

The Evolving Economic and Political Architecture in Asia and its Geo-Strategic Impact



Summary Report of the Global Leadership Seminar September 27 – 30, 2006,
Tufts University European Center, Talloires France

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Preface

Transcontinental awareness is becoming an increasingly important element in understanding global political and economic developments. *The Global Leadership Seminar* seeks to raise this awareness by convening representatives from three continents to participate in discussions around contemporary global issues. More particularly, the seminar strives to foster dialogue between students, faculty members, and persons with practical experience in business and government from Europe, the United States, and Asia. At this stage, the participating institutions include four leading graduate schools of international affairs and public policy: College of Europe, Bruges, Belgium; Fletcher School of Law and Diplomacy at Tufts University, USA; Lee Kuan Yew School at the National University of Singapore, Singapore; and the Master of International Affairs and Governance Program at the University of St. Gallen, Switzerland.

The first colloquium took place September 28 – 30, 2006 at the Tufts University European Center in Talloires, France, and was comprised of a Student Seminar and a Leadership Seminar. The Student Seminar brought together approximately 40 students and faculty for an intensive two days of discussions. The first day was devoted to “The Proliferation of Weapons of Mass Destruction,” and the second day’s topic was “Regional or Multilateral Economic Governance: How to Proceed after the Doha-Round?” The objective, in both instances, was to lead the young participants to a better understanding of the complexities and varying perspectives surrounding these two critical issues.

The Leadership Seminar on September 30, 2006 convened upper echelon managers and administrators in private and public organizations together with faculty members of the four participating institutions for an informal, broad-based exchange of ideas focused on the topic, “*The Evolving Economic and Political Architecture in Asia and its Geo-Strategic Impact.*” The security situation in Asia and the prospects for regional integration in the area provided the political and economic background. The further question whether the 21st century is going to be an Asian century (for many participants a fact and not a question) served as a thought provoking starting point, and the meeting closed with a discussion on how to respond to the Asian challenge.

The discussions were supported by short presentations which provided factual background and raised critical issues for dispute. Their clarity and thought provoking inputs greatly contributed to the understanding of the complex issues and proved enormously helpful for the deliberations. I thank the presenters in alphabetical order for their very helpful insights:

Stephen W. Bosworth, Dean of the Fletcher School of Law and Diplomacy, Tufts University

Harinder Kohli, President and CEO of the Centennial Group, Washington D.C.

Kishore Mahbubani, Dean of the Lee Kuan Yew School, National University of Singapore

Jacques Pelkmans, Jan Tinbergen Chair for European Economics and Director of the European Economic Studies Programme at the College of Europe, Bruges

Wolfgang Schuerer, Professor for International Affairs at the University of St. Gallen and Chairman and CEO of MS Management Service AG

Jusuf Wanandi, Chairman of the Supervisory Board and Member of the Board of Directors of the Center for Strategic and International Studies (CSIS), Jakarta.

The meeting respected the Chatham House Rule. Accordingly, participants could express their personal opinion without risk of public disclosure. Nevertheless, we find it helpful to make the main results of the discussion available to a wider public. Christoph Frei authored the following report which gives a candid summary of the issues discussed and the areas of convergences of opinion. As with every summary report and as compared to the actual experience of the participants during the day, the richness of individual arguments is partly lost, which is compensated by greater coherence of main lines of discussion. I am convinced that participants and outside readers join me in thanking Christoph Frei for the great job he has done.

I also express my gratitude to institutions and organisations which have made this seminar possible. The Ecoscientia Foundation and the Holcim Group have provided invaluable financial support. Tufts University offered their splendid European Center in Talloires on the shores of Lake Annecy. The hospitality of Gabriella Goldstein, director of the Tufts European Center, and her staff makes the Center a place to remember far beyond its physical attraction.

Thanks to sponsors, organizers and participants alike, we are off to a very good start. May this first conference mark the beginning of a fruitful and lasting cooperation.

Heinz Hauser

The Evolving Economic and Political Architecture in Asia and its Geo-Strategic Impact

Prof. Dr. Christoph Frei, University of St.Gallen

Introduction

Since the dawn of advanced civilizations in Mesopotamia, India, and China, the tension between *constancy* and *change*, between a *steady state* and *transformation* has been a permanent issue for mankind. The term of reference may have changed over time – from Heraclitus' "pantha rhei" to Schumpeter's "creative destruction" to recent jargon "because change happens." Yet, coping with transformation still poses a formidable challenge for modern societies as well as business corporations as market shares decline, jobs are redirected, and demographic developments introduce further complications. For these challenges to be addressed, they must be put in context.

Coping with change, coming to terms with transformation was also the main objective of our discussions on September 30, 2006. The rapid transformations in Asia's economic and social landscape raise a multitude of questions. The broad topic of the colloquium – "The Evolving Economic and Political Architecture in Asia and its Geo-Strategic Impact" – was structured into four sessions to give greater focus and thrust to our exchanges. The summary presented below makes no claims to completeness. All it hopes to achieve is to concentrate on selected focal points, questions as well as answers, which may in turn serve as starting points for further exploration.

I. An Asian Century Ahead?

Just before the Asian financial crisis in 1997, the American economist Alwyn Young caused a stir by suggesting that East Asia's so-called growth miracle was a myth. He calculated that most of the region's faster growth was due to increased inputs of labour and capital rather than to overall factor productivity growth. Paul Krugman, another American economist, summed up the argument as follows: "The miracle turns out to have been based on perspiration rather than on inspiration." Then the crisis hit. Currencies plunged, banking systems imploded, unemployment rose sharply.

