mutually held by both leaders and followers." (Burns 1979: 18, emphasis in original).

What is significant in this definition is that leadership is competitive; potential leaders have to appeal to the motives of potential followers. Leaders might be able to get potential followers to see the world through their eyes. In contrast to mere power holders, leaders are effective because they induce change. Leadership, again in contrast to brute power, is inseparable from the wants and needs of followers, but these wants and needs may be changed through social interaction. Material capabilities and the distribution of benefits can influence intersubjective understandings. Certainly, material conditions, such as the existence of nuclear capabilities, have both constraining and enabling effects on actors' behaviour and define the costs and benefits of alternative actions, as Wendt (2000) and Wight (2006) have emphasised from an IR perspective: "in acknowledging the independent effects of material conditions it is also important not to lose sight of the discursive conditions that invest them with meaning" (Wendt 2000: 166, emphasis in original).

Conceptualizing leadership in this way also opens the view for leaders who operate below the global level, thereby overcoming a major limitation of hegemonic stability theory, which suggests that hegemons are scarce in regional affairs as well as in particular issue areas. While hegemony is an extreme case, an advantage of the approach developed here lies in its neutrality with regards to geographic scope or dimension of subject area. Most importantly, though, power can be analysed by focusing on both material capabilities and foreign policy strategies. Both the impact of material capabilities on intersubjective understandings and the role of a prospective leader's vision in this process can be analysed within this framework. The following analysis will show us where intersubjectivity exists and where it does not, thereby unveiling the ability of China to act as a leader in the region and revealing the fields where China's leadership is not accepted.

7.3 China and Southeast Asia: Strategic Leadership, Increasing Influence

Since the end of the Cold War China has increasingly engaged with various regional actors. Based on a set of new policies such as the open door policy (1980), the Good Neighbour policy (1990) and the Going Global strategy (2002) the Chinese government has invented a new foreign policy. China's long term vision of a 'peaceful rise' presented in 2003 was especially directed at its Asian partners in order to reassure them that China will not seek hegemony. Li Junro, Vice-President of the Central

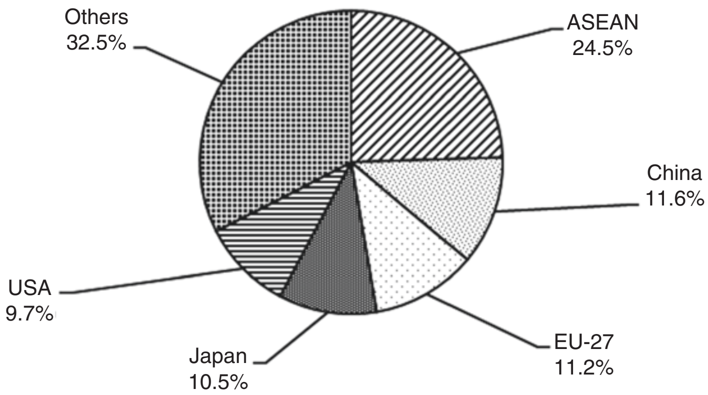

Fig. 7.1 China's Role in ASEAN Foreign Trade in 2009 (in percent) (Source: Own calculations based on IMF Direction of Trade Statistics 2009)

Party School stressed that: "China's rise will not damage the interests of other Asian countries. That is because as China rises, it provides a huge market for its neighbours. At the same time, the achievements of China's development will allow it to support the progress of others in the region (Zan 2004). In her analysis of China's rise in Southeast Asia Elizabeth Economy (2005: 413) acknowledged the peaceful-rise strategy as a diplomatically skilful move to reassure those unsettled about China's rapidly growing economic and military strength. To further its own interests in the region the Chinese government applied a mixture of policies, which include trade cooperation, confidence building measures and development aid. This strategy contributed to a new, more positive perception of China among Southeast Asian countries (Shambaugh 2005: 65). Diplomatic ties between China and Southeast Asian countries improved considerably. Consequently, in the current competition among the US, Japan and China for regional influence in Southeast Asia, China appears to be the most active power (Dosch 2010).

In a number of areas China has already become more important for ASEAN than Japan which had traditionally been the largest trading partner and biggest donor of ODA for Southeast Asian countries. As we will see in the course of this section, China distributed public as well as private goods to the countries in Southeast Asia, thereby tentatively underpinning the theoretical link between wealth and foreign policy as suggested by power transition theory. For ASEAN, in 2009, trade with China, as shown in Fig. 7.1, ranked second behind intra-ASEAN trade. While intra-ASEAN trade made up 24.5 percent of total trade, China's share amounted to 11.6 percent, followed by the EU-27 (11.2 percent), Japan (10.5 percent) and the USA (9.7 percent). While the EU was more important as the final destination for ASEAN exports (EU share of 11.5 percent) than China (10.1 percent), imports were larger from China (13.3 percent) than from the EU (10.8 percent). China's bilateral trade with individual ASEAN member states increased significantly in the last

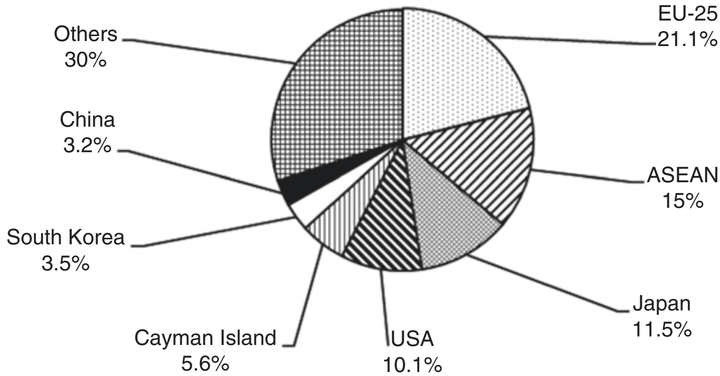

Fig. 7.2 Sources of Foreign Direct Investment Flows to ASEAN, 2007–2009 (in percent) (Source: Own compilation based on Association of Southeast Asian Nations (ASEAN 2012): ASEAN Statistics)

decade, and China became one of the top trading partners for most of the ASEAN member states (IMF 2009).[2]

Foreign direct investment (FDI) from China to Southeast Asian countries surged as well. Out of total inflows to ASEAN in 2008 and 2009, China, as illustrated in Fig. 7.2, ranked number seven with a share of 4.3 percent and 3.8 percent respectively. From 2007–2009, FDI inflows from China amounted to USD 5.3 billion, representing a share of 3.2 percent of total inflows. Official statistics on FDI, however, even seem to underestimate China's involvement in ASEAN. Given the fact that a growing share of China's global FDI outflows is directed at offshore financial centres such as the Cayman and British Virgin Islands and Hong Kong, we can expect that China's de-facto investment activities are much larger. Counting the FDI flows from China, Hong Kong (2.8 percent in 2007–2009) and Cayman Island together, the total share would come up to 11.6 percent, overtaking Japan as the third largest investor in 2007–2009. Even when cutting this estimate by half, China would be the fourth largest investor behind the USA. In some of the smaller ASEAN neighbour countries, investment from China has become crucial for the transportation infrastructure and in the energy sector.

Economic incentives to induce followers to change their policies also played their part. China has become an important donor country for the less developed countries in the ASEAN, especially Cambodia, Laos, Myanmar and Vietnam. Development cooperation seems to be based on the principle of creating 'win-win' situations by offering no strings attached to project financing, while supporting the market entry of China's companies. However, Japan is still the most important of the top 10 donor countries for Cambodia, Indonesia, Laos and Vietnam in the period 2000 to 2008. In the period 2000 to 2008, Cambodia registered a total of about USD

[2] For more details on the development of merchandise trade between China and ASEAN member-countries (based on UNCOMTRADE data) see also Chen, Chap. 2, in this volume.

486 million ODA-comparable Chinese aid. According to official statistics from Laos, Chinese ODA-comparable aid accounted for about USD158 million between 2000 and 2007 (Schüller et al. 2010: 3). This finding might suggest that leadership is always competitive, and that China is not alone in its strive for leadership in the region. However, if we include China's contributions into the pattern of aid provision by DAC donors, the picture changes considerably. In 2007 and 2008, displacing Japan, China became the largest donor to Cambodia. The Chinese aid commitments also changed the sectoral distribution of total aid commitments to Cambodia, due to its concentration on the transport sector. In terms of the sectoral distribution of Chinese assistance to Southeast Asian countries, other authors also point to the importance of transport infrastructure (rail, roads), construction works (such as buildings for ministries, parliaments, conference centres and sports stadiums) and the social sector (health, education) in China's aid to the region (Woods 2008: 12).

In October 2009, China announced to set up an ASEAN-China Investment Cooperation Fund in the form of a private equity fund for the support of infrastructure projects, energy and information technology with a volume of USD 10 billion. Complementary to this initiative, the Chinese government wants to establish an ASEAN loan programme of USD 15 billion. Although the terms of the loan programme were not made public, it is said to include USD 1.7 billion loans at preferential conditions. In addition, China will offer special aid to Cambodia, Laos and Myanmar as the less-developed ASEAN member countries amounting to USD 39.7 million (RMB 270 million) and donate 300,000 tons of rice to the East Asia emergency rice reserve (McCartan 2009). Disaster Relief and humanitarian assistance to ASEAN were two areas of development cooperation in which China was already quite active. Besides a loan of USD 1 billion to Thailand during the 1997 Asian financial crisis, China has offered help in the form of relief material and cash for the tsunami-stricken countries (Zhang 2007: 260–61).

What is true for trade and investment also applies to the provision of a stable and liquid reserve currency for foreign market participants and the willingness to act as a lender of last resort in financial crises, as one major prerequisite for sustained regional leadership. In this sector, the Chinese role vis-à-vis Japan seems to be less significant. Early on, Chinese president Jiang Zemin reassured neighbouring countries that his government would "adopt a positive attitude towards strengthening financial cooperation in Asia and [be] ready to participate in discussions on relevant mechanisms for cooperation" and promised that certain "practical moves on our part will promote the development of economic and technological cooperation as well as trade and investment liberalisation in the Asia-Pacific region" (FMPRC 1997). Similarly, Japan announced it would play an active leadership role to counter the crisis. Comparable to the trade sector, the starting signal was given for a quest for leadership in the region that turned out to be the dominant feature of East Asian international relations in the years to come.

At the height of the crisis, Japan came up with an initiative to set up an Asian Monetary Fund (AMF), which was not realized due to opposition from the West, especially the USA. It was also immediately rejected by other Asian countries, most loudly by China. Contending that such an institution would be redundant given the presence of the IMF and that it would foster a split between Asia and North America, the proposal was buried for the time being (Kwan 2001: 11, 22–23, 127). However, Japan subsequently announced bilateral assistance plans such as the New Miyazawa Plan, worth USD 30 billion, and special yen loans, amounting to JPY 650 billion (Japan Times, 14 July 2001). It was much later that China successfully played an equal part in the finance sector. The prime example for this novel endeavour is the multilateralization of the Chiang Mai Initiative (CMI) that was implemented in February 2009 and served as the core of the AMF that was boldly proposed by Japan in 1997. The 13 ASEAN + 3 countries agreed that they would expand the regional currency swap arrangement to up to USD 120 billion. While the size of the fund stood at USD 80 billion before, China and Japan engaged in a contest over which country would offer more to enhance its liquidity. In an immense effort of symbolic value, both governments decided to pay an equal amount. Both Tokyo and Beijing contributed USD 38.4 billion to the pool, while South Korea supplied another USD 19.2 billion (BBC Monitoring Global Newsline Asia Pacific Economic file, 3 May 2009).[3]

China's attempt to become the regional leader is also supported by its soft power politics. Kurlantzick (2007: 1) defines soft power as a country's ability to influence by persuasion rather than by coercion. With the exception of security policy, soft power politics in the broad sense covers all other elements in the relationship between countries, including trade, investment, aid but also cultural initiatives. In China's soft power politics both government and non-government actors are involved, but Kurlantzick has emphasized that specific government guided policies and strategies can be identified. The spreading of Chinese culture through language teaching is one of the most prominent activities. By January 2010, some 18 Confucius Institutes have been set up in Southeast Asia. Besides language teaching, these institutions represent cultural centres offering lecturers on Chinese economic development, Chinese films etc. Confucius Institutes are often located at universities that are interested in the support of China studies. In Southeast Asia most of the Confucius Institutes can be found in Thailand, which belongs to the more developed ASEAN member countries.

Another instrument of soft power politics is the exchange of students. In the period of 2003 to 2005, the number of students from ASEAN member countries in China increased quickly. Most students were either from Vietnam or Myanmar. In 2009, the total number of international students enrolled in Chinese universities amounted to 238,184. These students came from 190 countries – an increase of 6.7 percent compared to 2008. The Chinese government has also increased its scholarship programs and has offered 18,425 scholarships in 2009. Most of the international students came from Asia (161,605 or around 68 percent). Among the top 10 sender countries were South Korea (64,232), Japan (15,409), Vietnam (12,247), Thailand (11,379), India (8468) and Indonesia (7926). The Ministry of Education plans to further increase the total number of international students to 500,000 by 2020 and become Asia's top destination for international students. At the same time, the

[3] See also Loewen, Chap. 5, in this volume.

Chinese government scholarships will be extended to more international students from developing countries. The long term vision of China *vis-a-vis* ASEAN in terms of cooperation in the educational sector has been presented by Liu Yandong, Chinese State Councillor, at the opening ceremony of the first China-ASEAN Education Minister Roundtable at the beginning of August 2010. Liu proposed to "study the feasibility of educational integration at a proper time to ensure the supply of skilled people for the development of the China-ASEAN Free Trade AREA". In addition to the exchange of students, Liu Yandong pointed out, the recognition of academic degrees is necessary. The expansion of the international broadcasting of the Chinese Television is another instrument of soft power politics. Southeast Asian states are a market for both Chinese films and information. Within the framework of media cooperation between China and ASEAN countries, China Central Television (CCTV) offered to use its news for international news broadcasting, and the Chinese News Agency Xinhua organizes training classes for ASEAN journalists.

Thus, beside trade and investment, Chinese culture is becoming increasingly important as an instrument of soft power politics. Ethnic Chinese living in ASEAN countries represent another element of this policy. One can therefore state that China's position as a provider of public and private goods has been growing along with its economic importance globally and in the region. In sum, China is increasingly acting like a traditional big power. Beijing has become increasingly involved in Southeast Asia over recent years and increasingly sets the rules of the regional game. China's new foreign policy placed also a high priority on regionalism (Shambaugh 2005; Ku 2006; Ba 2003). This form of regionalism can be characterized as comprehensive regionalism since it covers a multitude of multilateral regional cooperation initiatives in Southeast Asia. The latter does not only include ASEAN but also sub-regional cooperation initiatives such as the Gulf of Tonkin economic cooperation (Pan Beibu) and the Greater Mekong Sub-region (GMS) initiative. With the help of these multilateral institutions China creates a web of economic and political networks and increasingly becomes the driver of regional institution building. This, however, should not be taken as a preference for multilateralism. Instead, China increasingly exerts regional leadership by setting the rules and organizing a growing network of both bilateral and multilateral relationships the fields of economics and security (Bünte and Nabers 2013).

7.4 Advancing Regionalism on China's Terms: The GMS and the Gulf of Tonkin Initiative

China has also been more actively engaged in sub-regional cooperation initiatives in Southeast Asia, namely the GMS and the Gulf of Tonkin (also called Pan Bei Bu-) initiative.[4] While the GMS revolves around China's connection towards Mainland

[4] See also Krahl and Dosch, Chap. 4, in this volume.

Southeast Asian countries, the Pan Bei Bu initiative attempts to strengthen cooperation with maritime powers in Southeast Asia. The GMS initiative represents the sub-regional cooperation of the six Mekong riparian countries China, Laos, Myanmar, Thailand, Cambodia and Vietnam. Whereas the ADB has played a key role in establishing this sub-regional forum in 1992, China has since then increasingly taken the leadership role in the design of the Mekong basin cooperation. The GMS has been directed at facilitating sustainable economic growth and improvement of the standard of living in the Mekong region through trade and investment. Another priority has been the cooperation of public and private sectors related to transportation, especially cross-border roads, as well as power generation and distribution. Another concern is energy security, which is mainly related to the issue of hydropower of the Mekong and dam construction. According to Chinese plans, future areas of cooperation will include energy, telecommunication, tourism, health and human resource development (Bünte and Schüller 2011: 51). China's core interest in the Mekong region is mainly economic. The domestic economic interest is the integration of China's landlocked western provinces and the promotion of border trade with the adjoining countries Burma, Laos and Vietnam. Mainland Southeast Asia is to be developed as a market for products from Yunnan and Guanxi. A further domestic economic strategy attempts to narrow the income gap between the ethnic Chinese Han population and ethnic minorities. The central government in Beijing hopes that an economically emerging West will reduce domestic migration from Western China to the booming coastal cities. Cooperation within the GMS has channelled and institutionalized Thailand, Vietnam and China's respective decades long attempts to pursue sub-regional leadership or even hegemonic ambitions. The GMS is also formally linked with external powers such as Japan, Australia, South Korea, New Zealand and various EU states. The GMS is a loose consultative framework, which benefits from its regular informal meetings and the regular exchange of information. It helps to transform the conflict-ridden sub-region into a peaceful region, which is today more integrated within the structures of global international relations (Dosch and Hensengerth 2006: 276).

Apart from the GMS, China launched the Pan-Beibu Gulf Economic Cooperation Initiative in 2006. It includes the maritime ASEAN states Vietnam, Malaysia, Indonesia, the Philippines, Singapore and Brunei. The driving force behind this initiative is Guangxi province, which is one of the poorer provinces in China and wants to become a transport hub and logistics centre connecting southern China and ASEAN. According to Chinese policy makers this sub-regional cooperation initiative should be based on the extension of infrastructure (ports, shipment, logistics, tourism, finance, investment and trade) and expand towards industrial cooperation and development step by step, including cooperation in other economic and social areas (such as environmental protection, human resource development, technology, health, disaster prevention and relief). Consequently, the provincial government of Guangxi has actively lobbied some ASEAN countries to support this cooperation initiative (Gu and Li 2009: 15). The cooperation approach embraces the idea of "one axis" – the so called Nanning Singapore economic corridor – and "two wings" (the GMS and the Pan Beibu Economic Gulf cooperation). Since the inauguration of the new initiative a number of annual meetings took place in Nanning, the capital of Guangxi. A group of experts was invited to the 2008 Forum to undertake feasibility studies about closer economic and maritime cooperation between China and its maritime Southeast Asian neighbours. A number of infrastructure initiatives connecting Western China with its partners in Mainland Southeast Asia have been launched and completed (Bünte and Schüller 2011: 56). While China's provincial government has intensified this subregional cooperation scheme, some Southeast Asian countries have been so far reluctant to implement some of projects. ASEAN member countries have not voiced any concern against this Chinese regional cooperation initiative. Vietnam and Cambodia in particular are welcoming the closer cooperation on cross-border issues (Hosokawa 2009: 77). However, there are signs that most of the other ASEAN members together are reluctant to abandon its role as a 'driver' in regional integration. With the adoption of the Master Plan on ASEAN Connectivity (Master Plan) in October 2010, the Southeast Asian countries demonstrated that they have their own development agenda. Many of the infrastructure projects listed in the Master Plan overlap, however, with those proposed by China (Bünte and Schüller 2011). This, however, leads to another question: how is ASEAN responding to China's growing assertiveness and leadership? Does it follow?

7.5 China and ASEAN: Who Is Leading, Who Is Following?

We have seen that China is increasingly acting like a dominant regional power. To be accepted as such, it also has to be accepted by the subordinate states – leadership always requires followership. Leadership is constituted by shared ideas and relies on the intersubjective internalisation of ideas, norms, and identities. Leadership also involves persuasion, exchange, and transformation. It is a form of power, but it implies mutuality. China's policy towards the ASEAN partly takes this into account. China's overall approach of closer economic and political integration with ASEAN as regional cooperation can be summarized as follows:

Trust Building ASEAN was initially established as a united front of countries against the communist threat. By entering into an institutionalised interaction with ASEAN, China wanted to demonstrate that a fundamental change in the relations with the Southeast Asian countries has taken place. The participation in the ASEAN security dialogue on sensitive issues such as the South China Sea has been an important signal of trust building (Park and Estrada 2010:11).

Appeasing the Concern of ASEAN Members that China's Economic Rise Would Threaten Their Development In the agreement on the ASEAN-China Free Trade Area (ACFTA) China offered flexibility on sensitive commodities and preferential treatment to the less developed countries within ASEAN.[5] China's concessions included an 'early harvest' provision involving early (though partial) liberalisation

[5] On the China-ASEAN FTA see also Chen, Chap. 2, in this volume.

of China's agricultural sector over 3 years (agriculture being the most important issue in ASEAN's trade relations).

Access to the ASEAN Market Many of China's neighbours have natural resources such as minerals, oil and hydropower that Chinese companies are interested in. In addition, the ASEAN market is becoming more attractive for Chinese capital and consumer goods. Through its Going Global strategy the Chinese government supports the internationalisation of companies from China and their access to the Southeast Asian market (Chia 2004: 65).

Restricting the Influence of Other Regional Powers China's stronger engagement with Southeast Asia can also be related to the country's self-image as the traditional hegemon in Southeast Asia that competes with Japan and the US. While China's policy seems to take ASEAN concerns into account, it is not clear whether Southeast Asian states are really following. Alice Ba points to ASEAN's 'complex engagement' with China, alluding to the non-confrontational, open-ended and informal way of cooperation. She argues that this plays an important part in persuading China to change its ASEAN policy and be more responsive to ASEAN concerns (Ba 2010). Some scholars point out that they are balancing against China, accommodating or even bandwagoning with it (Acharya 1999; Kang 2003; Roy 2005; Ross 2007; Goh 2007). It has, however, also become clear that ASEAN states increasingly take into account Chinese leadership. In interviews both Vietnamese and Cambodian diplomats refer to "win-win situations" in evaluating the cooperation with China – even Indonesian officials use this term, which is often used by the Beijing government to describe their relations towards Southeast Asian states. This is, however, above all related to economic engagement and refers to China's development policy (Bünte and Schüller 2011). In political terms, most Southeast Asian states traditionally hedge against China primarily by accepting the need for a US role in the region. While Vietnam, Laos and Cambodia have been increasingly drawn into the Chinese orbit, they also accept the continued US engagement in the region. Moreover, ASEAN has sought to deepen ties with not only the US but also Japan, Russia and India. The Five Power Defence Arrangements link the region with the United Kingdom, Australia and New Zealand (Roy 2005: 310). This shows that Southeast Asian countries increasingly acknowledge Beijing's leadership, but they also fear Chinese hegemony and attempt to balance it with the US. As Martin Stuart-Fox (2003: 241) put it:

> The ASEAN ten will do all in their power not to provoke China. What they want is to both slow and ease the changing power balance. They want the United States to remain a powerful presence, serving as a balancing force in the regional power equation, and have made this known; but they do not want to be part of any balance-of-power coalition. At the same time, they also want to make room for China.

The reason for this is not only China's proximity and power but also the belief in the genuine strength of ASEAN, which is deemed as the most important organization to mediate and enmesh China into a network of regional contacts (Goh 2007). The South China Sea disputes, however, also reveals that this political balancing might run into problems when it comes to the core of both China's and ASEAN's interests, namely territorial integrity.

7.6 The South China Sea Dispute

The South China Sea conflict is a territorial dispute about the Spratly and Paracel Islands. These are a collection of mostly barren coastal reefs, atolls and sand bars in the South China Sea covering an area of around 70,000 square miles. The area is claimed by China, Taiwan, Vietnam, Malaysia, Brunei and the Philippines. The other major controversy in the South China Sea is the struggle about the Paracel islands that are claimed by China and Vietnam. Except for Brunei all claimants maintain a military presence on some of the islands. The controversy lay relatively dormant until 1988 when China and Vietnam clashed over Fiery Cross Reef. Since then hostilities in the area have regularly erupted, most prominently between China and the Philippines. Although a resolution of the conflict is not in sight, the ASEAN Declaration on the South China SEA of 1992 is often praised as a first step toward a peaceful settlement. Though it is non-binding, most observers and many politicians have expressed their hope that the agreement will bring the claimants to the negotiating table and force the adversaries to refrain from violent actions. Although China signed the Declaration in 2002, it is so far not willing to institutionalize further conflict resolution mechanisms. The Code of Conduct is non-binding and lacks provisions on conflict resolution in the case of armed clashes. It therefore remains to be seen whether ASEAN's multilateral approach and non-binding commitment to the principle of the non-use of force will be sufficient. China has opted for bilateral negotiations and refrains from negotiating on a multilateral basis on this issue. China signed a land border treaty with Vietnam in 1999 and another on the Gulf of Tonkin in 2000, which came into effect in 2004. These bilateral negotiations have reduced territorial disputes between Vietnam and China to the Paracel Islands only. Beijing signed an agreement with the Philippines for joint marine seismic undertaking in the South China Sea to explore the Spratleys for possible oil in 2004. Vietnam joined the agreement in March 2005, when the Vietnam Petroleum Corporation (PetroVietnam), the Philippine National Oil Company (PNOC) and the China National Offshore Oil Corporation (CNOOC) signed a tripartite agreement in Manila to jointly exploit oil and gas resources in the area. This agreement underlines Beijing's preference for bilateralism in areas of its core interests. Samuel Sharpe states accordingly that ASEAN has not been able to establish sufficient leverage to sign a wider code of conduct with China (Sharpe 2003).

Moreover, the South China Sea controversy is increasingly affecting ASEAN as an effective regional organization, as fissures between its members increasingly come to the fore. In July 2012, the grouping for the first time in history failed to issue a joint communique following the ASEAN Foreign Ministers' Meeting in Phnom Pen due to differences on how to reflect discussions in the South China Sea disputes. The Philippines and Vietnam insisted that their clashes with China should be mentioned in the ASEAN Chairman's statement. In April 2012, Chinese and Philippine ships confronted each other over the Scarborough Shoal. The chair, Cambodia's Foreign Minister Hor Namhong, refused to comply, which most observers believe was due to Chinese pressures on Cambodia or Cambodia's dependence on China's aid. This episode is only a snapshot which illustrates that China's rise might endanger ASEAN unity and could lead to a growing rift within the regional organization.

7.7 Conclusion

China's regional leadership has ambiguous effects on regional institution building in general and ASEAN in specific. Rule setting is rather random as China seeks to maximise its interests in the first place and sometimes rather ruthlessly. When it comes down to it, bilateral links are often preferred to multilateral ones. Although Southeast Asia has experienced a growing trend towards regionalism in recent years, China's rise is not the prime driving force behind this. Even if it is valid to say that China increasingly takes part in multilateral fora since the early 1990 or even advances its own sub-regional forums such as the GMS and Gulf of Tonkin initiative, regional institution building is only a by-product of this development. China's interest in regionalism in Southeast Asia is driven by the desire of China's southern provinces to catch up economically with the booming coastal provinces and has to be seen in the light of China's core interests of regional stability and resource seeking. ASEAN states make room for a rising China as they benefit from increasing trade and stability. As ASEAN is trying to link up with other regional powers in order to balance China's rise regional institutions become broader and more inclusive. China's rise encourages ASEAN states to intensify links with the US while at the same time remaining close partners of the Chinese in economic terms. This signifies a rather unstable and fragile system. China's tributary state Cambodia has caused major disconcord in ASEAN which clearly is in the interest of China. This also shows that China's rise increasingly challenges ASEAN's unity and role as driver of regional integration. While China's active integration in multilateral activities has seemingly improved Sino-ASEAN relations in the short run, there is a growing potential for conflict in the long run. China is increasingly exerting leadership in the management of regional order, above all in providing security and economic goods, which is perceived as beneficial by key governments in Southeast Asia – at least as long as it is balanced by the major superpower USA. Most ASEAN states consider an American (military) presence as a decisive contribution to securing the commercial routes in the region. The US also remains an important trading partner for most ASEAN states. Thailand, the Philippines and Indonesia are among the top 25 trading partners of the US. Moreover, the US is by far the largest investor in Southeast Asia, followed by Japan and the United Kingdom. Washington has signed trade and investment agreements with most of the Southeast Asian States. All this reinforces the position of the US in the region, which is still the most important external partner in Southeast Asia and is only gradually challenged by China. ASEAN will continue to pursue a double hedging strategy which is aimed at taking a maximum advantage of both Beijing's and Washington's strong involvement in the region.

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Chapter 8
Comparing Modes of Regional Economic Governance: The Gulf Co-operation Council and the Association of Southeast Asian Nations

Fred H. Lawson

Region: Middle East, Southeast Asia

8.1 Introduction

Surveys of economic integration in the Middle East and Southeast Asia commonly provide lists of regional organizations and groupings that have been set up to promote sustained growth and market efficiency in these variegated parts of the world. Among these can be found the Arab League, the Arab Maghreb Union (AMU), the Arab Co-operation Council (ACC), the Co-operation Council of the Arab States of the Gulf (or Gulf Co-operation Council, GCC), the Association of Southeast Asian Nations (ASEAN) and the Asia-Pacific Economic Co-operation (APEC). These regionalist projects have only rarely been analyzed in a rigorously comparative fashion, whether in the specialist literatures on integration in the Arab world and Southeast Asia or in more general studies of comparative regionalism. More important, existing scholarship on regional economic formations tends to ignore crucial variations in structures, policy-making procedures and developmental trajectories across different cases. Consequently, generalizations concerning the emergence, evolution and prospective impact of regionalist projects tend to be framed more broadly and loosely than one might wish.

Such conceptual shortcomings are likely to get perpetuated and aggravated as scholars set out to explore the dynamics of regional governance (Best 2008; Kahler and Lake 2009; Nesadurai 2009; Yoshimatsu 2010; Foot 2011; Elliott and Breslin 2011). Locating the primary sites of governance on a regional level, identifying the

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key actors involved in managing commercial and financial transactions and disentangling the complex interplay between formal and informal multilateral institutions will require careful attention to often-obscured differences among such superficially similar - but inherently disparate - entities as the ones that can be found across contemporary Asia.

8.2 Types of Regionalist Projects

Regionalist projects in the contemporary world can usefully be categorized in terms of four analytically distinct variables (Lawson 2008): (a) the degree to which multilateral (or supranational) institutions possess the authority to formulate and implement policy, independently of the actions and interests of member states; (b) the rules and procedures that govern decision-making in regional institutions; (c) the extent to which regional institutions provide incentives that might induce member-states to comply with programs that benefit the region as a whole; and (d) the amount of effort that regional institutions put into inculcating higher levels of interdependence among member states.

Operationalizing these concepts is no easy task. There is almost certainly an important difference between regionalist projects whose institutions can effectively and legitimately adopt and implement policies that regulate a significant number of economic matters – including things like trade, investment, labour supply, employment practices and business activities - and ones in which regional institutions exercise authority over none. Given the wide variety of specific matters that has been identified in the literature on regional integration (Lindberg 1970; Nye 1968), however, defining “a significant number” the way that this literature does – as more than half of the matters at hand - seems excessive. In fact, ceding control over as few as two important matters to multilateral institutions would be a remarkable act on the part of self-interested, sovereign states, each one jealous of its own prerogatives and distrustful of others’ intentions. It therefore appears reasonable to recognize three analytically distinct types of regionalist projects: (1) those in which multilateral institutions exercise authority over no major economic issues; (2) those in which multilateral institutions exercise authority over one or two major issues; and (3) those in which multilateral institutions exercise authority over three or more major issues.

How decisions get made in multilateral institutions plays a central role in differentiating regionalist projects from one another. Regional organizations in which programs can only be undertaken if each and every member-state gives its approval have little in common with ones that can adopt and implement policies even if not all member-states vote to do so. It thus makes sense to code decision-rules according to whether policy-making in regional institutions operates on the basis of (i) unanimous consent, (ii) some arrangement whereby a subset of member-states exercises a veto or (iii) majority rule (whether simple or weighted). It is important to remember that characterizing decision-making procedures according to formal agreements and stated procedures may well blind us to how such agencies actually work. In the case of the Gulf Co-operation Council, for instance, it is hard to imagine that any major initiative could be carried out without the support or acquiescence of Saudi Arabia, no matter what the GCC Charter might say. Determining whether or not specific member-states enjoy de facto veto power is more likely to involve informed judgments than iron-clad stipulations.

Incentives that can encourage member-states to comply with regional directives come in a wide variety of forms. The most obvious entail positive or negative sanctions, that is, rewards to governments if they act in accordance with regional interests or punishments if they behave in a self-interested or exploitative manner, respectively. Some (but not many) multilateral institutions command pools of resources, which enable them to confer or withhold sanctions at their own discretion; others possess no resources of their own, and rely on individual member-states to mete out rewards and punishments. Between the two extremes stand regionalist projects that entail arrangements which amplify the benefits of mutual cooperation and make it highly (and cumulatively) unattractive for member-states to defect from the collective interest.

Finally, regionalist projects differ with regard to how dependent member-states become on one another. Even though existing studies measure levels of regionalism in terms of the proportion of trade and investment that members undertake among themselves, it is more instructive to categorize regionalist projects according to how costly it would be if intra-regional trade and investment suddenly vanished. This definition corresponds to the notion of interdependence that is held by most students of world politics, not to mention common sense (Baldwin 1980). Whether or not multilateral institutions are taking steps to promote regional interdependence might well be inferred from official pronouncements, although public statements of intent must always be treated with considerable caution. More perplexing is the question of whether a regionalist project is promoting interdependence only if it adopts explicit programs designed to forge connections whose disruption would prove costly to all member-states, or instead if it simply encourages the emergence of mutual reliance indirectly.

These four attributes offer a promising typology that can be used to identify 54 different types of regionalist projects (Fig. 8.1). A more precise way to distinguish divergent forms of regionalism would be to conceive of each one of these structural features as a continuum, along which particular cases could be situated relative to one another. But since four-dimensional space is almost impossible to depict on a one-dimensional surface, and seems to be just about as hard to visualize, the matrix presented in Fig. 8.1 represents a plausible starting-point for comparative investigation.

8.3 Economic Regionalism and the Gulf Co-operation Council

Situating any particular instance of economic regionalism in terms of the framework laid out in Fig. 8.1 is a tricky intellectual exercise. Even more difficult is the task of explaining why regionalist projects shift from one cell of the matrix to

Number of Areas over which Regional Institutions Exercise Authority	Rules of Decision-Making	Incentives fostering Compliance with Regional Directives: Individual Member-States' Provision of Resources		Institutions that boost Gains from Co-operation		Multilateral Resource Pool	
	Initiatives to increase Interdependence	No	Yes	No	Yes	No	Yes
None	Unanimity	ASEAN 1967	ASEAN 1976				
None	Veto			GCC 1995			
None	Majority Vote			ASEAN 2003-10			
1 or 2	U nanimity				GCC 1981-83		GCC 1991-92
1 or 2	Veto						
1 or 2	Majority Vote			ASEAN 1992			
=3	Unanimity						
=3	Ve to				GCC 2008-10		
=3	Majority Vote						

Fig. 8.1 Types of regionalist projects (Source: Own compilation)

another as time goes by. To illustrate the utility of the typology, I propose to deploy it to chart the developmental trajectory of regional economic governance in the Gulf Co-operation Council (GCC), and then offer some comparative remarks concerning the Association of Southeast Asian Nations (ASEAN).