Yet, with the notable exception of Japan, growth resumed quickly and confidence rose. With more than half the world's population—easily four times that of the United States and Western Europe combined—the emerging economies of South and East Asia have made breath-taking progress in the last few years. Today, the region as a whole is a major force in the global economy. It currently generates large trade and savings surpluses, provides huge capital outflows to the rest of the world, and is

increasingly becoming the manufacturing and IT hub of the world economy. China and India have joined Japan and the Newly Industrialized Economies (Hong Kong, Singapore, Taiwan, Korea and Malaysia) as strong participants in global trade; and they keep achieving enviable economic growth rates.

It may be useful to give some examples illustrating these statements. Forty-five years ago, Maoist China experienced the most catastrophic famine the world had ever seen. Today, the same country is growing faster economically than any other ever has, with production doubling roughly every seven years. For the time being, China has replaced Japan as the primary engine of the region's growth. If the trend persists, it is likely to pass the United States as the biggest economy in the world within four decades. Other Asian countries may not yet be giant economies, but there is no reason to think they will not attain that status in the years and decades ahead.

No big deal, perhaps? In light of what the French so aptly call "histoire longue", one might indeed say that things are merely getting back to normal. China and India, after all, must be considered as re-emerging rather than emerging economies as they are regaining an eminence they once enjoyed. For more than a thousand years and well into the 19th century, these two were the world's biggest economies by a comfortable margin. Today, they are clearly on the rebound. At market exchange rates, China ranks among the world's top ten economies; in purchasing-power terms, India already makes that list as well. Between the two giants, China scores higher on many key ingredients of growth at this time; in the long run, however, India may pull ahead because its population will continue to grow long after China's will have levelled off.

Re-entering the global economy

Asia is, once again, an economic power. Its companies are serious, and often dominant, players in virtually every industry. Illustrious examples include China's Sinopec, set up in the year 2000 and already among the ten biggest oil companies in the world; or Infosys, India's largest IT company with a market capitalization of over US \$ 22 billion; Japan's Toyota Motors, an enterprise on the brink of becoming the world's biggest car manufacturer with profits four times those of DaimlerChrysler; South Korea's Samsung, finally, one of the world's biggest and most profitable companies for consumer electronics. Increasingly, Asian brands are becoming global brands.

In 2004, East Asia alone accounted for 26 percent of world exports and 23 percent of world imports (as against 11 and 12 percent respectively in 1970). Commodity markets are shaking from the repercussions of East Asia's growth and its demand for energy, steel, aluminium, and many other resources. As Asian workers enter the global economy, the world's non-agricultural labour force has virtually doubled in two decades. Finally, East Asian central banks now hold some \$2 trillion in American assets. Who would have predicted twenty or even ten years ago that East Asia would become the largest foreign creditor of the United States?

Of course, progress has been uneven. A few economies still lag behind, so do political regimes. Some of them do ugly things, some are still unstable; and in many coun-

tries, major parts of the population remain desperately poor. The bottom line, however, is impressive. In little more than a generation, hundreds of millions of people have risen from a life of day-to-day subsistence to a world of middle-class consumerism. And even those who have not yet risen to upper socio-economic echelons do henceforth see the powerful example of those fellow-countrymen who have.

Extrapolation is always perilous as a method of predicting the future, but Asia's economic transformation and political evolution in recent decades suggest that the geopolitical map of the world is about to be reshaped. On the Asian compass, there are two magnetic poles from now on—not only Washington, but also Beijing. Even American soft power—less visible than its hard power but enormous and invaluable nevertheless—is being challenged at this time. India and East Asia are developing a vibrant contemporary culture that offers alternatives to Hollywood and MTV. They produce not just for local markets, but for all of Asia, if not the world. In higher education as well, there are credible alternatives to American and European universities. In 2004, 926,000 researchers were employed in China, a 77% increase over 1995. The entire region is investing heavily in homegrown alternatives to Harvard, Stanford, and Oxford. These new institutions may have a long way to go to match the depth and breadth of their Western models, but they are making progress, and they are certainly less expensive than their American rivals. India and China already produce nearly one million engineering graduates a year, compared with roughly 170,000 such graduates from the US and Europe. Even if one—arrogantly and unwarrantedly—presumed that only the top 10 percent of Indian and Chinese students were as talented as the top half of Americans and Europeans, these two countries alone graduate more high-quality engineers at this time than the West.

A new confidence

Fluency in English will continue to be an essential tool for success internationally, but younger people increasingly see fluency in Mandarin as a marketable skill. These may be mere shifts in attitudes and perceptions, yet it can easily be argued that they have political significance. Declining soft power limits the ability to mobilize support in the region, but also in the United Nations and other international institutions. In Asia as much as anywhere else, new governments are coming to power that are less bound by history—and less in awe of the United States. Thus, we may well be living through the early years of what might come to be known as the Asian Century.

Some argue, in fact, that the Asian Century has already arrived. Beyond numbers and statistics, the mindset of Asians has fundamentally changed. Their economic success has brought a new confidence that they can hold their own with North America and Europe. Gone are the days of nagging self-doubt and scepticism. The ghosts of Western imperialism may linger here and there, but for the most part they have faded away. Another manifestation of Asia's new self-confidence is the insistence of Asian nations on a commensurate - and hence strengthened - representation in international organizations. The financial crisis of 1997 taught them, at the latest, how important it is to have a say about when and where the fire brigade will be sent in case of fire—or, more subtly, in case of various fires. Hence they are raising a se-

ries of uncomfortable questions. How long will the IMF remain under European and American control and the U.N. Security Council in the exclusive hands of the victorious powers of World War II? When will the G-8 Summit be broadened to include new Asian partners? And more fundamentally yet, will the Western world continue to respect the venerable Western principles of free and fair trade even if this free play of forces allows the strongest economies in the world to emerge in Asia?