8.3.1 Early Regionalist Initiatives

Despite the appearance of a handful of multilateral agencies and institutions in the Gulf, economic regionalism among the six smaller Arab Gulf states - Kuwait, Saudi Arabia, Bahrain, Qatar, the United Arab Emirates (UAE) and Oman - remained minimal during the 1970s (Nye 1978; Beseisu 1981; Heard-Bey 1983; Legrenzi

2011: 20–25). Only in the wake of Iraq's September 1980 assault on the Islamic Republic of Iran did regionalist initiatives begin to blossom. In February 1981, the six foreign ministers met in Riyad and appointed a Committee of Experts to work out the precise steps whereby greater economic integration might be fostered. The committee began work later that month, basing its deliberations on two very different proposals. The first, submitted by Kuwait with the backing of Saudi Arabia, envisaged the immediate implementation of a wide range of measures to promote economic unity; the second, sponsored by Oman, accorded higher priority to military co-operation, particularly joint efforts to protect sea lanes in the Gulf. Even after the Committee of Experts opted for the Kuwaiti proposal, a Saudi-sponsored "national security council" for the Gulf took charge of co-ordinating the activities of the six countries' internal security services (Christie 1986: 4, Cordesman 1984: 627). On 24 May 1981, the foreign ministers of the prospective GCC member-states met in Abu Dhabi and nominated an experienced Kuwaiti diplomat, 'Abdullah Y. Bishara, to be secretary general of the organization; the next day the rulers of the six countries arrived in Abu Dhabi to sign the GCC Charter (Document 1983-84a).

Immediately after constituting themselves as the Supreme Council of the GCC, the six rulers promulgated a Unified Economic Agreement (UEA). This document pledged the signatories to establish a uniform system of tariffs on goods coming into local markets, practice nondiscrimination among GCC member-states in regulations governing the flow of capital and labor across their common borders, "co-ordinate their policies with regard to all aspects of the oil industry," harmonize their respective industrial development programs and take steps "to unify investment in order to achieve a common investment policy" (Document 1983-84b). The rapid adoption of the UEA convinced some observers that economic rather than security considerations lay behind the formation of the GCC (Priess 1996: 150). This impression was reinforced by the July 1981 appointment of an activist secretary general to oversee the Arab Gulf Organization for Industrial Consultancy (AGOIC); the new AGOIC head quickly authorized construction of a regional tire factory in Kuwait and aluminum rolling mill in Bahrain, among other collaborative projects. GCC industry ministers met in October 1981 to discuss ways to co-ordinate future manufacturing projects (Legrenzi 2011: 68). Furthermore, the member-states in November 1982 set up a Gulf Investment Corporation to promote complementary strategies for diversification of the regional economy (Al-Fayez 1984–85, Legrenzi 2011: 67).

It seems evident that the GCC at its inception should be placed in the fourth column of Fig. 8.1: the initial agenda of this particular regionalist project contained a handful of measures intended to augment the level of interdependence among the six member-states, and the UEA called for the establishment of a free trade area that was intended to provide incentives for greater inter-state collaboration. It seems equally clear that the GCC belongs in the fourth row of the matrix. The organization's secretariat was accorded considerable leeway to set standards and measures for common use among the member-states (Barnett and Gause 1998: 176), while unanimity was mandated in order for policies to be adopted and carried out, whether by the Supreme Council of rulers or the Ministerial Council of foreign ministers.

8.3.2 Initial Regression

After an early burst of regionalist enthusiasm, economic integration among the GCC states sputtered and stalled. Virtually no effort was made during the organization's first five years in existence to unify the member-states' disparate monetary systems (Hitiris and Hoyle 1986; Zaidi 1990). With regard to commercial affairs, the Ministerial Council in May 1983 recommended the adoption of a common external tariff. By the fall of that year, Kuwait and Bahrain had brought their customs regulations into conformity with the proposed system, but Saudi Arabia, Qatar and Oman pleaded for additional time to reconfigure their customs administrations, while the UAE expressed outright opposition to the revised tariff structure (Middle East Economic Digest [MEED], 9 September 1983).

Furthermore, the winding down of the Iran-Iraq war accompanied a marked resurgence of trade barriers throughout the Gulf. In early 1988, Saudi Arabia raised customs duties from 7 to 12 percent on most imports, while increasing tariffs from 10 to 20 percent on re-exports coming into the kingdom through Port Rashid in the UAE (MEED, 13 February 1988). Bahrain, meanwhile, adopted new regulations that authorized state agencies to discriminate in favor of domestic products, so long as the price differential between locally-produced items and equivalent imports remained less than 10 percent (MEED, 16 January 1988). Even when the six ministers of industry proposed in June 1989 to regularize tariffs among member-states, the proposal ended up being rejected by the six finance ministers, who recommended that different products continue to be treated in different ways (MEED, 2, 9 and 16 June 1989). The Supreme Council endorsed the finance ministers' recommendation, once again delaying the implementation of a unified customs regime (MEED, 12 January and 23 February 1990).

Meanwhile, slumping prices on world oil markets combined with wartime disruptions in trade and finance to create unprecedented economic difficulties in all six member-states. Each government responded to the crisis in a substantially different fashion (Hunter 1986; Lawson 1991). Oil-rich countries pursued sharply divergent strategies inside the Organization of Petroleum Exporting Countries from the ones that were adopted by their less well-endowed GCC partners (MEED, 28 October 1983). Moreover, the August 1982 collapse of Kuwait's unofficial stock market, the Suq al-Manakh, shot a chill through regional financial circles. The ensuing turmoil prompted the central banks of the GCC states to adopt new regulations to govern lending and bookkeeping practices by the financial institutions that operated inside their respective borders. These regulations tightly restricted the flow of monetary reserves and investment capital from one member-state to another (Azzam 1988: 97).

Industrial integration proved no more ineluctible than commercial or financial integration. In the fall of 1984, the AGOIC published a major report on trends in the Gulf cement industry. The report advised GCC member-states to work together in the production and distribution of cement, so as to reduce unit costs and preclude the emergence of surplus capacity in the region. In particular, it urged the UAE "to stop issuing licenses for new [cement] works, and instead concentrate on co-ordinating clinkers supply and grinding capacity [with other countries]," while calling on the Kuwait Cement Company to postpone plans to enlarge its existing plant. Neither government followed the AGOIC's recommendations. Instead, each of the GCC states took steps to expand its own cement industry, "looking for salvation to an early end to the war between Iraq and Iran, and a surge in cement demand to supply reconstruction work in both countries" (Azzam 1988: 148–149). In a similar fashion, as the demand for aluminum surged in regional markets, Qatar, Saudi Arabia and Umm al-Qaiwain in the UAE all announced plans to construct large-scale smelters, which would compete not only with one another but also with existing aluminum plants in Bahrain and Dubai (MEED, 26 March 1988). Conversely, whereas the AGOIC strongly recommended that the GCC take steps to augment regional iron and steel production, the UAE authorities shut down recently opened rolling mills in Abu Dhabi, Dubai and Ras al-Khaimah as soon as they showed signs of operating at a loss (Azzam 1988: 150–151).

8.3.3 Renewed Economic Regionalism

An evanescent spurt of regionalism among the six member-states occurred in the aftermath of the Second Gulf War. As soon as the fighting ended in March 1991, GCC finance ministers authorized the creation of a USD 10 billion fund to support Arab and Islamic countries whose economies had been damaged as a result of the conflict. Responsibility for managing the fund was placed in the hands of a special commission composed of directors of existing Gulf development agencies. The commission's activities were linked to the operations of the World Bank and International Monetary Fund, and preference was accorded to private sector projects (MEED, 3 May 1991). At the end of November 1991, GCC trade ministers met in Qatar to discuss ways to accelerate the formation of a regional customs union; in mid-December the governors of the six central banks announced that they intended to issue a single currency by the year 1999 (MEED, 20 December 1991, Middle East Memo, 30 October 1992). Prospects for a unified currency brightened when Kuwait decided to join the other GCC states in pegging the value of the Kuwaiti dinar to that of the US dollar (MEED, 14 February 1992).

By mid-1992, the postwar flowering of economic regionalism had begun to wither. The Ministerial Council decided in early June to entrust the management of the newly-created assistance fund to the central bank of Saudi Arabia. The council also announced that no regional customs union could be expected to emerge until at least the year 2000 (MEED, 12 June 1992). Since the European Union had demanded that a GCC customs union be set up as a precondition for deregulating commerce between the two entities, GCC ministers of industry advised the secretary general to stop focusing on trade negotiations with Europe and instead "shift our sights to other [regional] groupings in the world" (MEED, 6 November 1992). As external investment in local manufacturing rebounded that fall, Saudi Arabia and the UAE stepped up their efforts to manipulate tariffs as a means of promoting their respective domestic industrial sectors (MEED, 13 November and 4 December 1992). More important, the Saudi delegate to a September 1994 conference of GCC finance ministers reported that his colleagues had "agreed that finding a fixed exchange rate for GCC currencies is no longer the priority it had been some years ago. Since the establishment of the GCC," he continued, "exchange rates have remained stable even without a written accord" (MEED, 30 September 1994).

Nevertheless, the mid-1990s witnessed a renewed outburst of economic regionalism. In September 1994, Bahrain's Chamber of Commerce opened a center for the arbitration of intra-GCC commercial disputes, whose board of governors included representatives from the chambers of commerce and industry of all six member-states (MEED, 9 September 1994). The GCC opted to become a full partner in the International Mobile Satellite Organization at the end of 1994, a move which committed the six countries to permit unrestricted use of cellular telephones across their borders (MEED, 9 December 1994). About the same time, special GCC commissions approved measures that equalized handling charges for the unloading of cargo at local airports and granted GCC citizens the right to buy and sell corporate shares offered in any GCC stock market (MEED, 6 January 1995). The six finance ministers meeting in Riyad in March 1995 agreed to link automated teller machines across the GCC, eliminate restrictions that prevented citizens from applying for loans at GCC banks outside their home countries and "undertake economic activities in the educational field" (MEED, 7 April 1995). Six months later, the AGOIC published a comprehensive prospectus that was designed to persuade European companies to invest in complementary mineral extraction ventures in the six member-states (MEED, 27 October 1995).

Substantial portions of the 1995 and 1996 Supreme Council agendas were devoted to exploring collaborative responses to regional economic problems, particularly the troublesome question of how to generate attractive jobs for the GCC's rapidly expanding population of well-educated young people (Anthony 1996: 167, 176). At the 1997 summit, plans were approved to connect the member-states' electricity grids and allow banks chartered in any one GCC state to set up branches in all of the others (Glubb 1998). The resurgence of multilateralism was even apparent in talks concerning the formation of a customs union. Despite indications in late 1996 that the Ministerial Council had abandoned all hope of adopting unified tariff regulations in the foreseeable future, the project continued to be debated during the course of 1997 (MEED, 8 November 1996 and 11 July 1997). Ironically, the major sticking-point in the negotiations at this point was the UAE's refusal to raise tariffs to match the proposed uniform rate of 8 percent (Middle East Executive Reports, October 1997).

This period of resurgent regionalism along the Arab coast of the Gulf displayed a quite different combination of attributes from the one that characterized the early years of the GCC's existence. Despite the activities of the AGOIC, the organization clearly drifted from the fourth to the third column of Fig. 8.1, and despite sporadic expressions of intent to place authority over a wider range of economic issues in the hands of the secretariat, it is safe to say that policies regarding major economic matters could not actually be adopted and implemented by GCC agencies acting on their own. More important, by the mid-1990s the original decision-making rule of unanimity in the Supreme and Ministerial councils had effectively been abandoned, in practice if not in principle. One or another member state from time to time withheld its consent to some proposed GCC program, without blocking or derailing the overall project of economic integration. Only Saudi Arabia had the capacity and standing to exercise a veto over the adoption or implementation of regionalist initiatives.

8.3.4 Second Regression

Economic regionalism among the GCC states stalled once again as the 1990s waned. Writing in 2001, Humayon Dar and John Presley remark that "progress toward a common external tariff has been very slow despite pressures to present a unified front, particularly over trade with the European Union and as part of a negotiating stance for membership of [sic] WTO for all member states." Furthermore, "after 20 years of operation …the share of intra-regional trade in the GCC has only increased from five per cent in 1982 to a little over seven per cent by 2000." And rather than tending to converge as time went by, GCC regulations governing external trade and investment practices actually diverged from those adopted by individual member-states during the late 1990s (Dar and Presley 2001: 1163–1164).

Measures designed to revive Arab Gulf regionalism were announced periodically, even though none of them generated a sustained push toward economic integration. The *Middle East Economic Digest* (12 January 2001) reported that at the December 2000 meeting of the Supreme Council, the long-debated customs union "was discussed but rejected" and "lip-service was also paid to the establishment of a single currency, which was approved in principle." In January 2001, the GCC secretariat announced that Saudi Arabia and Qatar had finally pledged to implement reductions in duties on a variety of goods produced in other member-states, as a concrete step toward realizing the Gulf customs union (ArabicNews.com, 11 January 2001); at the end of the year, the Supreme Council fixed the projected common external tariff at 5 percent and advanced the date for the inauguration of the customs union from January 2005 to January 2003 (Arab News, 1 January 2002, Legrenzi 2006: 8–9).

Finance, economy and trade ministers from the six member-states gathered in Qatar in December 2002 to put the finishing touches on the planned customs union. The host country's minister of finance emerged from the meeting to report that "all obstacles were removed," and that the union would come into force the following month (Arab News, 16 December 2002). He went on to announce that the GCC intended to set up a common market by the fall of 2010. Nevertheless, the organization's secretary general in January 2004 told reporters that no more than "the first phase" of the plan to establish a full customs union had so far been accomplished, and that a second year-long preparatory phase had gotten underway (Gulf News, 14 January 2004).

Even as the secretary general was speaking, Bahrain and Oman were engaged in negotiating free trade agreements with the United States. Talks between Manama and Washington reached a mutually satisfactory conclusion in September 2004, and the two governments signed a bilateral free trade pact two months later. Saudi officials quickly condemned the treaty, calling it a "clear violation of the GCC's economic accords and decisions" (Agence France Presse, 18 December 2004, al-Momani 2008: 57). But public vituperation on Riyad's part failed to frighten other member-states away from pursuing similar arrangements: Talks between the US and Oman proceeded apace, while the UAE initiated discussions with Washington in February 2005 (Kahwaji 2005). Faced with growing interest in such treaties on the part of Qatar and Kuwait, the Saudi government relented, and in May 2005 the six finance ministers agreed that GCC member-states would be permitted to form bilateral free trade areas with outside countries (MEED, 3 June 2005, Zorob 2013: 189–192).

Economic regionalism suffered a more pronounced setback in December 2006, when Oman unexpectedly withdrew from the initiative to create a single GCC currency. Confronted with Oman's defection, Saudi Arabia's finance minister observed that plans to create a unified currency by 2010 had begun to look overly "ambitious" (Gulf News, 12 December 2006). Five months later, Kuwait stopped pegging the value of its currency to that of the US dollar, in accordance with common practice among the GCC states, and started to peg it instead to a basket of major world currencies (Gulf News, 7 June 2007, Woertz 2007). The combination of these two events left the longstanding plan to introduce a unified Gulf currency effectively "moribund" (Kechichian 2007).

8.3.5 *Regionalism Redux*

On the other hand, the Supreme Council in January 2008 formally inaugurated the prospective GCC common market, which promised to allow the unrestricted movement of goods, capital and labor across the borders of the six member-states (Agence France Presse, 3 January 2008). This new regionalist initiative was predicated on the cardinal principle that any citizen of one member-state enjoys full citizenship rights in all other GCC countries: "The common market thus endows GCC citizens with equal treatment in respect of all economic activities, particularly, movement and residence. It allows GCC citizens to work in private and public sectors in each Member State as well as to receive any applicable welfare benefits such as pension and social security payments" (Puig and Al-Haddab 2011: 317).

Arguably more important, the GCC secretariat announced plans to create an independent tribunal that would possess the authority to adjudicate commercial disputes (MEED, 4–10 January 2008). The new judicial body was envisaged as having the ability to impose penalties on companies and individuals whose actions contravened the terms of GCC economic conventions. In early 2009, the UAE persuaded the Supreme Council to set up a high commission to oversee the implementation of the customs union. The commission was tasked with harmonizing rules of origin across the six member-states, as well as working out a mutually acceptable mechanism whereby domestic producers could be protected against outside competition (Low and Salazar 2011: 21). That May a GCC risk management center was opened in Kuwait, charged with monitoring threats to the region associated with epidemics or other natural disasters (Low and Salazar 2011: 51).

Meanwhile, three kinds of regional infrastructure steadily took shape under GCC auspices. The first was a unified pipeline network to distribute natural gas among the six member-states. Bahrain assumed the leading role in advocating the construction of the pipeline, partly to ensure that its domestic aluminum plants would enjoy a stable supply of natural gas and partly to facilitate the completion of a new fertilizer complex operated by the Gulf Petrochemical Industries Company, a joint venture of the Bahraini government, the Petrochemical Industries Company of Kuwait and Saudi Arabia Basic Industries Corporation (MEED, 30 May-5 June 2008). The second was an integrated regional railway system, designed to stretch from the Kuwait-Iraq border in the north to the Omani port of Salalah in the south and incorporating the most important railroad lines inside Saudi Arabia. As part of this extensive project, which was estimated to cost some USD 25 billion, the proposed causeway linking Bahrain and Qatar was re-engineered to accommodate regular train traffic, so that Bahrain could be brought into the system (MEED, 13–19 March 2009, Kuwait Times, 3 January 2010). The Supreme Council pointedly reaffirmed its commitment to the railway project at its December 2010 meeting.

Third, 2010 saw the inauguration of a unified electrical power grid connecting GCC member-states. Kuwait, Bahrain, Qatar and Saudi Arabia boasted a fully integrated electricity distribution network that spring, and transmission lines across the desert to the UAE and Oman moved into the final phase of construction during the second half of the year (MEED, 9–15 July 2010). At the same time that the electrical lines were laid, fiber optic cables were put in place, opening the possibility that an integrated GCC telecommunications network might at last coalesce. In addition to the unified grid, the GCC secretariat set up a specialized agency, the GCC Interconnection Authority (GCCIA), to supervise the generation and distribution of electrical power across the region. The GCCIA was expected to "act as the regulator and manage the flows of electricity through the network once two [member-]states negotiate a deal" (MEED, 9–15 July 2010). The agency immediately sat down to draw up the terms and procedures that would govern the future sale of electricity among the GCC countries.