It is a telling fact that Asian governments today are far more attached to the very principles that have made the Western world rich than are the established powers themselves. But it is also clear that patience on their part is required. Keeping in mind that old, established powers tend to resist the emergence of a new order, Asian leaders will have to keep pressing for change without expecting miracles.

External resistance against an “Asian century” is undeniable. It remains an open question whether there are also possible internal sources of resistances and slow-downs – be they political, economic, or environmental – and whether Asian governments have the ability to come to terms with related problems. What impact does extremely rapid economic growth have on the environment? How robust is the stability of the Chinese political system? To what extent and for how long will the Chinese leadership manage to keep change of gigantic proportions under control? How strong are centrifugal forces in India? What role will an aggressive Islamism backed by generous external financing play in Southeast Asia? To these and other questions optimists and sceptics have contradictory answers. What is becoming obvious, however, is that Asiatics want to and will increasingly be tackling their problems on their own.

II. Security Issues: Conflicts Old and New

What are the wider implications of these remarkable developments? If it is true that the pecking order of regional power—economic, political and military—is undergoing radical change, then what are we to expect? Is Asia becoming ‘only’ a better and more prosperous place to live or a more secure one as well? More particularly, what does the rise of China imply for its neighbours, for the rest of Asia, and for the world?

The overall picture may not be rosy, but positive it certainly is. Asia has enjoyed peace, to a certain extent even political stability for 35 years, and there is no obvious reason why this benign state of affairs should come to an end any time soon. As large flows of direct investment from both inside and outside the region have powered economic growth, so have they entailed rapid increases in intraregional trade and investment, freer movement of people across borders, and, perhaps most important, development of an Asian middle class. Also, there is a growing recognition that investment and trade produce vulnerabilities as well as opportunities. The prospects of Asia’s new regionalism will be taken up and discussed in more detail below.

Cold War perennials

While these trends and processes are promising indeed, various problems remain. Above all, two residues from the Cold War keep absorbing minds and resources alike. First, there is China's "renegade province" across the Taiwan Strait. In Beijing, a democratic Taiwan is still seen as a direct threat to its national unity and the future of the Communist Party. Whenever Taiwanese governments pursue independence more aggressively (if only in order to strengthen political cohesion at home), the effort resonates widely in China, even among proponents of greater openness and political reform. In this context, the United States pursues a delicately balanced strategy. It tries to keep China at bay by constant reassurances about its dedication to a One China policy, carefully worded political messages as needed, and occasional displays of military power in the Taiwan area. At the same time, it continues to reassure or chastise Taiwan as the situation requires, including warnings and admonitions when Taiwan leaders make statements that worry Beijing. So far, no one has come up with convincing policy alternatives. Instead, the prevalent view seems to be not to disturb a dangerous but reasonably stable situation.

A second Cold War perennial concerns the issue of North Korea, by now probably the world's only monolithic and hereditary dictatorship—an odious regime indeed. From what we know today, it has achieved the production of both nuclear weapons and delivery systems, which in turn provides Pyongyang with the capability to inflict enormous damage on its neighbours. The question is whether the regime might under certain circumstances actualize this potential or whether its real aim is to achieve recognition, attention and, above all, material support. Be that as it may, if there are lessons to be learned from the past decade, the most important one seems to be that negotiations are the only feasible way to end the North Korean nuclear threat. Economic pressures and isolation have little bite against a country prepared to limit its interaction with the outside world severely and one whose rulers do not shy away from imposing great hardship on its own population. Yet, even if there is no reasonable alternative to negotiations, it is far from certain that an agreement can be reached in the current Six-Party talks.

Periodic crises have accentuated both of these Cold War hangovers, and both defy simple solutions. More importantly, neither can be peacefully managed—let alone peacefully resolved—without American involvement. In fact, the United States and most of its friends continue to see America's involvement as essential to preventing war in both cases and as a basic test of American credibility.

Strained relations

Another potential source of instability in East Asia is in the odd relationship between China and Japan. In the past few years, relations between the two countries have worsened significantly. The history of the first half of the twentieth century remains an open sore. By all accounts, the Japanese have never fully come to terms with the legacy of their actions in the Thirties and during World War II. Small wonder, then, if other Asian nations, particularly China, despite its own, sorry Communist history, and South Korea publicly view Japan as still unrepentant and unapologetic. In turn,

Japan's inclination toward circumlocution and avoidance of meaningful accountability for the past comes at a price. One result is that Japan's position in East Asia remains clearly less influential than would be expected given its huge contributions to trade and investment and the vast amount of economic aid it has provided its neighbours, including China.

Sino-Japanese differences, however, will not fade away once Japanese prime ministers stop visiting the Yasukuni Shrine. The economic interdependence between the two countries is deepening, but they are also lining up as strategic rivals. Beijing is unhappy with recent trends of Japanese defence policy while Japan, now the fourth largest defence spender in the world, clearly measures its own capabilities against those of China. For some time, neither country's leadership seemed able to talk constructively to the other about how to address these issues and a difficult past, much less how to heal their differences and pursue obvious common interests. At the end of September 2006, there was a ray of light in that Shinzo Abe, Japan's new prime minister, declared that his first priority would be to travel to Beijing, and the first formal summit between the two countries in five years took place early in October. East Asia's future will depend heavily on how relations between these two countries evolve.

Obviously, economic, educational and cultural exchange could play a most helpful role in this context. Beyond and above these lower echelons, however, many Asians wish and hope for continued American presence and political involvement to encourage dialogue and restraint on both sides. The United States, in turn, is confronted with yet another challenge. On the one hand, it needs to be careful not to spark regional fears of a remilitarizing Japan or—even worse for the Chinese side—an anti-China alliance. On the other hand, it must continue to reassure Japan about the vigour of the American-Japanese security alliance in spite of obvious implications of China's slow, but seemingly inevitable rise for U.S. interests in East Asia.

From all this it is clear that American presence remains indispensable. At the same time, however, the setting has changed. One of the less noticed trends in East Asia is the emergence of a new generation of nationalist leaders, particularly in democratic countries, who are no longer willing to accept the delivered wisdom of the United States. In South Korea, for example, the generations born after the Korean War, including many current politicians and government officials, are reexamining their history. They are increasingly attentive to China, which has supplanted the United States as South Korea's largest trading partner and whose views regarding North Korea are more compatible with their own than are those of the United States. In light of these developments, the U.S.-South Korean military alliance no longer seems an assured long-term element in East Asia's future. While American military might is still respected in the region, there is a growing awareness that the exercise of U.S. power is becoming more problematic. With its focus largely on traditional security issues (hard military power, nuclear weapons in North Korea) and the "war on terror" (Islamists in Indonesia), Washington seems to be somewhat behind the curve. More specifically, the current administration stills seems to lack a clear perspective on the implications of what is happening in China.

Discussing China's future

Yet, what can we really know about China's development? The sceptics among us look beyond economic success and see a country threatened by smoldering social and economic tensions and enormous environmental difficulties that might ultimately result in political or economic breakdown or both, or produce aggressive waves of nationalism. They argue that the authoritarian and ostensibly communist government no longer has any vision or moral authority and that the regime, therefore, might no longer be able to manage peaceful leadership transitions. Some observers have been predicting political and economic breakdown for years—and yes, they may be right one day.

The optimists, on the other hand, believe that China's economic dynamism will continue, that prosperity will spread inland from the coast; that the government will gradually open more political space; that it is not only well aware of environmental problems, but also starting to do something about them. To be sure, there is no freedom of expression in China as of yet, and there still are serious violations of human rights. At the same time, the optimists argue that the Chinese have more freedom today than they have had in centuries; that there is an impressive diversity both in thought and debate; that the quality of Chinese analysis and discussion is outstanding indeed.

Whatever different opinions and concerns, East Asia has (all countries have) a growing stake in China's continued success. Economic interdependence is already such that a hard landing for the Chinese economy—and this is not the worst of all scenarios—would have a devastating effect for the outside world. Even so, the extent to which China's growing economic and political clout poses a 'challenge' or even a 'threat' to the outside world is not all that apparent. The sceptics remind us, of course, that it has been some two hundred years since the world has had any experience with a powerful China – and that the world has never seen a strong China and a strong Japan at the same time. They fear that the communist regime may gradually assume a twenty-first century version of its imperial political role in East Asia.

Again, we do not know. What we do know is that for many years now, China's leadership has been generally prudent and patient, intent on not arousing the neighbourhood or antagonizing major economic partners, particularly the United States. This may change one day—but for decades to come, China will remain, relatively speaking, a poor country. Even if Chinese leaders like to challenge the United States in one specific area (that is, the Taiwan Strait), they cannot seriously compete militarily. Nevertheless, the single most important interstate relationship of the 21st century may well turn out to be that between China and the United States of America. To manage this highly complex relation will pose formidable challenges on both sides.

In the context of security issues in Asia, our discussion remained, by and large, focussed on one specific region—a telling fact all by itself. Northeast Asia has arguably become one of the most important areas of the world. Enormous power resides there—actual and potential, economic, political, and military. So do Asia's thorniest

security problem; and looming over all is the question of how China's journey turns out in the end.

We did, eventually, touch upon other regions and issues, such as Pakistan and the delicate stability of its military regime, the ongoing conflict between Pakistan and India, and the possibility (deemed remote) of an incremental destabilization of Asian countries by Islamist fundamentalism.

A classical argument set forth by liberal institutionalists is that a high level of exchange and cooperation significantly reduces tensions and other destabilizing effects of anarchy among sovereign states. At this time, the argument is clearly gaining ground in Asia. Also, it is an indication of their new awareness and confidence that Asians increasingly want to do things "on their own". Widening and deepening regional cooperation is seen by many countries as a potentially important political tool to help prevent conflict in the area. Its proponents would like to involve and imbed China, above all; their goal is to tie the giant into a web of reciprocal benefits and obligations—a web that they believe will induce China to use its new power prudently and to take fuller account of its neighbours' interests. Will the future confirm their views?

III. The Prospect of Regional Integration

In the aftermath of the 1997 financial crisis, there has been a surge in interest in regional cooperation. A number of concrete initiatives are already proceeding at the sub-regional and sector level, while a host of more ambitious ideas are increasingly being discussed at regional meetings. The initiatives under consideration cover a wide range of issues, from promoting tourism in the Golden Triangle to efforts at increasing trade and investment with neighbouring countries, from the fledgling Central Asia Regional Economic Program to the recent South Asia Free Trade Agreement. The most far reaching ideas as of yet are to establish an Asian Economic Community between the ASEAN Plus 3 (China, South Korea, Japan) and countries such as India, Australia, and New Zealand, and a move towards monetary and financial integration in at least East Asia. At a 2005 Asian Development Bank meeting, China, South Korea and Japan decided to double the amount of reserves available under the Chiang Mai initiative for mutual assistance in case of a crisis.