Greater regionalist activism emerged as well among the chambers of commerce and industry. Just under 15,000 licenses to conduct business in another GCC country had been awarded to companies in the six member-states by the end of 2005. These businesses gained momentum during the second half of the decade, and gradually transformed the chambers of commerce and industry into outspoken proponents of further economic integration. In October 2011, for example, Qatar's chamber of commerce and industry presented to the Technical Committee for Land Transport of the Federation of GCC Chambers a proposal to form a single GCC land transportation company. Such a company, the Qatari delegation argued, could be expected to "facilitate transport flow, organise cargoes and manage drivers' affairs, such as issuing visas" (Gulf Times, 17 October 2011).

Regionalist initiatives on the part of private companies accompanied an unprecedented jump in investments from one member-state to another. Between 1990 and 2003, no more than USD 3.6 billion had been invested in the Arab Gulf states by local economic actors. By 2009, however, "the amount of cross-border investments [had] increased significantly, especially in the telecom sector" (Shediac et al. 2010: 15). Many of these investments involved mergers and acquisitions: A report prepared by the management consulting firm Booz and Company observed that "intra-GCC [mergers and acquisitions] activity has been quite robust across all industry sectors, growing to USD 26.4 billion between 2000 and 2008" (Shediac et al. 2010: 16). The largest share of acquisitions during these years accrued to companies based in Kuwait and Qatar, while most targets for mergers were located in Saudi Arabia, Kuwait and the UAE. Such investments were given an added fillip by the Supreme Council in December 2010, when it approved regulations that permitted companies based in one GCC country to set up branches in other member-states "on an equal footing with national firms" (Gulf News, 9 June 2011).

By the second decade of the twenty-first century, the GCC had become a much different type of regionalist project from what it had been either at the time it was founded or during the mid-1990s. There remained substantial incentives for the six member states to collaborate with one another, including the gradually developing common market; signal steps in the direction of increased interdependence were being made, both under the auspices of the AGOIC and through the activities of the chambers of commerce and industry. At the same time, unanimity in policy-making had been supplanted by a unitary veto system, while authority over policies concerning regional infrastructure had started to be transferred into the hands of specialized agencies. These trends put the contemporary GCC in the fourth column of Fig. 8.1, and in the eighth row.

8.4 Economic Regionalism and the Association of Southeast Asian Nations

It has become common for scholars of regional integration to compare the GCC's halting and limited steps in the direction of economic regionalism with the deeper and more comprehensive form of regionalism that can be found in ASEAN (Parrenas 1998; Yu 2008; Low and Salazar 2011). Even if one sets aside the misgivings that have been expressed about the extent of economic regionalism that actually exists in contemporary Southeast Asia (Hund 2003; Jones and Smith 2006; Jones and Smith 2007), the evolution of economic regionalism in this corner of the world clearly exhibits moments of heightened integration and periods in which integration has stagnated or regressed. These trends can usefully be compared to the trajectory that one sees in the GCC.

8.4.1 Early Regionalist Initiatives

ASEAN emerged in August 1967 as a regionalist project undertaken by Indonesia, Malaysia, Thailand, the Philippines and Singapore. Although the impetus for the project arose from severe threats to regional security, the founding Bangkok Declaration asserted that the new organization's objectives were "to accelerate economic growth, social progress and cultural development in the region" (Narine 2002: 15). The grouping at the outset exhibited what Shaun Narine (2002: 16) calls "a fairly loose institutional structure," consisting of a forum of member-states' foreign ministers (the Annual Ministerial Meeting), a subsidiary Standing Committee and a collection of National Secretariats charged with co-ordinating the commercial and industrial policies of the five member-states. No secretariat was created to draw up or carry out initiatives that might advance the interests of the group as a whole, and decision-making by consensus (in other words, by unanimous consent) constituted a defining characteristic of the institutional culture that came to be known as "the ASEAN Way" (Narine 1997; Ba 1997; Rüland 2000: 438–443; Acharya 2001; Soesastro 2003: 9).

Little attempt was made by the five governments to boost the level of regional interdependence (Irvine 1982). Malaysia, Thailand and the Philippines all turned away from the programs of import substitution industrialization that they had pursued during the 1950s, but immediately adopted policies that aimed at achieving sustained growth through increasing exports, following the example of Singapore; Indonesia, by contrast, maintained its commitment to import substitution industrialization (Narine 2002: 26). At the start, then, ASEAN exhibited a mode of economic regionalism that can best be located in the first column of Fig. 8.1, and in the first row.

8.4.2 Initial Regression

Political disputes among the ASEAN member-states prevented economic integration from gaining momentum during the first years of the organization's existence. As early as the spring of 1968, Malaysia and the Philippines fell into overt conflict with one another; as a result of the bilateral dispute, "ASEAN meetings were canceled until May 1969, and Malaysia and the Philippines suspended diplomatic contact" (Narine 2002: 19).

8.4.3 Renewed Economic Regionalism

ASEAN heads of state gathered for the first time in Bali in February 1976 to relaunch the organization. The meeting produced the Declaration of ASEAN Concord, which "spent its greatest effort to define areas of economic cooperation, specifying four: cooperation on basic commodities, such as food and energy; cooperation in the creation of large-scale ASEAN industrial projects; cooperation in intraregional trade liberalization; and joint approaches to world economic problems" (Narine 2002: 23). Eight specialized committees were set up, five of which were responsible for dealing with economic matters. The five economic committees reported directly to the economy ministers of the member-states, although their day-to-day activities were supervised by a newly-created ASEAN Secretariat (Narine 2002: 27). Shortly after the Bali summit, the five economy ministers started holding annual meetings parallel to those of the foreign ministers.

On the basis of advice from the United Nations Economic Commission for Asia and the Far East, the organization took steps to deregulate intraregional trade. A year after the Bali summit, provisions were made for preferential trading arrangements to be concluded among the member-states. "However," Narine (2002: 27) points out, "the kind of products that the ASEAN states agreed to include in the PTA[s] were often obscure, and not important enough to truly affect intra-ASEAN trade." Substantial tariffs and non-tariff barriers remained firmly in place, and plans to pursue jointly-owned industrial ventures that would be granted preferential access to all member-states failed to materialize (Ravenhill 1995: 851; Chia Siow 1997: 287–288; Tan 2004: 936). An ambitious scheme to raise the level of regional interdependence, called the ASEAN Industrial Complementation program (AIC), was discussed at the Bali summit, but not approved until 5 years later (Ravenhill 1995: 852; Narine 2002: 28). The first project to be proposed under the terms of the scheme, a plan to make components for automobile manufacture in a co-ordinated way across different countries, did not win the approval of the economy ministers until 1983.

It is often asserted that the 1976 summit marked a decisive step in the direction of heightened regionalism among the ASEAN states. Yet the preferential trading arrangements that were authorized at that meeting left control over regional trade firmly in the hands of the individual member-states, and negotiations among governments continued to dictate the terms under which commercial deregulation took place. Furthermore, the total dominance that state governments exercised over economic planning, policy making and program implementation make it impossible to place the organization anywhere besides the first row of the matrix. On the other hand, the new preferential trading arrangements can be considered a means of inculcating some degree of regional interdependence. The late 1970s, therefore, saw ASEAN move from the first column of Fig. 8.1 to the second column, but remain in the first row.

8.4.4 Second Regression

Economic regionalism in Southeast Asia receded markedly at the end of the 1970s. The annual meetings of the economy ministers failed to displace the Annual Ministerial Meetings as the central forum for deliberations concerning commercial and industrial affairs (Soesastro 2003: 7). Even in the area of automobile manufacturing, where regional integration was most pronounced, "the fact that most ASEAN countries managed to set up their own domestic automotive industries in collaboration with well-known multinational firms from outside ASEAN [pointed] towards a certain lack of trust amongst members in matters involving mutual co-operation" (Chatterjee 1990: 70). John Ravenhill (1995: 853) reports that by the close of the decade, the items that had been granted preferential status under the terms of the various PTAs "amounted to less than one percent of intra-ASEAN trade."

Regionalism stagnated throughout the 1980s, and with the exception of Singaporean investment in Malaysia virtually no intra-ASEAN investment took place (Chia Siow 1997: 282). Persistent rivalry among member-states over the location and shape of proposed collaborative projects eroded the commitment to consensus among governments, and by mid-decade the organization had "adopted the '6 minus x' principle, which allowed individual countries to opt out of participation in specific cooperative schemes" (Chia Siow 1997: 288). The 1987 heads of state meeting made no effort to transform the patchwork of intra-ASEAN PTAs into a coherent regional free trade area.

8.4.5 Regionalism Redux

Four years later, however, ASEAN economy ministers proposed that the organization set up a free trade area to promote regional manufacturing (Ravenhill 1995: 853, Chia Siow 1997: 288–289, Narine 2002: 126). The proposal was endorsed by the heads of state at the January 1992 summit in Singapore. The leaders pledged to cut all tariffs on regionally produced manufactured goods and processed food to no more than five percent by January 2008, and created an ASEAN Free Trade Area Council to oversee the implementation of the plan (Ravenhill 1995: 859).

Furthermore, the heads of state adopted a more ambitious set of priorities and objectives for the organization (Chin 1995). Triennial meetings of member-state heads of government were mandated; the secretariat was enlarged and charged with "initiat[ing], advis[ing], coordinat[ing] and implement[ing] ASEAN activities"; four new agencies were created to provide the secretary general with the capacity to carry out these broad tasks: a General Affairs Bureau, an Economic Co-operation Bureau, a Functional Co-operation Bureau and an Economic Research Bureau (Narine 2002: 101). Still, the secretariat's authority to make decisions or adopt programs independently of the five member-states remained severely constrained; it continued to be "deliberately underfunded, the intention being that it would play at best a minor supporting role to the national governments" in shaping regional economic policy (Ravenhill 1995: 861).

The ASEAN free trade area quickly ran into difficulty, and lost its strongest proponent when Thailand's Prime Minister Anand Panyarachun was voted out of office in September 1992 (Narine 2002: 128). The secretariat drew up a set of recommendations designed to revive the initiative in the fall of 1993, and in December 1995 the heads of state reaffirmed their commitment to deregulating the regional market and authorized the formation of two supplemental institutions: the ASEAN Investment Area (Tan 2004: 941) and the ASEAN Framework Agreement on Services (Hill and Menon 2010: 6). Intra-regional trade registered a dramatic upsurge in the mid-1990s (Chia Siow 1997: 294), but negotiations over precisely when and how to put the principles entailed by the free trade area into practice dragged on through the second half of the decade. Despite the augmentation of the ASEAN secretariat, Narine (2002: 131) reports that at the turn of the century, "most of [the free trade area's] administrative work is [still] done by the ASEAN secretariats within member states. ASEAN's reluctance to institutionalize [the free trade area]," he continues, "reflects its familiar concerns with maintaining and protecting the sovereignty of its members." Intra-ASEAN trade grew at a slower pace after 1995, but as in earlier decades the largest proportion of regional commerce took the form of bilateral exchanges between Singapore and the other member-states (Lim 1994; Hill and Menon 2010: 14).

ASEAN thus exhibited a different mode of economic regionalism in the early 1990s from the ones it had during earlier bursts of integrative activity. The strengthening of the secretariat with regard to trade and investment policy, combined with the shift away from consensus in decision-making, tempts one to situate the organization in the sixth row of Fig. 8.1. But the degree to which multilateral agencies could act independently of member-state governments remains open to serious debate. Similarly, the evident stagnation of any trend toward division of labor in the regional trading order strongly suggests that ASEAN belongs in the third, rather than the fourth column of the matrix.

8.4.6 Regionalism in Crises

ASEAN's members responded to the 1997 Asian financial crisis in unilateralist and incommensurate ways (Rüland 2000: 428–429, Abad 2003). The major regionalist initiative that was formulated in the wake of the crisis, the ASEAN Surveillance Process (ASP), never got off the ground (Soesastro 2003: 22, Jones 2011: 58). "In 1998, ASEAN secretary-general Rudolfo Severino claimed that the two factors proving to be an impediment to an effective ASP were the ASEAN Secretariat's institutional limitations in managing the surveillance process and the reluctance of ASEAN countries to share economic information with one another" (Narine 2002: 163–164). Other regionalist institutions, such as the ASEAN Action Plan on Social Safety Nets, turned out to be "either too complicated to implement or require a level of coordination and cohesion that ASEAN has deliberately avoided in the past" (Narine 2002: 164).

ASEAN's evident failure to come up with a co-ordinated response to the 1997 crisis set the stage for a fundamental reconfiguration of economic regionalism in Southeast Asia. The seven member-states (Brunei had joined the organization in 1984 and Vietnam in 1995) cultivated closer ties to Japan, the Republic of Korea and the People's Republic of China. ASEAN gradually transformed into ASEAN+3 (Stubbs 2002; Hund 2003). At the same time, the organization courted several new members: Laos, Burma (Myanmar) and Cambodia all joined in the immediate aftermath of the crisis. Taken together, these moves watered down the institutional capacity of the secretariat, and reconsolidated policy-making authority in the hands of individual state governments. In an effort to offset the power of its new regional partners, particularly Japan and People's China, ASEAN repeatedly shifted shapes as the century drew to a close. Such diverse entities as Asia-Pacific Economic Co-operation, the Asia-Europe Meeting, the ASEAN Regional Forum and the East Asian Economic Caucus were all explored as complements, and arguably alternatives, to the original regionalist project (Higgott and Stubbs 1995; Rüland 2000: 435). Progress toward a regional free trade area slowed down in November 2000 with the adoption by the heads of state of a revised protocol regarding permissible exceptions to the mandated tariff reductions (Chiou 2010: 29), and at the January 2002 summit Indonesia even "publicly called for the creation of an 'escape clause' in the implementation of the AFTA" (Chiou 2010: 35).

In October 2003, the heads of state adopted yet another plan to enhance economic regionalism among the ASEAN states: the Bali Concord II. This compact envisaged the emergence of an ASEAN Economic Community in place of the stalled ASEAN Free Trade Area, a community "in which there is a free flow of goods, services, investment and a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities in [the] year 2020" (Soesastro 2005: 3). Yet Bali II suffered from at least two fundamental problems. In the first place, it was so vaguely worded that it provided the ASEAN secretariat with no concrete guidance about how it might be implemented (Tan 2004: 948); an attempt to clarify the nature of the ASEAN Economic Community was made at the November 2007 heads of state meeting, but even this plan included 17 "core elements" and 176 "priority actions", with little hint of what to do first (Hill and Menon 2010: 23). Second, the accord assigned small and medium-sized enterprises a key role in energizing the integration process, even though "the SME sector in ASEAN is largely underdeveloped" (Soesastro 2005: 10). Such difficulties pushed member-states toward greater collaboration with Japan, South Korea and People's China under the auspices of the ASEAN + 3 framework (Hill and Menon 2010: 24).

ASEAN continues to hover in the third row of Fig. 8.1, with member-states unwilling to concede more than token authority over important areas of economic affairs to the agencies of the secretariat. Commitment to a regional free trade area remains strong, at least in principle, although the commercial and industrial complementarities that have emerged in the opening decade of the twenty-first century involve relations between the ASEAN states and external countries, rather than among the ten member-states themselves. Prospects for intra-Southeast Asian interdependence look dim, even as so-called "open regionalism" reinforces ties of mutual dependence across the South China Sea.

8.5 Conclusion

Regionalist projects in all parts of the world espouse broadly similar objectives and deploy almost identical rhetoric in their founding documents and official pronouncements. Moreover, nearly all regional economic formations explicitly preserve the fundamental prerogatives of member-states, and as a result exercise authority over few if any major economic matters. Yet the institutional arrangements and procedural rules that characterize disparate regional formations vary widely from one case to another. Such differences lay the foundation for divergent developmental trajectories, and may even determine whether particular regional entities survive and flourish, or instead stagnate and collapse.

Over the last three decades, the Gulf Co-operation Council has displayed a remarkable developmental trajectory, which all-too-often gets overlooked or dismissed by outside observers, who tend to claim flatly that the organization has failed to live up to original expectations. The GCC began as a regional formation that intended to increase the level of interdependence among its six member-states, while offering a strong institutional incentive for collaboration in the form of a proposed free trade area. This mix of features closely resembled that of the early Arab Maghreb Union, except that AMU governments devolved no policy-making authority onto a supranational agency (Lawson 2008). By the mid-1990s, the GCC had moved away from the campaign to promote greater interdependence among member states, and had effectively replaced the decision rule of unanimity with a unitary veto in the hands of Saudi Arabia. At the same time, whatever policy-making authority had been accorded to the GCC secretariat and its functional agencies evaporated, leaving regionalist initiatives firmly in the hands of the Supreme Council.

By 2010, the GCC exhibited yet a third configuration. Incentives for member-states to collaborate in the overall regionalist project remained moderate at best, but measures intended to heighten the level of interdependence among the six economies had once again been placed on the agenda. Unanimous consent continued to be unnecessary in order for regionalist initiatives to be adopted and implemented, and supranational agencies gained authority over sectors of the regional economy that had previously been governed exclusively by individual states.

ASEAN's developmental trajectory turns out to have been considerably different from that of the GCC. During its first years in existence, no important matters were transferred to multilateral agencies by the individual member-states, and a culture of unanimous consent permeated policy discussions. At the same time, states provided whatever small incentives there may have been for heightened collaboration, and steps to promote regional interdependence were virtually non-existent. Only one major change occurred when the organization was revitalized in 1976: The governments agreed to encourage greater regional interdependence through the introduction of a hodgepodge of preferential trading arrangements.

A much different mode of regionalism came into being with the reconfiguration of ASEAN that took place in 1992. The norm of consensus had by this time largely evaporated, and multilateral agencies had started to gain a bit of control over aspects of intra-regional trade. These developments, fragile as they were, raised the overall degree of integration in Southeast Asia, and - more importantly for analytical purposes - transformed ASEAN into a type of regionalist projects that is closer to the one that characterizes the contemporary GCC. Comparing these two regional formations in the late twentieth century would have involved a problematic examination of apples and oranges, but engaging in such an exercise today is likely instead to highlight fundamental convergences.

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Chapter 9
East Asian Regionalization and North Korea: From Confrontation to Cooperation

Rüdiger Frank

Region: East Asia, North Korea

9.1 Introduction

Ever since the Korean War (1950–1953), the Democratic People's Republic of Korea (DPRK or North Korea) has been a major hot spot of international relations in East Asia, although not always of its own volition. With the two nuclear tests of 2006 and 2009, the official confirmation of having a Uranium enrichment program in mid-November 2010 and naval clashes with South Korea including the sinking of the corvette Cheonan (천안) in March 2010 as well as the shelling of Yeonpyeong (연평) island in late November of the same year, we observe that there has been an escalation of the security threat emanating from the Korean peninsula. The death of Kim Jong Il in December 2011 has added insecurity about the future course of North Korea. The situation is complex. While the DPRK seems to prefer bilateral talks, in particular with big powers, the heterogeneity of national interests involved has led to a number of multilateral approaches, starting with the UN mandate in 1950 and including more recently the Framework Agreement of 1994 and the Six Party Talks. These attempts usually involved a limited number of actors and were targeted towards a specific result such as denuclearization. Most importantly, the multilateral talks with North Korea have so far on both sides been driven explicitly or implicitly by what we propose to call *confrontational cooperation*.[1] Alliances

[1] For more details on historical precedents and the continuation of this strategy to present time see Frank (2008).

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were formed and pitted against each other or against a single country. North Korea's denuclearization was the normative final goal of such efforts.

In this paper we explore the possibilities for another form of multilateralism, *cooperative cooperation*, i.e. a form of cooperation with a focus on what is in the interest of all involved partners. Set against this background, it seems counterintuitive that our analytical position is strongly influenced by neo-realism. The mainstream view is that cooperation, in particular in its institutionalized regional form which aims to create win-win situations, is something that can best be explained from a liberalist point of view and that its existence contradicts realist thinking (e.g. Haggard 2007: 25ff.). However, we suggest interpreting regional cooperation as just another tool of power politics which is highly compatible with the realist approach centred on interests and power. To paraphrase von Clausewitz: regional integration is the continuation of inter-state rivalry by other means (Von Clausewitz 1991).

It is our impression that China's leaders share this view despite forwarding a strongly liberal rhetoric when emphasising the "peaceful rise". However, China has developed a quantitative tool to measure power, which along with interest, constitutes a core concept of political realism. The Comprehensive National Power index (CNP, *zonghe guoli*) consists of weighted indices of: Natural Resources, Economic Activities Capability, Foreign Economic Activities Capability, Science and Technology Capability, Social Development Level, Military Capability, Government Regulation and Control Capability and Foreign Affairs Capability (Pillsbury 2000). Rather than taking official statements at face value, it makes sense to look at the constellation of interests and actual actions. Such an approach seems particularly important if we consider the emotional and polemic debate surrounding North Korea that can easily obstruct our view of the facts and processes that might lead to pragmatic solutions. We will first very briefly discuss a few core characteristics of multilateral and regional cooperation based on the existing literature. We will then analyse the interests of the DPRK, or more precisely, of its leadership, as well as various ways by which the leaders try to pursue these interests. Such will include ideological and economic challenges and the dilemma of reform in state socialist systems. We will show that the only productive and sustainable way to combine political stability with economic reform requires international cooperation. We argue that the DPRK is in principle interested in international cooperation but also regards such as risky and thus is reluctant to go too far in making formal international cooperation commitments. Based on this line of analysis we propose a multilateral setting that would satisfy all the needs of the North Korean side and thereby open the path towards denuclearisation and, more generally, the normalization of the DPRK as a member of the international community. We will then briefly test this model against the interests of other involved parties and discuss how realistic our proposed solution is.

With such admittedly lofty goals, a disclaimer is due. We subscribe to the realist notion that the world is as it is, not as we wish it to be. Rather than producing a set of specific policy recommendations, the goal of this paper is to think out of the box and to explore a direction that has not been considered yet - for good reasons. We acknowledge the practical difficulties of our model's implementation. Nevertheless, we argue that our proposal is not one of pure ivory tower rhetoric either. The global security environment, the East Asian region, and even North Korea are highly dynamic environments and therefore the prospects for the application of our model might soon change for the better.

9.2 Theoretical Considerations

Our basic theoretical assumption is that of a rational interest and power-centred cost-benefit analysis of the North Korean leadership as the main actor on behalf of the DPRK, which we regard as relatively homogeneous due to its autocratic nature.

East Asia (defined broadly as China, Japan, the two Koreas plus ASEAN) is a region that has to date seen relatively little progress regarding formal integration. Our theoretical focus is thus more on the question of whether and under which conditions integration could happen, and less on the actual details of the resulting institutional construct. Integration theory, which is often centred on the European Union (Bieling and Lerch 2005; Wiener and Diez 2004; Rosamond 2000), therefore appears to be less useful for our purpose. However, the issues discussed there do apply to this analysis in principle as Ernst Haas' definition of integration demonstrates. Looking at the post-1945 European experience, Haas (1958: 16) described the process "whereby political actors in several, distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new centre, whose institutions process or demand jurisdiction over the pre-existing national states". In other words, nation states give up some of their sovereignty and transfer and delegate it to institutions that are multilateral, at least formally. This is a serious concession; what can persuade a national government to make such a decision?

Our efforts at exploring the state of the art on this issue have been less fruitful than expected. The largest part of the literature addresses the notions of 'what' and 'how': what is being done? What should be done? And what are the effects? Institutions are explored regarding their effectiveness, free trade agreements are analysed regarding the gains they can produce, security threats are identified and ways to resolve them are discussed. But the question of "why?" is treated with surprising ambiguity if discussed at all.

A very general explanation for international cooperation is offered by the realist theory of international relations. Indeed Morgenthau's classical realist argument described as the "main signpost" of his theory is that nation states pursue their interests, defined by power (Morgenthau 1973). If states decide to enter into multilateral agreements including regional integration initiatives, they either hope to maximise their gains, or to minimise their losses. A certain constraint is posed by the fact that in real life, decision makers operate under the condition of incomplete information. Therefore our understanding of their actions is guided by their perception of potential gains and losses.

However, interests are rarely homogeneous. Given the complexity of modern nation states, we suspect that contrary and conflicting interests are the rule rather than the exception. A decision that favours security might be detrimental to the economy; a decision that helps agriculture might be problematic for industry; a decision that is beneficial for family A might be disadvantageous for family B. It is therefore necessary not only to get a proper understanding of the (actual or perceived) interests of a nation state and of the elite that represents it; we also need to gather insights into the ranking and relative weight of the individual issues, a task that often remains incomplete.

Despite the aforementioned constraints, our cost-benefit based approach seems at least partly to be backed by the current literature:

> "The principal concerrns of the countries of the Asia-Pacific region have been to develop their economies and to consolidate the political order of their respective states in the face of greater exposures to exigencies of the international economy and rapid social change at home. To these ends there has been a trend towards enhancing cooperative security through an array of multi-tiered and overlapping economic and security associations." (Yahuda 2004: xiv).

States are either pushed into regional alliances out of a fear of losses, or they are pulled into them by a hope for gains. Losses and gains need to be understood very broadly, in an economic, political, military and cultural or social sense.

Our view seems to be supported by functionalism as well. Functionalism regards single states as increasingly incapable of managing increasingly complex and often border-crossing challenges. This pushes states into forming regional alliances. Regional institutions are viewed as reducing transaction costs and uncertainty, as well as being capable of functioning as important instruments of statecraft (Mastanduno 2007: 30). Some authors identify a Chinese scheme to counter the US as the driver behind East Asian economic integration; Chow (2007: 11) speaks of an "Asian Monroe Doctrine" to exclude the United States. Does this mean that East Asia is on its way towards becoming a well-organized China-centred bloc?

Many authors are sceptical albeit for different reasons. Regional identity as such has long been alien to East Asians (Rozman 1991). Japan's East Asian Co-Prosperity Sphere during World War II did not help to make the concept more popular, although there have been a few strong tendencies to revive pan-Asianism. Arrighi et al. (2003) contend that regionalism in East Asia is much less formalised than in Europe, but they argue that it nevertheless exists. A certain dynamic has emerged since the 1990s, following the end of the Cold War and the collapse of the bipolar world system, a vacuum was created that to some extent led to the formation of regional alliances in an attempt to substitute the previous world order (Yahuda 2004). This view is shared by Rozman (1991) who describes East Asia as one of three regions contending for world superiority. The same author (2008: 91) argues that "East Asian regionalism was born of economic crisis in 1997–1998". Pempel (2005) observes that regionalism (a state-driven process) and regionalization (progress achieved as the result of uncoordinated bottom-up efforts) have both been important in shaping regional cooperation in East Asia.

However, not only if compared with the EU, East Asian nation states seem to be reluctant to take the necessary bold steps of ceding substantial parts of their sovereignty. Some authors regard the heterogeneous Asian culture as a detriment to regionalism, however this point is contested. Rozman for example argues that Confucianism regarded as a regional tradition and a set of ideals can be seen as an engine of dynamism within contemporary East Asia. This refers to economic development, but can it also apply to regional integration? Unlike Liberalism and Marxism-Leninism, Confucianism a regional ideology that has not spread beyond its origin (Rozman 1991: 14). Nonetheless this paper will not go into further details of the complicated and somewhat dangerous discussion of East Asian values, as such can easily drift into right-wing nationalist debates (Mahathir and Ishihara 1995). However, we suggest keeping in mind the possible existence of a joint cultural foundation in East Asia.

An expression of the obvious dilemma posed by the need to cooperate on one hand and the reluctance to delegate authority to supranational institutions on the other is exemplified by the eagerness to conclude bilateral free trade agreements (FTAs). Park (2006: 167 f.) hints at external reasons in discussing the origins of FTAs in East Asia. He identifies two main reasons: the rapid expansion of FTAs elsewhere, in particular involving the USA and Western Europe, and the slow progress in multilateral trade talks in the WTO context. Importantly he argues that East Asian FTAs form the core of cooperation that goes beyond the narrow scope of trade and investment, laying the foundation for more general cooperation and coordination.

Another possible reason for the absence of significant progress in formal regional integration is the existence of an alternative model to achieve national interests. In this context, Ikenberry and Inoguchi (2007) discuss the future of the still existing hub-and-spokes model of a post-WWII East Asian order that grouped allies such as Australia, Japan, South Korea and Taiwan around the United States as the centre or 'hub'. This model is still operational, however, as Ikenberry and Inoguchi concede, the region is ripe for multilateralism because of China's rise and the increasing complexity of national and supranational political and economic challenges.[2]

To summarize: the literature is relatively ambiguous about the reasons for regional cooperation, which from our perspective involves the voluntary transfer and delegation by nation states of part of their sovereignty. We take a rationalist perspective and assume that such concessions will only be made if they will be viewed by decision makers as promoting key national interests. Such can be achieved in two ways - maximising gains, or minimising losses. A functionalist view provides additional insights into how this would look in a less abstract form of power-aggregation, reassurance and governance. We have also discussed, without reaching a clear result, the idea of a regional identity both from a long-term cultural point of view as well as from the perspective of shared experiences such as the Asian financial crisis of 1997/1998. We have found that bilateral agreements such as FTAs currently seem to be a compromise between the need to cooperate and the reluctance to give up too much in exchange. The rise of China, it seems, has the

[2] See also Chen in this volume who discusses the prospects of "a two-hub-formation" of regional integration in East Asia.

potential to change individual East Asian states' views and significantly influence their calculations of the costs and benefits of multilateral cooperation.

How does North Korea fit into such a framework? North Korea is often seen as one of the major obstacles to regional cooperation in East Asia (Pempel 2008: 20). However, there also seems to be an effect in the other direction; Kim and Jones (2007) conclude that the newly emerging regional order in East Asia, characterized by cooperation among greater powers, poses a challenge against North Korea's strategy of national survival.

We regard North Korea as an actor in international relations that is determined by the perspective of its top leadership, with only marginal direct influence from other sources, in particular from thegrassroots levels of society. North Korea operates in a regional environment that is still undergoing a transition from a structure built during the Cold War era towards a new architecture. As this process seems far from concluding, we focus on the drivers of integration rather than on the functionality of specific formal institutions. In particular, we explore possible reasons for a voluntary transfer of authority from the national to the regional level.

What does North Korea want? And how can it be achieved? The answer is relatively simple and obvious if we follow the realist paradigm that all states are in principle the same. Thus, superseding everything else including the final goal of a Korean unification, the current leadership in the DPRK is interested in regime survival as it guarantees the maintenance of the leadership's privileged positions, preventing severe punishments by external enemies and achieving all other objectives that depend on the existence of North Korea as a state.

However, as we will discuss below, this existence is seriously challenged on many fronts. Economically, North Korea has difficulties that go as far as an inability to provide sufficient quantities of staple foods for its population. Militarily, North Korea struggles with the high costs of maintaining and modernizing a vastly overblown military. In foreign policy, North Korea is surrounded by enemies that are actively and openly pursuing a policy of regime change in the DPRK. Ideologically, North Korea is challenged by the successful transformation of China that it has so far failed to reproduce. All this is heightened by the economic and political attractiveness of South Korea. South Korea through a number of debates with Japan[3] entered what previously was the DPRK's domain - Korean nationalism. North Korea is further challenged by an enormous social transformation resultant of half-hearted economic reforms. Until Kim Jong Il's death in late 2011, the unresolved question of power succession further added to the regime's nervousness. Since the 29 year old Kim Jong Un took power, it is fair to assume that having a new and untested leadership also does not add to feelings of security and stability – although this might change in the next few years (see Frank 2012).

The North Korean nuclear programme is part of this complex equation. It fulfils multiple purposes, of which deterrence is only one. We will focus on those aspects

[3] This includes the issue of naming the sea between Korea and Japan, the ownership of two rocks situated between both countries, the question of historical texts in Japanese schoolbooks on the colonial period, etc.

of the programme that the DPRK leadership seems to hope will contribute to maintaining regime stability. Through attaining a better understanding of the problems for which the nuclear programme is supposed to provide a solution, we lay the foundation to think about alternatives. These alternatives will reduce the relative value currently attached to the nuclear programme by Pyongyang and thus make denuclearisation more likely.

9.3 Strategies for Regime Survival

Repression seems to be the North Korean domestic strategy for regime survival that is most widely noticed abroad. Kornai (1992) identifies it as endemic to socialist systems, a view to which we subscribe. However, this focus on repression should not obscure our view of the fact that the North Korean regime also resorts to persuasion. In fact, we argue that this is the preferred strategy. Coercion is costly and risky. Coercion requires a massive security apparatus, and can result in counter pressure as the history of Korea's own anti-colonialist struggle has demonstrated. Acknowledgement of this perspective can be seen in the details of sanctions against the DPRK, such as the ban on the export of high-quality spirits which were allegedly used by Kim Jong Il to reward his most loyal followers. Persuasive strategies to achieve regime stability, although applied domestically in North Korea, have important positive repercussions for external relations - in particular economic strategies.

The use of ideology as a collectively operating mechanism of controlling behaviour is typical of autocratic systems. Socialist ideology is based on the assumption that there are structural, natural laws that govern societies, and that socialism will win over capitalism automatically and eventually: "The victory of socialism is inevitable because it is a law governing history that the new wins while the old vanishes." (Rodong Sinmun 2007). The central, even vital role of ideology is not only evident when we consider the huge propaganda apparatus of all states that claim to be socialist. Kim Jong Il, the former North Korean leader, expressed his view on the central role of ideology very clearly when he analysed the reasons for the collapse of socialism in Europe: "The most serious lesson of the collapse of socialism in several countries is that the corruption of socialism begins with ideological corruption." (Kim Jong Il 1995).

It should be noted that 'socialism' usually means 'North Korean socialism', which has little to do with Marx's writings or the realities of, for example, pre-1990 Eastern Europe. Extreme nationalism is at the core of North Korea's ideology (Myers 2010). Any attempt at integrating the DPRK into an international framework will be analysed in Pyongyang regarding the effects of such an action on ideology, and in particular on nationalist considerations. Ideological reservations are a major constraint for international cooperation. The fear of the leadership of facing the challenge of other ideologies is enormous, as the following quote demonstrates:

"The bourgeois ideology and culture make people... mental cripples who idle time away with debauchery, dishonesty and corruption." (Rodong Sinmun 2011).

Ideological fears are not unwarranted. One reason for this is the dramatic underperformance of the North Korean economy. If ideology and repression provide the political resources for stability, the economy pays the bills. The military and internal security apparatus need arms and other equipment, pay for their soldiers and other funding; a huge propaganda machine needs human resources, broadcasting systems, printing machines, paper and ink. A system that claims moral and historical superiority faces the dilemma of having to live up to its own high standards by providing material affluence. We should not forget that socialism is an economic idea built around central planning and state monopoly - with the promise to produce better results than capitalist competition.

However, for reasons that often appear miraculous to socialist leaderships and the people "on the ground" alike, this claim rarely corresponds with reality. Despite the perfectly organised allocation of resources through a sophisticated central planning system, the existence of a workforce blessed with omnipresent encouragement through propaganda and without fear of unemployment, and despite (or because of?) the absence of a ferocious business cycle, socialist economies are plagued by chronic shortages that Kornai (1992: 233) identified as another of socialism's main features. North Korea has experienced the worst form of such shortages, a famine, in 1995–1997.

Accordingly, all socialist systems, in particular towards the final stage of their existence became preoccupied with their economies. North Korea is not different, although the lack of staple food adds a special dimension. Despite the undeniably strong influence of suppression and ideological coercion, the key objectives of the Pyongyang leadership, regime survival and ultimately national unification, depend on its ability to stabilise and modernise its economy.

9.4 Saving the Economy

North Korea as a typical state socialist society of the classical stage[4] has for decades been highly static and risk-averse. The obvious economic problems were met with a series of "perfection drives" (Kornai (1992: 401). These resulted in temporary improvements but were not able to resolve the economy's systemic problems. The famine of 1995–1997, and possibly even more so the example of China seem to have changed the leadership's perspective even though mass starvation and deaths did not result in any known substantial political uprising.