The question is, of course, whether the level of commitment and political willingness in the major countries is at the levels requisite to achieve major breakthroughs. If Asian governments want to maintain the current rates of economic growth, then broader and deeper cooperation looks like a must. What are the prospects in this context? It may be helpful to start out by looking at the social and economic profile of the region.

Remarkable diversities

Depending on how we draw the lines, Asia comprises approximately 40 countries most of which are home to several distinct languages, religions and cultures. Every part of the region has—and cultivates—its own history. There are vast differences in political goals, philosophies, and institutions. Physically, high mountains, deserts, and water bodies create natural barriers. It is a remarkable diversity indeed: The two most populous countries of the world are in the region (China and India), accounting for 68% of Asia's population, while 14 countries—the small islands in the Pacific, the Maldives and Bhutan—have less than one million people each. In terms of population, China is 110,725 times the size of Tuvalu. As mentioned above, four of the ten largest economies in the world are now in Asia (Japan, China, India and South Korea), but so are some of the smallest and most isolated economies (again, the Pacific Islands or Bhutan). Japan, Singapore, Hong Kong and Taiwan are among the richest countries in the world with per capita income of between \$20-40,000, while countries such as Bangladesh, Cambodia, Laos, Mongolia, Myanmar, Tajikistan and Vietnam remain among the poorest with less than \$500 per capita.

If we look at historical, cultural, political and economic ties as well as geography, Asia is, really, an amalgam of three major sub-regions: Central Asia, South Asia, and East (including Pacific) Asia. *Central Asia*, while physically very large, is small in terms of population (2.7% of Asia) and GDP (less than 1%). In addition to sharing a long common history and religion (Islam) as well as ethnicity, for much of the 20th century the eight countries of Central Asia shared the same political and economic system as an integral part of the Soviet Union. In the 1990s, economic ties with Russia and amongst themselves withered away. Only recently have the political leaders started to discuss among themselves the need for jointly tackling common issues (such as water and environmental management) and reviving economic links. The broadest and most promising forum is known as Central Asia Regional Economic Program (CAREC). Compared to most other regional cooperation forums in Asia, however, CAREC is still at a very early stage. *South Asia* comprises seven countries and a total population of 1.4 billion people. Despite different predominant religions (Islam in Pakistan and Bangladesh, Hinduism in India and Nepal, Buddhism in Bhutan and Sri Lanka) and some 30 distinct languages, these countries share similar ethnicity and culture. Moreover, natural physical barriers on the western, northern and eastern borders, and oceans in the south have historically kept the people of this sub-region close together and provided a degree of natural protection from the rest of the world. Under British rule, these countries shared an integrated economy, a common administrative system and the same legal institutions. In the wake of the traumatic division of first India and Pakistan and later on Bangladesh and Pakistan, the three largest countries essentially severed economic and physical ties. Today, intraregional trade still is amongst the lowest of any major sub-region of the world. Over the last few years, there have been modest steps towards re-establishing social and physical links between India and Pakistan. After long deliberation, a regional free trade agreement came into effect on January 1, 2006. India has also started to pay more attention to economic relations with East Asia—a development which could eventu-

ally provide a catalyst towards forging stronger economic links between South Asia and East Asia.

East Asia and Pacific is the largest sub-region of Asia in terms of countries (27), population (2 billion) and economic output (90% of Asia as a whole). It also has been the most dynamic in terms of participating in and benefiting from globalization. While pursuing different political systems and despite lingering political issues (as discussed above) between some of the largest countries, the people share common social and economic values, such as the importance attached to education; propensity for hard work and high savings; pragmatic policies to achieve economic growth. Also, there are strong economic links already between these countries, with intra-regional trade accounting for about 55% of total trade. The region has been active in exploring ways to enhance comprehensive economic cooperation and integration and clearly offers the biggest potential in this regard. Regional leaders meet in a host of forums on a regular basis, with ASEAN being the oldest and most active.

The European reference

Thus, its sheer diversity—cultural, political, economic and ethnic—makes it highly unlikely that East Asia could ever grow into a replica of the European Union. Still, in light of the undeniable success of Europe during the last fifty years in steadily moving towards deeper and broader economic integration, it is not surprising that leaders involved in similar efforts elsewhere in the world often use the European Union as the basic reference point. The question is, then, whether (and what) the Asian region can in fact learn from the European experience.

When Europe started, in the aftermath of the Second World War, on its journey, it already shared a distinct common heritage, culture, religion and political aspirations, in addition to having relatively similar levels of economic conditions and institutional capacity. Physically, the original six members of the European Economic Community were smaller in size and more homogenous than India alone is today! (In fact, even Latin America, which is more diverse than Europe, appears much more homogenous when compared with Asia.)

Thus, the beginnings of the European project arose from a fortuitous coming together of several important elements. These allowed strong personalities like Monnet to put forth a powerful and persuasive vision which, in turn, was accepted and actively promoted by the then leaders of the two largest countries on the continent, France and Germany.