[4] Kornai (1992:19) identifies four stages of socialism: revolutionary-transitional system, classical system, reform system, and post-socialist (transition) system. However, "interpretation of the prototypes as consecutive historical periods can be accepted only as an initial and not entirely accurate approach... In some countries the order of appearance is different, or the stages alternate with one another."

Starting around 2000, North Korea embarked on a path of cautious but far-reaching changes. These were preceded by a constitutional amendment in 1998 to legalize private plots and profit-oriented activities; the introduction of a new ideology (*sŏn'gun* or Military First) that explicitly abolished the leading role of the working class in society; price reforms in July 2002 that not only created a one-time inflationary push in the range of 1800–6000 percent for a number of key goods and services but also changed the price relations among various goods, introduced a deepened wage differentiation and devalued the domestic currency vis-à-vis the US Dollar by 75 times (see Frank 2005).

The results of the aforementioned changes fell short of expectations, mainly because the price reforms targeted agriculture and not the dominant industrial sector. Markets were elevated from the previous semi-legal status and substantially expanded in number and scope of traded goods, resulting in hyperinflation that hovered around 200 percent annually between 2002 and 2005 (estimate by the author). The result was not only growing discontent but also a dramatic change of the society as a whole. Whilst previously, the only way to advance was through the ranks of the state, the monetisation of the economy and the new relevance of wealth changed the outlook of many North Koreans and created an alternative path of upward social mobility that was independent of the state and actually challenged the state's dominant role. Moreover, the state wages could not keep pace with the growing revenues from engaging in free market activities. Accordingly, many North Koreans decided to act as a typical *homo oeconomicus*[5] and abandoned their regular working places. The state resorted to a number of counter-measures to curtail the influence of markets including expropriation through a currency reform in late 2009, but such was to no avail (Frank 2010a).

We have seen that for North Korea to achieve their key objective (regime survival), a number of strategies have been used by their leadership. Due to a combination of internal and external reasons, these strategies have recently reached a stage where they can function only poorly. The economy seems to play a key role in this context. Accordingly, it is fair to say that regime survival in the DPRK depends on the leadership's ability to make its economy more successful. A reform attempt undertaken around 2000–2005 failed, but the problem remains. So what is the way out?

9.5 External Economic Cooperation

Due to a number of reasons including lacking the vast territory and huge population of China, as well as facing a very different economic structure and external conditions (if compared to China in 1978), following the Chinese reform blueprint too closely seems impossible for North Korea. If other cases can serve as an indicator

[5]A fictitious type of human being: self-interested, rational, utility-maximizing, responsive to restrictions, with clear preferences, and possessing (complete) information (Franz 2004: 4).

of what needs to be done to get out of the economic impasse, then we should rather think of countries like South Korea. South Korea had been poor and even lacking in food supplies during the 1950s and 1960s but was able to turn itself into a successful economy primarily through external economic cooperation. South Korea received loans for investments and was granted market access to pursue its export-oriented growth strategy (Woo 1991). Is such a strategy available for North Korea to pursue as well?

As argued above, domestic options for improvement are both limited and widely exhausted. Therefore external economic cooperation seems to be the only way out. In principle, this approach is not new to North Korea. In the past it has meant, first and foremost, aid and assistance. North Korea has a long record of successfully attracting external economic support ranging back to the Korean War (1950–1953) that triggered a massive inflow of relief goods and later resulted in large scale reconstruction and industrial investment activities by "brotherly" socialist countries (Frank 1996). In the late 1950s and early 1960s, Kim Il Sung was able to exploit the ideological feud between China and the Soviet Union to extract resources from both sides, a practice that has in principle been repeated up until present time with different partners (Frank 2008).

Such initiatives were usually short-lived, and preferential trade with socialist partners virtually collapsed around 1990. Attempts at generating the political will for economic support elsewhere, i.e., in capitalist countries such as the United States through the nuclear programme were successful in 1994 but failed in autumn 2002. Playing the nationalist tune was effective, leading to massive inflows of resources from South Korea especially under Presidents Kim Dae-jung and Roh Moo-hyun. By the end of Roh Moo-hyun's administration, transfers had amounted to USD 4.4 billion from 1995–2008. They included a tourism project developed by Hyundai Asan in the North Korean Mt. Kŭmgang and a special industrial zone near the North Korean city of Kaesŏng (BoK 2007; KDI 2007; Nanto and Manyin 2011). The Chinese hunger for natural resources led to a growing number of instances of FDI in mining (Thompson 2011).

After the 2000–2005 economic reforms which were based on the liberalization of agriculture ended in North Korea, we can observe signs of a modernisation effort focusing on industrial production. These include a number of administrative rearrangements such as new laws and regulations; the creation or upgrading of institutions related to foreign trade and investment; and personal remarks by Kim Jong Il to the effect that foreign trade should be intensified and contracts should be fulfilled. On January 4th 2010, the DPRK designated Rasŏn, the country's first free trade zones formed in the North-Eastern cities of Rajin and Sŏnbŏng, as "special cit[ies]". In obvious relation to the upgrading of the Rasŏn zone, a few weeks later the State Development Bank was launched to fund development projects. In July 2010, the Joint Venture and Investment Guidance Bureau was upgraded and reorganised into the Committee of Investment and Joint Ventures of the DPRK. In August 2010 new laws were enacted to facilitate trade with other countries, improve labour rights and protect the interests of economic entities under state supervision. Finally, the opening of the Pyongyang University of Science and Technology (PUST) in October 2010 can be seen in the larger context of the DPRK's attempts at upgrading and modernizing its economy through increased international cooperation (see Frank 2010b and Frank 2011).

At this point, it is hard to tell whether the North Korean leadership embraces external economic cooperation as a principal solution to its economic malaise, or whether the mentioned steps towards increased trade and investment are just another perfection measure, i.e., a short-term remedy. In any case, given the need to reform and the economic structure of the DPRK as well as the geopolitical conditions within which it operates, external economic cooperation seems to be a very promising strategy to achieve a sustainable solution.

However, there is one dilemma involved from Pyongyang's perspective. Unlike agricultural reform that functions more or less independently of outside cooperation, economic recovery and development through the modernisation of industry depends on the ability to export, to secure loans and FDI, to participate in the international financial system and to create foreign exchange revenue needed for crucial imports.

9.6 The Role of Nuclear Weapons

Nuclear weapons are the Achilles heel of what one day could be called North Korea's "industry first policy". As the United States demonstrated through the BDA affair[6] and various sanctions (see Frank 2006) nuclear weapons can seriously hamper North Korea's access to sources of international finance as well as its trading activities. Previously successful cases of export-oriented growth have had substantial politically motivated external support. Given North Korea's history of industrialisation, highly educated and disciplined population, large deposits of minerals as well as neighbourhood to the huge Chinese market such active support by the West might not be a necessary condition for success. However, if it is indeed true that external economic cooperation is the only sustainable way to achieve the leadership's vital interests including securing power, North Korea must make sure that the United States does at least not exclude it from international economic cooperation. However, this is exactly the case at present time. And the reason for the massive sanctions on exports, imports and financial transactions is - Pyongyang's nuclear programme.

Based on this logic we argue that the relative cost of maintaining this programme is growing. The benefits of the North Korean nuclear programme are mainly threefold: providing prestige and legitimacy to the current, otherwise not overly successful leadership; gaining international attention that translates into external economic support and diplomatic inclusion; and providing an effective military deterrence in the context of an otherwise lost conventional arms race.

[6] In autumn 2005, allegations were raised by the U.S. Dept. of Treasury that Banco Delta Asia in Macao was hosting North Korean accounts that were used for illegal purposes. The result was a collapse of the DPRKs ability to make international financial transactions.

In short, one solution to the nuclear problem is finding ways to achieve these benefits by other means. As already mentioned, international economic cooperation would constitute a key to most of these problems, since they are economy-related: securing sufficient access to food; modernisation of the country's infrastructure; providing enough energy for the industrial sector; providing fertiliser for agriculture; generating hard currency for imports. To the degree that the economy becomes more efficient, the need for extracting aid and assistance from external partners will decrease, and thus the need for 'risky' means of coercion. A perfect substitute for the military aspect of North Korea's goals will be hard to find; however, it should at least be possible to create a security architecture in which the DPRK would be satisfied with the possession of a limited nuclear deterrent while forfeiting nuclear proliferation.

9.7 North Korea's External Cooperation: Options and Ideal Partners

North Korea has in the past engaged in international cooperation efforts on various occasions. This demonstrates its readiness to interact with the international community, but also points at the limitations thereof. The key question for the Pyongyang leadership is how to minimize the risk that cooperation will lead to dependency under the condition of being a relatively weak player on the international stage.

One answer is multilateral diversification. There is little congruence in the specific interests of the involved. They are therefore likely to apply different policies vis-à-vis North Korea. In a bilateral setting, the result of a power game is determined by subtracting the power of the weaker player from the power of the stronger player. North Korea's chances to succeed are very low in such an environment when they face, for example, China, the USA or South Korea alone. However, the more partners that are involved, the better the chance that their interests and thus their actions towards North Korea differ and at least partly offset each other.

Figure 9.1 provides a schematic view of this situation. At the centre is North Korea, with little absolute power (expressed through the size of the arrows) vis-à-vis the four partners (power levels A, B, D and E are much bigger than C). The four partners have interests (expressed through the direction of the arrows) that neither correspond with those of North Korea nor with those of the other involved parties. They all try to "drag" North Korea into different directions at the same time, thereby offsetting each other's applied power (A, B, D, E), leaving only a fraction of it as effective power that influence the direction of movement. This gives North Korea a chance to modify the course of action despite its inferior absolute power (C), because in this multilateral setting, effective or relative power counts. Accordingly, depending on the actual circumstances, numerous directions of resulting movement are possible, as shown by I, II, III and IV but not limited to such.

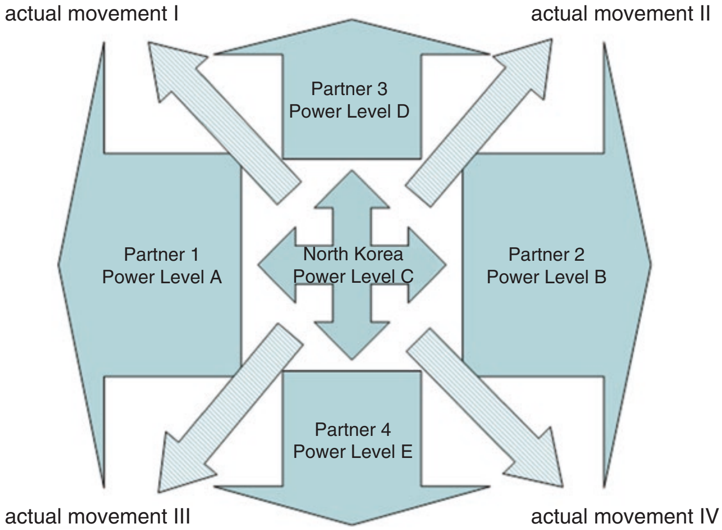

Fig. 9.1 North Korea and effective power with four partners (Source: Adopted and slightly modified from Frank 2008)

A necessary condition for such a game to function is that all partners keep playing. As soon as one or more of them decide to withdraw, the offsetting power gets lost and North Korea finds itself back in a series of disadvantageous bilateral settings. This has happened at least once in the past, when around the early 1960s both Beijing and Moscow stopped their attempts to lure Pyongyang onto their side. The result was *chuch'e* (주체), a policy of self-reliance that was much more of a necessity than a deliberate choice, no matter how it is being officially displayed today.

But the nuclear programme cannot be ignored and thus guarantees the DPRK international attention as discussed in the previous section. We would argue that Fig. 9.1 is an abstract illustration of the Six Party Talks (SPT), involving North Korea, the USA, China, Japan, South Korea and Russia. All these countries have their own agenda, which is more or less skilfully utilised by Pyongyang. The SPT are an ad hoc initiative started with the sole purpose of resolving the North Korean nuclear issue. Reflecting the strategic game as visualized in Fig. 9.1, for North Korea, the SPT are a mechanism to extract external support by way of conflict, not of mutually beneficial cooperation.

However, we should note that the mechanism as displayed in Fig. 9.1 only works for partners with a significantly greater absolute power if compared to North Korea. They engage in a game of coercion, or what we call confrontational cooperation: they interact, they negotiate and they conclude agreements and hold summits. But they do so in order to weaken the other side, to coerce the other side to do what they want or to bolster their own position strategically. Such a game ends with victory, defeat, or impasse but not with a sustainable win-win situation.

Should we therefore discard the idea of a multilateral solution to the North Korean problem including the nuclear issue? We argue that there is an alternative. If confrontational cooperation leads nowhere, what would be needed for cooperative cooperation? I.e. one that lets all involed parties win?

To a certain degree, we can use the model of confrontational cooperation as outlined above to extract a few core characteristics that partners in such an alternative form of cooperative cooperation should have. These should have less of an interest in interfering with North Korea's domestic affairs. In fact, they should be more or less disinterested in engagement with North Korea as such. Instead, their interest towards North Korea should be strictly based on issues and not politically or ideologically motivated. These issues must be of a much softer type than such vital problems as a nuclear weapons programme. From Pyongyang's perspective, smaller (in terms of power) states would be preferred over bigger ones so that there would be no need to involve them in a game of coerced offsetting as shown in Fig. 9.1. We also believe that optimal partners are geographically close but not immediate neighbours. Given the North Korean system, more autocratic systems will be preferred over explicitly liberal democracies. Our understanding of the North Korean system further suggests that multilateral relationships are preferred over bilateral ones, although rather in the form of bilateral multilateralism. Given the centralized and bureaucratic nature of the North Korean state, formal and institutionalised cooperation will be preferred over informal networks, although all forms of binding commitments will be avoided.

We thus have outlined, in very broad terms, an alternative model to the current type of confrontational multilateral cooperation within North Korea that we believe is a dead end. But, how realistic is its practical implementation? In the following section, we will explore North Korea's record of international cooperation and search for indicators that it might be ready and able to engage in such an alternative scenario.

9.8 North Korea and Its Record of International Cooperation

Measuring cooperation is a complex endeavour involving qualitative and quantitative criteria. For the purpose of this paper we will use only a few indicators. We look into North Korea's membership in multilateral organizations and alliances, as well as at the official position towards international cooperation. Flows of trade and investment will be used as quantitative indicators to measure actual cooperation.

In the past, unless dictated by necessity, North Korea has carefully avoided entering into binding multilateral agreements. Although a socialist country since 1948, the DPRK was neither a member of the socialist block's military alliance (Warsaw Pact, founded in 1955) nor of its economic forum (Council of Mutual Economic

Aid, founded in 1949), although it participated as an observer in the latter. Influenced by historical experience, following the end of the Korean War and Stalin's death in 1953, Kim Il Sung had sought to keep his country at arms' length away from its two major allies in Beijing and Moscow. He was worried by the 20th Party Congress of the Communist Party of the Soviet Union, its attack on Stalinist leadership style (Khrushchev 1956) and the propagation of peaceful coexistence with the class enemy. Kim was equally unhappy with the extreme policies of Mao, including the risky 100 Flowers Movement and the Great Leap Forward knowing that similar adventures could cost him his power. The *chuch'e* ideology has been developed against this background, emphasising, in a nutshell, that domestic resources should be used to a maximum before turning to external support and that self-reliance should be aspired for in the fields of ideology, national defence and economic and foreign policy. Adapting external technologies and techniques was allowed, as long as these were "adjusted to the specific conditions" of North Korea. As shown above, the DPRK concentrated on a multitude of bilateral relationships with socialist countries for the purpose of extracting maximum support while minimising concessions that had to be made in return.

However, contrary to widely held views in the West, "self-isolation" has not been part of that policy. North Korea has shown a great willingness to participate in less restrictive multilateral settings.[7] The focus of North Korea's more active foreign policy initiatives was the Non-Aligned movement (NAM). In addition to economic contacts, the DPRK tried to export its *chuch'e* ideology. Kim (1981: 124) argues that the major reason for these efforts was the creation of a favourable international situation for an all-Korean revolution, "thus hastening the victory of world revolution". Since the 1990s North Korean participation in the NAM is mainly aimed at gathering support for its struggle against the United States.

UN membership was out of reach for a long time since both Korea's, North and South, claimed it exclusively. North Korea's ability to react to changing conditions was demonstrated by its agreement to joining the UN separately in 1991, thereby reluctantly acknowledging the new international environment and South Korea's establishment of diplomatic relations with the Soviet Union (1990). Such a step had long been avoided by both Koreas since it was commensurate to the official recognition of the other side as a legitimate and sovereign state.

A breakthrough in terms of North Korea's integration into the East Asian region was the year 2000. One month after the first ever summit meeting with the South Korean president in Pyongyang in June 2000, then Minister of Foreign Affairs Paek Nam-sun attended the ASEAN Regional Forum (ARF) meeting in Bangkok to join this process that was started in 1994. While the intention might have been intended to be a backdoor entry to direct talks with the United States, it also opened an opportunity to formal and regular exchange with ASEAN members. As witnessed previ-

[7] According to the CIA World Factbook, North Korea is a member of: ARF, FAO, G-77, ICAO, ICRM, IFAD, IFRCS, IHO, IMO, IOC, IPU, ISO, ITSO, ITU, NAM, UN, UNCTAD, UNESCO, UNIDO, UNWTO, UPU, WFTU, WHO, WIPO, WMO.

ously, North Korea avoided binding memberships but nevertheless expressed a clear interest in dialogue and participation.

Two multilateral initiatives stand out if we consider the progress made so far: the Six Party Talks (SPT, discussed above) and ASEAN. The latter seems to be much better suited for a cooperative solution than the SPT. The single member states are relatively small. Most of them are also not too interested in North Korean domestic affairs. Non-interference is one of the core principles of ASEAN. Not all political systems of ASEAN members can be described as authoritarian; however, Western-style liberal democracy has not taken a firm hold in all member countries either. None of the ASEAN members are a direct neighbour of North Korea, but they are culturally and geographically close enough; in fact, North Korea already has well-developed bilateral relationships with many ASEAN member states. There are currently ten members of ASEAN and expansion is being discussed. Progress has been reached in terms of formalisation as well. Theoretically ASEAN thus meets the criteria for an alternative group of partners for a cooperative relationship with the DPRK.