Even a brief flashback of this kind makes it abundantly clear that the context in Asia today is fundamentally different from that prevailing in Europe after the Second World War. Above all, there appears to be no overwhelming desire amongst the public at large or even amongst the political leaders to embark on a project that would blur the boundaries of individual nation states. Suspicion of supra-national bodies and authority remains strong among Asian governments, while mutual trust is a scarce resource indeed. In Europe, even—or precisely—smaller countries actively promote supranational authority because they want binding legal rules to protect them; in Asia, Nepal is suspicious of integration because the Nepalese do not

want India to run their own economy. In fact, political differences, tensions and mistrust are widely considered to be the main obstacles to faster and more comprehensive regional cooperation. Thus, the term *integration* may well be used to express a long-term vision; at this stage, however, employing the notion seems clearly premature. In the years and decades ahead, Asia needs to find and develop its own, unique approach to regional *cooperation*—an approach which could be based upon a few, but essential principles.

A framework for cooperation

First, with political realities in Asia being what they are, regional cooperation will have to be primarily *economic in nature*. Thus, projects and initiatives must be judged and justified essentially on the basis of their economic impact—which implies hard-nosed assessment of benefits and costs for each participating country.

Second, a top down approach to proceed with comprehensive efforts is unlikely to succeed; an ambitious Pan Asian vision for more than 40 countries does not appear to be realistic at this stage. Instead, a pragmatic *step by step bottom-up approach* seems more appropriate and promising. Furthermore, the use of “variable geometry” or “multi speed” cooperation is an absolute must.

Third, it is hoped that Asian leaders continue to steer an “*open regionalism*” course that will, in turn, continue to keep the region “open” to the rest of the world: this will not only help preserve a major factor in East Asia’s economic success so far, but also mitigate fears that may be generated in other parts of the world about Asians working together more closely.

Finally, the *three major sub-regions*—Central Asia, South Asia and East Asia—should be treated distinctly according to the issues and concerns of most immediate common interest. At the same time, the sub-regions should, obviously, not be isolated from each other; rather, any opportunity to enhance collaboration across sub-regional borders should be seized. Based on such a basic framework, regional cooperation could and should be actively promoted in at least five major areas. What are they?

Physical connections—particularly robust transport and communication links—are essential for the movement of goods, services, and people across countries. If connectivity is a bed rock of any economic cooperation effort, Asia is certainly no exception. Well chosen initiatives and projects could, in this context, produce visible benefits of pragmatic regional cooperation and create support for further steps.

By definition, *regional commons* have both their roots in and are amenable to effective solutions at regional levels. Therefore, such commons are a natural agenda item, as it were, for regional economic cooperation. Within Asia, examples include HIV/AIDS, the Avian Flu, piracy, water management, biodiversity and environmental management, or acid rain. It should be possible to tackle such issues at sub-regional levels in order to find solutions as expeditiously as possible.

Increased and free trade in goods, services, labor and capital are generally regarded as a basic objective and the primary benefit of regional cooperation. In addition to fol-

lowing an “open regionalism” approach, a single regional market along the lines of the European Union must remain the ultimate goal. Given the plethora of bilateral free trade agreements already agreed or currently under negotiation, a first and immediate challenge will be to develop a more uniform and cohesive regional free trade agreement. Early breakthroughs are most likely in East Asia, where in turn the ASEAN and related forums (such as ASEAN plus 3, plus India) are most likely to act as the core of efforts and initiatives.

As regards *financial integration*, Asia appears in a position to follow a different sequencing than Europe. There, momentum towards cooperation picked up only after that region had created a single market for goods and services, and the pace of financial integration accelerated after the adoption of a single currency. In Asia, the emergence of nascent regional financial markets is not the result of any proactive policy action, but a by-product of market driven trade expansion. Thus, it looks as if financial integration could proceed ahead of more *formal monetary and exchange rate coordination*, which is likely to require much more time.

A long and winding road

How to proceed? Some lessons of experience from Europe and the Americas seem relevant and applicable to Asia; in general, however, economic cooperation, let alone integration, promises to be more challenging in this region. Apart from the manifold political impediments mentioned above, financing is, as always, an important issue. If well-focused, the requirements for tackling regional commons would probably be smaller than for physical connectivity. On the other hand, financial support required to offset at least part of the adjustment costs arising from trade liberalization could be much greater and would be necessary on an ongoing basis, as the experience in Europe amply demonstrates. The total financing needs would, therefore, be significant. The European Union spends about 1% of the countries’ total GDP, which would translate into roughly \$100 billion a year for Asia.

Obviously, the road will be long. At the same time, the region is coming together in ways unimaginable only a short time ago, a result largely, but not solely, of the growth and increasing openness of China’s economy, which is pulling the region into an orbit of growing investment and trade. It should also be kept in mind that many parts of Asia already enjoy a number of advantages that should facilitate progress: primary focus of most policy makers on economic growth and development; a large pool of hard working and well-educated labour force keen to improve its economic well-being; a rapidly growing middle class throughout the region; surfeit of domestic savings which offer the potential of increasing investment and developing regional financial markets; and a much more globalized world economy of which Asia is already an important and active participant.

IV. How to Respond?

In the previous three sections, we discussed the fundamental changes in Asia's economic and political architecture, old and new issues in the context of regional security, and prospects of enhanced Asian cooperation. In the fourth and final section, we turn to adequate responses on the part of European and American decision-makers. Obviously, the economic potential of Asia is so great and growth is so rapid that Europe and the United States must, whether they like it or not, come to terms with what may well turn out to be a genuine shift in the global balance of power.

While Asian cooperation is inchoate and much remains to be done, the United States and Europe would certainly be wrong to dismiss the region's efforts as insignificant or to discount their potential. Enhanced regional cooperation at all levels reduces the possibility of conflict among the participants, helps the more backward states develop, and offers another vehicle for managing China's emergence as a regional and global power. It should make Asia an even more important international player and a greater contributor to the global commonwealth.