9.8.1 The North Korean Position on ASEAN

The official position of the North Korean side on ASEAN in the past years has been remarkably friendly. Appeals for a peaceful resolution of the Korean question and the nuclear issue have been interpreted as reflecting the position of the DPRK government and denouncing the US position. The leading North Korean state media (Rodong Sinmun, Minju Chosŏn) carry articles praising ASEAN each year on August 8th, marking its founding anniversary. The tone is exemplified by the following quote from a 1999 article published by the state news agency: "In particular, ASEAN has resolutely rejected the hegemonism and strong-arm policy of outside forces to control ASEAN politically and economically, and dynamically struggled to defend the sovereignty of the member nations. "(KCNA, August 8th, 1999). In his speech at the ARF meeting in July 2000, North Korean Minister of Foreign Affairs Paek Nam Sun stressed that "...the DPRK government will make [an] active contribution to the joint exploration of the ways for peace and security suitable to the actual conditions of Asia in conformity with [the] purpose and ideal of the forum." (KCNA, July 30, 2000).

The North Korean readiness for cooperation seems to have gained momentum after the successful nuclear test of 2006 and the agreement with the US of February 2007. In August 2007, when the Minister of Foreign Affairs left for the annual ARF ministerial meeting, the official media issued more than just the usual few sentences documenting his departure. Under the title "DPRK Government Will Strive for Peace" details of the Minister of Foreign Affairs', Pak Ui Chun's speech were reported. Pak reminded the ARF that "it is indispensable for the ASEAN regional forum to thoroughly keep the essential principles of respect of sovereignty, non-interference in other's internal affairs, peaceful co-existence and ban on the use of force in order to fulfil its mission as a unique forum for political dialogue in the region" (KCNA, August 5, 2007). The emphasis on non-interference and the ban of the use of force is a direct response to the concerns voiced with regard to the nuclear test, but can also be interpreted as a reaffirmation of some of ASEAN's core principles. Reflecting the newly established dialogue with the US, Pak refrained from identifying Washington as the major threat to peace and security in the region and chose to criticise Japan instead calling it "one of the main factors of instability present in Asia".

The North Korean government's blueprint for its future regional cooperation might be reflected in the 2007 article commemorating the ASEAN founding anniversary:

> "[ASEAN] has exerted big efforts to protect [the] sovereignty of its member nations and achieve common prosperity and development while rejecting the outside forces' interference in the internal affairs of the countries in the region and the policy of domination aimed to put those countries under their control politically and economically". (KCNA, Aug. 8, 2007).

But ASEAN has more to offer to North Korea than economic cooperation without too many questions about the domestic political situation. It might also contain an interesting model case for North Korean attempts at rebuilding their economy without risking a sudden collapse as witnessed in Europe. In October 2007, only a few days after South Korean President Roh Moo-hyun returned from the second inter-Korean summit, the North's media were full with reports about a visit by Nong Duc Manh, Secretary General of the Central Committee of the Communist Party of Vietnam. Kim Yong Nam, president of the Presidium of the DPRK Supreme People's Assembly, praised the Vietnamese achievements in building their economy, a process "followed with deep attention "in North Korea (KCNA, Oct, 16, 2007). He also thanked Vietnam for supporting „the expansion of cooperation between the DPRK and ASEAN and its member nations", hinting at a possible advocacy role of Hanoi.

9.8.2 Quantitative Indicators

Finally, a glance at trade and investment flows of North Korea will help to identify their major partners, assuming that such exchanges both reflect and influence political positions. North Korea's trade is characterized by a relatively small volume, unsteady development and a relatively large deficit. Total North Korean trade in 2009 (excluding trade with South Korea) consisted of exports worth of USD 1.06 billion and imports worth of USD 2.35 billion. Exports had been growing annually since 2000 until 2004, when they increased by over 31 percent, then decreased slightly for three consecutive years, before picking up growth in 2008 at a rate of 23 percent only to decrease again in 2009 by 6 percent. Imports showed slightly more stability, growing annually since 1999 with the exception of a decline (−5.9

percent) in 2002 and in 2007 (−1.3 percent), as well as a major decrease in 2009 (−12.5 percent) (Statistics Korea 2010: 42).

If we look at the development of North Korea's trade since the collapse of the socialist camp, we find a surprising development. During the last 20 years, exports were not able to regain their 1990 level (USD 1.7 billion). Imports however have accomplished this by rising to almost the same amount as 1990 (USD 2.35 billion). We can only speculate about the reasons for this asymmetric development. For our purposes it suffices to note that North Korea does have the capacity to expand its economic exchanges with the outside world, and that it runs a trade deficit that is either covered by loans i.e. goodwill on the side of its trading partners or by sources of income that are not covered in the latter's official (mirror) statistics.

North Korea's ten largest trading partners accounting for a combined 94 percent of all North Korean trade in 2009 were, in descending order: China (52.6 percent), South Korea (33 percent), Germany (1.4 percent), Russia (1.2 percent), India (1.2 percent), Singapore, Hong Kong, Brazil, Thailand and the Netherlands (Statistics Korea 2010: 44). The ranking in 2006 was slightly different: China, Thailand, Russia, Japan, India, Germany, Singapore, the Netherlands, Sweden, and Taiwan. Their combined foreign trade with North Korea accounted for 91.7 percent of total trade.

As of 2009, North Korea in fact had only two major trading partners - China and South Korea, which combined for almost 86 percent of North Korean trade. We note the growing dominance of China as North Korea's major trading partner. Bilateral trade grew from USD 1.7 billion in 2006 to USD 2.7 billion in 2009; Beijing's share grew from 39 percent to over 52 percent during the same period. Trade with Thailand decreased markedly from USD 374 million in 2006 to just USD 44 million in 2009; this stands in close connection to decreasing food aid, a large part of which had been purchased by donors in Thailand. However, the picture has not always been like this. In 2006, North Korean trade with the Asia Pacific region amounted to almost 83 percent. Remarkably, this share had grown by 5.6% percent compared to 2005, whist trade with all other regions (Europe, Africa, America) declined in the double digit range (KOTRA 2007).

Given the relatively low bilateral trade volumes with countries beyond China and South Korea, it is difficult to recognise trends in economic exchanges. North Korean trade with Singapore for example was USD 67 million in 2006 and then went up to USD 120 million in 2008, down to USD 57 million in 2009. Trade with Hong Kong rose five-fold in that period (from USD 11 million to a still low USD 56 million). Trade with India peaked in 2007 at USD 126 million but fell to USD 60 million in 2009 (Statistics Korea 2010: 44).

The status of foreign direct investment can be described very simply: the situation mirrors trade. China is by far the most dominant partner, followed by South Korea which is mainly engaged in the Kaesŏng zone. Investors from other countries play only a minor role.

The conclusions we can draw for our analysis are that North Korea engages in trade and other economic exchanges with regional partners. This means that networks and regular personal and institutional exchanges exist but that at the same time the overall level of these exchanges is low and the full potential of these exchanges has not yet been fully met. Given the strategic concerns outlined above, these exchange statistics can by no means be a satisfactory situation from Pyongyang's perspective. Maintaining an almost unilateral dependency on China and South Korea stands in opposition to all North Korean statements regarding independence and thus poses an ideological as well as a strategic threat. Total trade of USD 5.1 billion (including trade with South Korea) is not excessively high if compared to an estimated GNI of USD 22.4 billion; however accounting for about 23 percent of GNI, it can also not be neglected (Statistics Korea 2010: 46).

9.9 Conclusion: North Korea and East Asia

We argued at the beginning of this chapter that a resolution of the North Korean nuclear issue as a main security threat in the East Asian region depends on finding a form of multilateralism that avoids the pitfalls of confrontational cooperation. An example of the latter are the strategies being pursued in the context of the Six Party Talks. We hope to have shown that cooperative cooperation is possible and desirable, as long as related blueprints are not based on illusions and wishful thinking but rather on a rational analysis of perceived national interests and the power relations guiding the international system. We have further argued that states will only enter into multilateral arrangements if they regard the costs in terms of reduced sovereignty as being significantly lower than the expected benefits of such a sacrifice. With the focus of East Asian countries to date having been on economic development and domestic political consolidation, the overall readiness in the region to engage in multilateral cooperation has been low if compared to Europe. The relative weakness of a common culturally based regional identity adds to this status although we have found voices that see a strengthening of this soft factor of cohesion in recent years. The single most important factor leading to a dynamic development of all these issues, including individual nation state's multilateralism-related cost-benefit-analyses, is the rise of China.

For the North Korean case, we found that it is both passively affected by this situation as well as being an active factor contributing to it in its own right. With regime survival being the top priority of the North Korean leadership, the economy plays a key role for maintaining the system but seems so far insufficiently capable of accomplishing this task. Economic success is thus an existential question for the leadership in Pyongyang. Due to a combination of factors, we have identified a necessity for North Korea to engage in external economic cooperation to resolve this problem. These factors include the typical structural weakness of a chronically inefficient socialist system, the failure of various perfection measures, significant external challenges, the growing need for external inputs as the level of sophistication of North Korea's industrialised economy keeps growing despite all setbacks, and a failed reform attempt that followed the original Chinese blueprint of 1978 too closely. We have argued that the North Korean leadership face two alternatives: do nothing and watch their system disintegrate further like those of former socialist countries of Europe; or actively search for a growth strategy that embraces international trade, finance and technology as key success factors.

Based on this logic, we have concluded that North Korea has a strong incentive to engage in international economic exchanges. At the same time, such contacts are perceived as ideologically dangerous. Our analysis of the DPRK's trade and FDI record has confirmed that despite the existence of such exchanges in principle, they currently fall short of their actual potential. However, we also found an additional factor that adds value to a more diversified, multilateral approach from Pyongyang's perspective: the almost unilateral trade dependency on China and, to a lesser degree since the establishment of the Lee Myung-bak government, on South Korea. On the political side, by joining a multilateral alliance, North Korea would inherit the group's international recognition and even gain political support against outsiders. External assistance would appear less threatening ideologically to Pyongyang if cooperation with the Southern brothers could be cloaked in the dust of multilateralism. A regional organization might also help break the stalemate that has so far prevented access to the wealthiest source of regional finance, Japan. Membership in a multilateral alliance could become a more reliable security alternative to simply having a nuclear weapons deterrent.

We therefore believe that from a North Korean perspective, the time is right for cooperative cooperation, i.e. cooperation focused on absolute rather than relative gains. But realists are rightly sceptical about win-win situations. Cooperative cooperation is therefore most likely to be possible among partners that are not in competition. Having applied the criteria for ideal partners for multilateral cooperation from a North Korean point of view, we have found that ASEAN matches these to a high degree, whilst the Six Party Talks are doomed to fail for structural reasons. The record of North Korean cooperation with ASEAN countries is very positive and ASEAN's policies including non-interference as well as its structure (absence of Great Powers) suggests that closer cooperation with North Korea could be possible.

The question we now have to answer is: would ASEAN be interested? A positive indicator is North Korea's membership in the ASEAN Regional Forum (ARF). However, the interest of ASEAN to invite such a potentially problematic case for closer cooperation is questionable. Furthermore, North Korea has no borders with any ASEAN member state and is not part of the Southeast Asian region. So why would ASEAN, far from being a well organised and coherent regional body, care about such a distant, small and potentially troublesome partner?

Admittedly the answer is not obvious. Without any active policy the status quo is unlikely to change any time soon towards a closer integration of North Korea into the ASEAN economic and security framework. But we believe that such an inclusion would serve ASEAN member state's interests for a number of reasons.

First, the general trend of a reorientation after the collapse of the bipolar world order around 1990 is still ongoing. Blocks like the EU and NAFTA emerged. Bilateral and regional FTAs seriously confront the universal claims of the

WTO. Security challenges range from Northern Africa and the Middle East to the South China Sea and the Korean peninsula. Thus, the formation and strengthening of regional alliances becomes a basic strategic necessity. North Korea, not least because of the pressing need to resolve its nuclear issue, could become a catalyst of East Asian integration.

Second, as the catastrophe at the Fukushima reactor in early 2011 has shown, the effects of nuclear security deficits know no borders and can be influenced by factors as incalculable as the weather. A nuclear showdown or accident on the Korean peninsula will not be limited to Korea itself.

Third, in any case, a destabilization on the Korean peninsula will adversely affect China and its economy. Being a major trading partner for ASEAN countries, an economic crisis in China will adversely affect their economies and have serious political repercussions. A similar logic can be applied to South Korea which is also an important economic partner for ASEAN countries.

Fourth, we have discussed the unused potential for actual economic cooperation. North Korea has raw materials that are becoming increasingly crucial to maintain the respective ASEAN economies' growth. Moreover North Korea is a huge potential market for ASEAN export goods including rice, textiles and other light industry products.

Fifth, an inclusion of North Korea would become even more logical if China would assume some kind of benevolent leadership role for ASEAN members in the future. As a matter of fact China's rise seems to have been an important factor leading to the dynamic development of the long ridiculed ASEAN that we could observe in the past decade.

The non-ASEAN countries such as China, South Korea and Japan would also under certain conditions benefit from the inclusion of North Korea into an ASEAN-based multilateral cooperation framework.

China, by handling the North Korean question has a chance to demonstrate leadership and responsibility commensurate with its economic rise. It can prove that it is able to defend a small Asian nation against the onslaught of an outside Big Power, solve problems "within the family" and keep peace in the region. It would thereby deliver what Japan had aspired but failed to do in the mid-twentieth century. Such a role would not be new for China; acting as the benevolent patron has been the Middle Kingdom's foreign policy position for centuries.

South Korea can advance its long-term goal of national unification by supporting North Korea's integration into a regional cooperation agreement. The current humanitarian, strategic and political dilemma faced by Seoul and the resulting complicated manoeuvres between the Scylla and Charybdis of dovish engagement and hawkish confrontation have cost more than one South Korean president the support of his voters. Regional integration could help solve this problem by delegating responsibility, as well as foster improved conditions for economic burden-sharing. Furthermore, the European experience suggests that regional integration needs administrative and economic centres. By resolving the North Korean issue, South Korea would remove one possible obstacle on its way to becoming a strong candidate for the location of, for example, the East Asian Commission, Parliament, or Central Bank.

Japan has been in a difficult situation since the collapse of the bipolar world. The decades-old Yoshida-doctrine of leaving defence to the United States and focusing on the economy does not correspond with the much more complex World reality post 1990. Answers have to be found on many questions, including the economic and military rise of China. Being perceived as (nothing but) Washington's extended arm in the East Asian region might prove increasingly burdensome. The Japanese economy depends on international cooperation for inputs and for markets. Both are to be found in the region, so a good relationship is crucial. Japan has decided to pinpoint the North Korean threat to justify its own "return to normality" as the remilitarisation is interpreted. However, once it has fulfilled this function, Japan may benefit by advocacy for a repentant North Korea to demonstrate its own qualifications as a regional team player. Accepting Pyongyang's membership in the Asian Development Bank could be one such step. Being left outside ASEAN + X is not an option for Japan, so it must find ways to enter - and North Korea might be the ticket.

Will North Korea shift its loyalties to a new centre following Haas' definition? Will it be welcomed there? Will such a new situation be stable enough and capable of resolving the economic and security issues at stake? Given the current stalemate, we believe that it is worth thinking about alternative solutions.

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Chapter 10
State Failure and Regional Containment: The Case of Afghanistan

George Gavrilis

Region: Middle East, Central Asia, South Asia

10.1 Introduction

State failure is largely seen as a negative. When states fail, their neighbours and the broader region usually experience a host of unpleasant externalities that include heightened trafficking, cross-border extremism, and refugee flows (Atzili 2007; Fearon and Laitin 2003). Whilst a large scholarly literature exists debating why states fail and how to enhance the limited menu of intervention mediums by international organizations (Krasner 2004: 86), little is known about the role that neighbouring and nearby states play in containing the negative effects of state failure and assisting the recovering state.[1] Yet neighbouring states may have a very strong incentive to act and their reaction may hold the key to a failed state's recovery, redefining regional economic and political ties.

Does a state's failure trigger unique or uniform responses across its more stable neighbours? What explains a state's strategic response to a neighbour's failure? Does bilateral assistance aggregate into multilateral initiatives to contain failure or

[1] On identifying state failure, see *Foreign Policy* (2007) and Rotberg (2002). On plausible and implausible solutions to state-failure, see Autesserre (2009), Barnett (2006), Fearon and Laitin (2004), Krasner (2004), Langford (1999). On warlords and state failure, see Reno (1997) and Marten (2007). On how international organizations and norms may cause or worsen state failure, see Englebert and Tull (2008), Atzili (2007), Fazal (2007), Herbst (2000), and Ratner (1996). On security threats caused by failing states, see Piazza (2008).

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create a greater role for regional organizations? This chapter presents a tentative framework and observations from the case of Afghanistan and its neighbours.

10.2 Framework

As a simplifying principle, it is useful to think of a failed state as a commons.[2] At one level, the commons analogy applies because the state lacks a credible government to provide central authority and enforce rule of law against insurgents, criminals, warlords, and so on. At another level, the analogy can refer to how neighbouring and proximate states may see the failed state. They all may suffer in varying degrees from proximity to the failed state but there is no overarching authority capable of delegating and enforcing a joint plan of action to coordinate assistance.

Each state in close proximity to a failed state may choose from four possible responses: One plausible reaction is to assume a defensive posture against a failed state. Neighbouring states can do this by increasing security measures in frontier regions to prevent incursions by traffickers, insurgents, or refugees fleeing the collapsed state. It may seek international aid to augment its military or policing capabilities or lobby international organizations and other states to redouble their reconstruction efforts. A second possibility is that a neighbouring state will behave aggressively and press the beleaguered government of a failed state to make political or economic concessions.[3] Neither of these two possibilities necessarily improves security inside the failed state or enables its recovery.