Thus, the United States and Europe should strongly and consistently support deeper East Asian and Asian regional cooperation. Greater cohesion in that part of the world is most likely to advance their own interests—and is probably best achieved by letting Asian countries themselves determine what sort of Community they want to work toward, including one that would welcome only countries of the region. As long as Asian regional cooperation remains consistent with the cornerstones of an international liberal economic order, any new Asian entity should be regarded as a global partner. At the same time, the United States, in particular, should make clear that it will remain engaged in the region, with strong bilateral relations, a continuing security role, and regular interaction with all existing regional institutions. As of yet, no country can substitute for the United States in keeping the peace and ensuring stability.

Involvement, not containment

So far, the U.S. approach toward expanded Asian regionalism has not coalesced. Given the wider ramifications of their specific relations, both China and the U.S. have no choice but to get along with each other. To be sure, China is a competitor of enormous potential. It seems far too early, however, to conclude, as some in America have done, that the two countries are bound to be antagonists. Restraints on both sides abound and go far beyond business and trade. China faces huge problems in its economy and polity. It is hard to envision how that huge country will be governed a decade from now, and what the role of the Communist Party will be. Its long-term success, however, is overwhelmingly in almost everybody's interest; in fact, breakdown in China would badly damage the entire world.

China, in turn, has shown on many an occasion that it wants to cooperate. In the short term, its aspirations for international respectability and influence, including its overwhelming interest in the success of the 2008 Olympics, makes China predis-

posed to accommodation, not confrontation. But even beyond, China wants and needs tranquillity and stability on its periphery as it concentrates on its own modernization.

The Chinese are realists, and the United States needs to be realistic about China. It cannot manage China, it cannot control it—and it should not try to contain it. But it should try to influence China as best it can. In light of achieving that goal, the thrust of policies should be clear and reasonably consistent. Thus, the United States should search for areas where serious cooperation is possible. It should encourage China's more active involvement in networks of mutual obligation and multilateral institutions (such as G8 or international peacekeeping) so as to engender involvement and shared responsibility. Obviously, the United States is more likely to make progress in that respect to the extent it can enlist friends and allies in a coordinated effort.

On a more abstract level and in looking beyond China, Western governments are probably well-advised to put more resources to consolidating democracy in countries where it is weak and still at risk. In authoritarian countries, emphasis on promoting market and intellectual openness promises to be at least as fruitful as promotion of democracy itself. To develop democratic habits takes time; Western support can bolster the process, but the drive for democracy must emerge primarily from within each country. For hard cases such as Burma or North Korea, choices seem limited. Continuing to stress concerns about human rights and providing humanitarian support is about as much as the Western world can do.

If the United States is struggling to develop a coherent strategy and consistent policies toward China and Asia, what can be said about the European Union and Europe at large?

Europe has enjoyed globalisation debates of its own for some time. A number of years ago, a certain 'globalisation fatigue' set in and even started to discredit the term, eliciting calls for strategic responses. Today, it is, perhaps, more the new perception of an industrious and competitive China than the unclear notion of globalisation that sparks new interest—and sometimes concern.

To some extent at least, concern over Asia's economic dynamism is due to a strong attachment to the 'good life' in Europe—an attachment that powerfully motivates people in the European Union's new member states and equally explains narrow margins of manoeuvre for reform all over the European continent. The 'good life' may be conceived as an attractive blend of democratic freedom, prosperity, social security, leisure, pension, a degree of labour protection and macro-economic stability. Again, this rich blend undoubtedly constrains many Europeans to a degree. Risk-taking is admired once it is successful, but typically cautioned against a priori and structurally discouraged in bankruptcy laws, social habits and risk capital markets. Competition may be more accepted at the EU and national levels than two or three decades ago. Nonetheless, it tends to be 'embedded' in excessive regulatory structures which can hardly be justified by market failures, but are due to specific interests or societal concerns. Moreover, and compared with Asia or the United States, the 'good life' in Europe is implicitly based on a wider range of public and collective goods. Europeans pay far higher taxes on the assumption that their respec-

tive governments fulfil their duties in this respect. Accordingly, a significant share of what is private consumption in the United States and some Asian countries is publicly administered and consumed in Europe. Tinkering with such time-honoured and widely accepted patterns can turn out to be very sensitive—especially when they are deemed to be part of the ‘good life’ and ‘solidarity’ associated with it in politics.

Homework yet to be done

Now, is the ‘good life’ in Europe threatened by Asia’s vitality? While European governments and European citizens cast an anxious eye in China’s direction, neither the Chinese nor Asiatics in general can be blamed for Europe’s problems. So far, the impact of Asia’s renewed dynamism has not been dramatic. It is true that jobs in low-skilled and low-tech sectors have been lost. The strongholds of European industry, however, have not been eroded. On the contrary, via foreign direct investments and exports in cars, pharmaceuticals, chemicals and machinery, Europe has, if anything, benefited considerably from globalisation while its weaknesses in, say, ICT have had the curious effect of rendering it less vulnerable vis à vis China and India.