A third possibility is that a stable neighbour will extend bilateral assistance to the failed state in the form of grants and loans, technology transfers, access to cross-border infrastructure, and training for bureaucrats. A fourth path involves multilateral action, such as when proximate states work through regional organizations or in concert to assist the recovering state and contain potentially threatening flows.

These four stylized strategies are not meant to imply a singular and static response to a neighbour's collapse. A neighbouring state may combine elements of two or more strategies, and these may change over time. For example, a given state can simultaneously defend its territory against threatening flows and extend bilateral assistance to the state recovering from failure. However, the four paths usefully capture the range of a state's responses: from defensive to aggressive, from hostile to friendly, and from unilateral to coordinated (Fig. 10.1).

[2] Here state failure refers to situations where central authority collapses, peripheral agents start to rule themselves, government agents lack coercive tools to police territory, and lack the capacity to extract revenues systematically. There is no commonly accepted definition on state failure. However, most scholars agree that there are multiple indicators that will vary from place to place and that these indicators should be measured on a continuum (Foreign Policy 2007, Rotberg 2002).

[3] These concessions are unlikely to be territorial—international norms prohibit redrawing the borders of failed states according to Ratner (1996), Herbst (2000) and Fazal (2007).

Fig. 10.1 Map of Afghanistan and its neighbours (Source: Accessed courtesy of the Perry-Castañeda Library Map Collection, University of Texas, Austin)

10.3 Afghanistan and Its Neighbours

This paper applies the aforementioned framework to Afghanistan's neighbours since 2001. In 2001 a United States military operation overthrew the ruling Taliban regime, dispersed al-Qaeda, and enabled the installation of an interim government. In the process, the operation heavily damaged public infrastructure, created millions of refugees, deposed ruling officials, bureaucrats, police and the military, and re-empowered outlying warlords who were eager to take advantage of the ensuing chaos. Despite the substantial efforts made by the international community to create a functioning central government, warlords rule in much of the country, the Taliban have reinvigorated their insurgency, and a staggering proportion of the economy is based on the illicit opium trade. The lingering failure of the Afghan state remains a concerning issue for both the international community and also the immediate geographic region.

But why investigate Afghanistan and its neighbours? Firstly, the severity of failure and importance of Afghanistan in regional and international security makes it an important avenue of inquiry. Secondly, Afghanistan sits on the confluence of a number of regions—the Middle East, South Asia, and Central Asia/Western China. This allows the author to explore how attempts to cope with failure potentially redefine state ties across sub-regions. Third, Afghanistan shares land borders with six states of varying military capacity, economic portfolios and security interests. The case study is not intended to provide a generalizable theory of state failure and regional containment; it is a plausibility exercise and intent on generating hypotheses that can be examined across broader cases.

Iran Iran participated alongside the United States and United Nations to help put together a new Afghan government. Behind closed doors, Iranian diplomats urged the United Nations to lead rebuilding efforts and insisted that the new Afghan government be composed not of ideologues, but of technocrats who could effectively govern. The government of Iran quickly moved to back up the interim government of Hamid Karzai, by extending USD 100 million in aid, paying the salaries of teachers, and sending technical equipment and supplies to Kabul government offices.

After 2002, Iran's aid and trade role in Afghanistan expanded. Tehran certified joint investment companies, sponsored food fairs, opened cement factories, extended purchase credits to traders, and trained commercial pilots. Iran initially dominated the food and electronics market in Western Afghanistan. Reportedly, 85 percent of food and 90 percent of basic electronic goods such as cables, sockets, and plugs in some western provinces were of Iranian origin. Yet by 2004 Iranian traders complained about losing the Afghan market to India, Pakistan, and China. The Iranian government delayed opening services essential to Iranian traders and investors in Afghanistan. Iran's Arian Bank, which opened in Kabul in late 2004, was the 8th foreign bank to be opened since the fall of the Taliban. Iran's opening of consulates also lagged behind Pakistan and India.

Tehran made more notable efforts to invest in Afghanistan's infrastructure. It extended an electric line into the western Afghan city of Herat and jointly sponsored highway projects with India throughout the Afghan west. An Iranian power company began supplying electricity to Herat in 2005, following the signing of a bilateral agreement in 2003. The Iranian government has also undertaken a number of road building projects to the Afghan border and inside Afghanistan.

Iran has devoted considerable resources to prevent the spill over of instability from Afghanistan – an estimated USD 600 million annually on counter-narcotics efforts alone. Nearly 10 percent of Iran's conscript army patrols the Afghan border, and walls and ditches are dotted along remote stretches of the border. Most notably, Iran cooperated with the United Nations Office of Drugs and Crime (UNODC) in an attempt to reduce the smuggling of opiates. Smuggling, which increased gradually after the fall of the Taliban, boomed drastically after 2004 as many cultivators turned to lucrative opium farming (Goodhand 2005). UNODC officials concluded that Iran was taking substantial measures against drug smuggling along the border and in 2004 UNODC set up 87 patrols on the Afghan side to combat drug smuggling.

Pakistan After the US invasion toppled the Taliban, Pakistan found itself in the awkward position of having to reorient its policy in order to support Karzai's government.[4] Pakistan had supported the Taliban and served as its lone diplomatic outlet during the late 1990s (Khalilzad and Byman 2000). Pakistani government officials pledged to support the recovery of the Afghan state with relief aid, enhanced economic ties, and military assistance, but much of this aid failed to materialize. Instead, it was the private sector in Pakistan that lobbied government officials in Islamabad to adopt a more constructive disposition towards Afghanistan.

Pakistani traders living in border regions encouraged the government to open up bank branches and consulates in Afghanistan, to facilitate business transactions.[5] Pakistani traders soon flooded Afghanistan with food products and consumer goods, lifting the official value of trade to USD 1.2 billion by 2006.

A trilateral military agreement was formed in 2003 including Afghanistan, Pakistan, and the US. The role of the trilateral was to coordinate and resolve security issues relating to the porosity of the shared border and the resurgence of insurgency and illegal activity in frontier zones. Nonetheless despite multiple meetings of the Trilateral and the formation of a joint Pakistan-Afghanistan economic commission, relations took a turn for the worse. Pakistan accused Afghan officials of collaborating with India in support of Pashtun separatism and of harbouring Baluchi separatists (Neumann 2007).[6] Afghan officials accused Pakistan of complicity in border raids and suicide bombings and alleged that Pakistan's frontier provinces served as training ground for extremists intent on bringing down the government in Kabul. Pakistan blocked overland shipments of Indian aid and military goods to Afghanistan, banned cement shipments to Afghanistan, and imposed severe restrictions on Afghan trucking that kept agricultural goods from reaching Pakistani markets. In 2006, Pakistan blocked the extension of South Asian Free Trade Association (SAFTA) benefits to Afghanistan, which Karzai had been actively seeking in order to enhance trade, investment, and government revenues.

India Although India is not contiguous to Afghanistan, it was one of the first countries to restore ties with Afghanistan.[7] The Indian government opened several consulates in Herat, Mazar-e Sharif, Kandahar, and Jalalabad as early as 2002, well ahead of Pakistan and Iran. Much to Pakistan's dismay, India extended substantial

[4] Privately international organization officials unfavorably compared Pakistan's frosty relations with Kabul against the more amicable climate between Tehran and Kabul.

[5] Traders and businessmen also argued that opening the Afghan market would provide access to Central Asian markets in the former Soviet Union. Eight Pakistani banks soon applied to open branches in Afghanistan and throughout 2003 the government opened a series of consulates in Afghanistan, including those in Jalalabad, Kandahar, and later Mazar-e Sharif.

[6] The Afghanistan-Pakistan frontier was created as a strategic buffer by the British in the nineteenth century and splits up ethnic Pashtun populations between the two states (Allan 2003; Neumann 2007). Pashtuns are the largest ethnic group in Afghanistan but are a minority in Pakistan. Respectively, they total 15 and 20 million. Afghan officials at times called for Pashtun self-determination while at other times Pakistan used the porous frontier area as a means to coerce and economically dominate Afghanistan (Qureshi 1966; Cheema 1983; Barfield and Hawthorne 2007).

[7] India is included here for two reasons: First, its role in aiding Afghanistan is substantial. Second, prior to partition and the creation of Pakistan, India bordered Afghanistan.

development aid to Afghanistan, participated in rebuilding critical infrastructure and competed alongside Pakistani traders in the limited Afghan market.

Between 2001 and 2004, India spent an estimated USD 400 million in Afghanistan on hospitals, roads, irrigation projects, and military equipment. In addition to opening numerous consulates, the Indian government underwrote the first trade fairs in Afghanistan. The Confederation of India Industry held a massive "Made in India" trade fair in Kabul in 2002, which attracted thousands of traders, the majority of which were Pakistani. Indian traders were particularly eager to export processed food items to Afghanistan but found themselves in steep competition with Pakistani products that were both *halal* and more proximate to Afghanistan. Indian traders partially resolved the problem by sending food via ship to Dubai-based traders who specialized in the export of Indian agro-commodities to Muslim markets. The firms in Dubai generated receipts and *halal* certificates that concealed India as the country of origin. This route became more important when Pakistan blocked the shipment of Indian goods to Afghanistan in 2003.[8]

India also took early steps to assist Afghanistan in rebuilding and expanding its infrastructure. Indian officials embedded a series of road-building initiatives in their trade discussions with Afghan officials. By 2003 India had signed an agreement with Afghanistan and Iran to construct a road from Zaranj (near the Iranian border) to Dilaram, a town on the Kabul-Kandahar-Herat road that United States Agency for International Development (USAID) was constructing. This road was intended to link Afghanistan's main ring highway with Iran and its port on the Gulf at Khahabar. By 2005 India's Border Roads Organization (BRO) had readied approximately 280 km of the road. In the same year, Indian and Turkish firms were awarded a contract to pave approximately 556 km of the ring road from Kandahar to Herat.[9]

China In regional terms, China's economic impact in Afghanistan is second to Pakistan. Trade with Afghanistan boomed from USD 25 million in 2002 to USD 500 million in 2004. The Chinese imprint on post-Taliban state building includes road building, hospital construction, irrigation projects, telecom, airport equipment, police training, as well as dozens of agreements on trade and security. Many of these initiatives kicked off in 2003, following the first disbursement of a multi-year aid package of USD 150 million.

One of the most notable initiatives was a road building project in Kunduz in northern Afghanistan, which reached the contract stage in 2003. A Chinese firm also won a contract funded by the European Union to construct a 137 km road linking Kabul and Jalalabad. China's road-building projects suffered a substantial setback when a June 2004 terror attack in Kunduz killed 11 Chinese construction workers. The attack curbed China's initial momentum and made officials hesitant about fur-

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[8] Pakistan did not, however, block Afghan goods bound for India. In 2006 Pakistan's trade with Afghanistan was estimated at USD 1.2 billion while India's trade stood at USD 160 million. Indeed, much of the profit gained in the private sector by Indian investors was outstripped by official aid to Afghanistan. India continues to give hundreds of millions in aid to Afghanistan.

[9] The ring road connects Afghanistan's major urban areas. The international community is currently upgrading, paving, and widening existing stretches of highway, a multi-billion dollar project.

ther investment and aid. China's active road-building projects in Afghanistan are more limited than India and Iran's and pale in comparison to those Beijing is sponsoring in Central Asian states like Tajikistan and Kyrgyzstan.[10] Moreover, while cheap Chinese household goods are present in many markets in Afghanistan, there are few Chinese traders, firms, and investors in the country as compared to Central Asia.[11]

Central Asia's Republics Three Central Asian states border Afghanistan to the north—Turkmenistan, Uzbekistan, and Tajikistan. Like Afghanistan's other neighbours, the governments of the Central Asian republics participated in multilateral talks sponsored by the US and UN to put together a stable interim government in Kabul.[12] While Central Asian diplomats showed up to international conferences on the reconstruction of Afghanistan, their governments extended negligible assistance to Kabul and avoided participating in economic development efforts and formal trade initiatives.[13]

Instead, Uzbekistan and Turkmenistan unilaterally sealed off their respective borders with Afghanistan by deploying military units, restricting private sector trade and passing onerous restrictions and visa policies. Tajikistan, which had been recovering from a devastating civil war that ended in 1997, maintained a more open border with Afghanistan; however, this appears to have been less to aid the recovery effort and more to maintain contacts with ethnic Tajiks in Afghanistan and to enable narcotics and weapons smuggling across the common border. Central Asian diplomats regularly complain that the international community has excluded them from

[10] Consider Tajikistan for instance, a post-Soviet Central Asian state sandwiched between China and Afghanistan. China is rapidly outstripping Russia as the main investor in Tajikistan. China has made massive investments in light industry and extended loans and grants for multiple road-building projects in Tajikistan. These projects include USD 600 million in loans for roads and tunnels. One notable project is a highway linking the Chinese-Tajik border with Uzbekistan. Another is the Shar-Shar tunnel which will link the Tajik capital with the south of the country. Indeed the bulk of a USD 900 million dollar export loan is slatted for the Shanghai Cooperation Organization's (SCO) projects in Tajikistan. The SCO's bank syndicate was founded in 2005 for major infrastructure projects such as these. Between 2001 and 2005 trade volume of SCO member states doubled.

[11] In Central Asian states such as Kyrgyzstan and Tajikistan, Chinese traders are entrenched in local operations in a number of important market towns. In Afghanistan, Chinese goods are imported via third party traders from Pakistan, especially ethnic Pashtun.

[12] Turkmenistan's officials expressed the opinion that the Taliban should be reintegrated into the government to some extent, Uzbekistan's diplomats argued for a hardline approach that would exclude and continue to decimate the Taliban, while Tajikistan's officials signaled that they would support any US initiative that gave ethnic Tajiks a prominent role in the Afghan government.

[13] There are a number of recent exceptions. Uzbekistan is now being paid to supply electricity to north Afghanistan and parts of Kabul. Turkmenistan has donated some oil and gas to assist reconstruction but transporting substantial quantities to Afghanistan remains a distant prospect given the heavily restricted border and lack of a direct pipeline. Tajikistan and Uzbekistan have also at different times allowed the US, UN, and NATO to use air routes, roads, and bases for lines of communication into Afghanistan. The transit fees and leases accrue their governments substantial revenue. On the issue, see Cooley (2008).

lucrative contracts and tenders in Afghanistan's reconstruction, but the lack of overall engagement with Afghanistan suggests that the republics are not willing to contribute more even if the opportunity should present itself.

10.4 Assessment and Conclusion

The aforementioned framework laid out four plausible state responses when another fails in their midst: (1) defensive posture to contain security problems from failure; (2) aggressive attempt to take advantage of neighbour's weakness; (3) bilateral efforts to assist recovery; (4) multilateral efforts to assist recovery. This case indicates that states responded in varying manners to Afghanistan's collapse. Uzbekistan and Turkmenistan largely opted for a defensive posture to seal off their territories from potential extremism, refugee flows, and trafficking emanating from a recovering Afghan state. Pakistan actively attended multilateral initiatives for Afghanistan but many of its policies (outside the private sector) appeared to take advantage of the interim government's weakness. Iran, China, and (to a lesser extent) India assisted Afghanistan largely via bilateral efforts.

Future iterations of this project will explain why states responded the way they did to Afghanistan's failure. However, it is interesting to note a number of factors that do not appear to be driving the reaction. First, the variation in response is interesting because most of Afghanistan's neighbours have strong historical or ethnic ties to Afghanistan, particularly Pakistan (with the Pashtuns), Iran (with the Hazara and Shias), Tajikistan (with the Tajiks in the north and Kabul), and Uzbekistan (with the Uzbeks in the north). Ethnic or historical ties would appear not to motivate policy. Second, geographic variables such as the length or accessibility of the border do not seem to shape the response to failure.[14] For example, India is not contiguous to Afghanistan and China shares with Afghanistan a relatively short stretch of impenetrable mountainous border. This insulates them both from the spill over effects of Afghan failure. Yet India's foreign aid, technical assistance, and infrastructure investments in Afghanistan greatly outstrip China's. One possibility is that the competitive state of Indian-Pakistan relations and persistent security dilemma between the two states gives India impetus to establish a stronger presence in Afghanistan.

Third, worthy of note, the multilateral response is the least favoured path across the four states. Neighbouring states may prefer to approach the failed state via bilateral or ad hoc agreements.[15] These agreements may be cancelled, altered, or ignored

[14] The borders of weak states are argued to be magnets for threatening transnational activities. On this, see Fearon and Laitin (2003).

[15] The most notable change in regional relations is perhaps denser ties and new forms of cooperation between India and Iran, ties that are based on infrastructure, trade, and transport initiatives over Afghanistan.

more easily than a formal initiative of a regional organization.[16] More interesting, the rebuilding of Afghanistan has not enabled an expanded role for regional interstate organizations (such as the Shanghai Cooperation Organization, the South Asian Association for Regional Cooperation, the Gulf Cooperation Council, the Economic Cooperation Organization). Regional organizations lag far behind the North Atlantic Treaty Organization – International Security Assistance Force (NATO-ISAF), the United Nations, and US and European-sponsored initiatives despite the low barriers to entry and limitless need for assistance.[17] Consider the case of the Shanghai Cooperation Organization (initially the Shanghai Five). The SCO—a weighty regional player in China, Eurasia, and Central Asia—was spearheaded by China to foster cooperation on issues of separatism, terrorism, and smuggling. The SCO triggered cooperation on security issues with China's Central Asian neighbours and provided an arena to solve territorial disputes—notably with Kazakhstan, Kyrgyzstan, and Tajikistan (Fravel 2008). Trade has also boomed on the back of the SCO initiatives and the organization funds sizable infrastructural projects in Central Asia.[18] However, the SCO may have overly formalised and bureaucratised China's approach to other regional states. Given that cooperation in cross-border security issues is channelled through the SCO, China's initiatives in Afghanistan have been cautious, guarded, and limited.

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[16] On these general IO dilemmas, see Abbott and Snidal (2000, 1998) and Keohane et al. (2000).

[17] An exception to this is the Asian Development Bank (headquartered in Manila) which funds a number of development projects throughout Afghanistan and Central Asia alongside the UN, US, and EU.

[18] On the activities of the SCO see also Ahmad, Chap. 6, in this volume.

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