Thus, globalisation in general and Asia’s recent performance in particular can hardly be blamed for Europe’s headaches and solitudes. Rather, Asia’s remarkable economic dynamism merely highlights the uncomfortable but long-recognized fact that Europeans have not yet done their homework. Small wonder, cynics may say: for years, reforms worthy of that name have proved a tricky and politically risky business for political leaders all over Europe. Labour markets provide a good example. While ‘employment protection legislation’ cannot but distort these markets in general, its impact is particularly pernicious in the third sector economy. Services generate 70 percent of the European Union’s GNP, tradable market services between 35 and 50 percent (depending on the country), and specific protected sectors easily between one-quarter and one-half of the latter share. Thus, EU member states have been more than reluctant so far to open a wide range of service sectors. When the European Commission courageously (if 30 years late) set out to liberalize intra-EU trade in services and foreign direct investment horizontally, this attempt inevitably foundered against absolute resistance from labour unions and other vested interests. With most of current debates focused on European institutional reform, this was the first truly European project, and one with teeth at that—yet, its fate amply demonstrates the reform trap Europe faces. Obviously, its rigid labour markets and generous welfare systems limit Europe’s capacity to compete. In the long run, however, the cards of European workers are probably stacked against them as a certain convergence of salaries across the continents seems to be only a matter of time.

There are other worries. In light of slow, but seemingly inevitable shifts towards a globalized knowledge economy, human capital policies in Europe are in dire need of vision and money. Policy makers love to talk about this, but keep letting other spending crowd out spending on education while promising lower or steady taxes. How, then, is the EU going to maintain productivity growth in the years and decades ahead? Obviously, there is no “Union” in this regard. Its 27 member states

(Rumania and Bulgaria have joined on January 1, 2007) include excellent performers (as measured against R&D, productivity per hour, long-run productivity growth) and others who do virtually no R&D and suffer from terribly low hourly productivity. Thus, there are huge differences; in services too, the contrasts are stark.

To be sure, the European Union (qua entity and institution) has developed many a reform strategy. Their credibility, however, is sadly low. The well-known Lisbon process is a case in point. Often suggested as a truly European project, it really is not. In all of the areas that have been included in the initiative (from labour market reforms to innovation policies), the member states ultimately decide on their own. The European Parliament has not been involved, while the European Commission just helps out. Thus, the incentive structure is weak at best and, since the member states have been involved in Lisbon via narrow policy elites only, no genuine commitment is ensuing on the part of national parliaments. And if, in spite of naming, blaming and shaming, a member state does not reform and attain the targets, only the press can howl.

In sum, there is no good reason for European governments to fear Asian-coloured facets of globalisation in their own right. There are plenty of good reasons, however, to take heart (and political will) and start engaging in more serious reforms at home. In this context, policy advice for “the European Union” is of limited use. Rather, it is individual member states which need to address their specific situation and start to solve their problems.

Beyond bonanza logic

Let us, finally, address a few strategic implications for Western multinational corporations. Politics, clearly, can only do so much. Even if political leaders were to engage more seriously in pro-market industrial policies, enhance educational opportunities and encourage innovation, research and development, comparative advantages would continue to shift in Asia’s favour for years to come. What does this mean for business communities in the Western world?

In light of what has been said, it stands to reason that an entirely new economic landscape is taking shape, one that is not only highly complex but also highly unstable. In this landscape, recurrent change does not provide much lead time but demands instant response and, therefore, a high degree of preparedness.

In this new context, sophisticated risk-opportunity-management is crucial. This, in fact, is about to become an entrepreneurial task both for the board and executive committee. A well-diversified geographical portfolio is a precondition not only for an effective risk control but also for an efficient exploitation of business opportunities.

More specifically, if it has become a must for Western multinationals to jump on the Asian train in many different areas, market entrance must be carefully prepared so as not to put critical technological know-how at risk. Protecting knowledge is easier said than done, as China seldom allows for simple outsourcing on the part of Western partners. More often than not, market access has to be bought at the price of

knowledge transfer. Western multinational corporations, then, need to consider not bonanza logic alone, but also the logic of calculable risk.

Second, intercultural competence is a prerequisite for success—in Asia as much as in other regions. The better Western companies understand Asia, its rich history and cultural diversity, the better they will be able to grasp the specifics of markets and stakeholders alike—and to adjust. Tomorrow's value chain does not stop with data, information and knowledge, but requires comprehensive cultural know-how. In addition, Western firms will need to train, coach and mentor their Asian employees—a huge task in its own right, but a prerequisite for sustainable success.

One of the most significant strategic responses on the part of Western companies is, third, a proactive regulatory dialogue in view of establishing a fair, level playing field. Regardless of whether universal standards should be the ultimate goal or not, China's neglect in areas such as xenotransplantation or biotechnical engineering are just two examples that should make Western regulators consider the consequences of their own lack of initiative and inaction. Labour and safety standards are another example. Furthermore, and given the fact that annual environmental damage in China alone is estimated at about 10 percent of GDP, related problems such as waste and pollution promise to become important for Western multinationals—all the more as related risks may easily turn into liability issues. If these and related problems are not taken up early on, Western firms (and all of us indeed) are bound to pay a price for common neglect.

While, fourth, western values and standards of good governance are still valid, their universal acceptance must not be taken for granted. As their supremacy is challenged on a daily basis, their role and significance need constant reaffirmation on one side and ever renewed approval on the other. Issues such as bribery need to be addressed from a corporate governance point of view as well as from a global capital market point of view. Multinational corporations relying on the inherent strength of Western values may expect a rude awakening.

Last but not least, decision-makers and stakeholders need to resist the temptation of linear thinking and analysis based on the focus of one discipline alone. Sound economic reasoning is crucial indeed, but a prism focused on economics alone is not adequate to monitor and understand current developments. Non-economic factors will have a major impact on the future of giants such as India and China. Moreover, transition periods may be discontinuous and chaotic rather than linear and smooth.

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