

EAST ASIA AND THE INTERNATIONAL SYSTEM

REPORT OF A
SPECIAL STUDY GROUP
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COORDINATOR



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Report of a Special Study Group to The Trilateral Commission

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The Trilateral Commission was formed in 1973 by private citizens of Europe, Japan, and North America to foster closer cooperation among these three democratic industrialized regions on common problems. It seeks to improve public understanding of such problems, to support proposals for handling them jointly, and to nurture habits and practices of working together. The European group has widened with the ongoing enlargement of the European Union. The Japanese group has widened into a Pacific Asian group. The North American group now includes members from Canada, Mexico, and the United States.

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Appendix: Trilateral Commission Special Study Group on East Asia and the International System

I. INTRODUCTION

East Asia today is a core part of the international system. Stretching from Japan and China in the north to Myanmar and Indonesia in the south, it has about 40 percent of the world's population and 25 percent of its gross product, about half the latter accounted for by Japan. Its economies possess almost half the world's gold and foreign exchange reserves. During the decade of the 1990s, East Asia accounted for more than 50 percent of new global petroleum demand despite the economic crisis at the end of the decade. It also accounts for about 40 percent of carbon dioxide emissions from fossil fuel consumption.

These statistics underscore a point stressed in the 1997 report to the Trilateral Commission entitled *Community-Building with Pacific Asia*—that there is virtually no global problem that can be managed, much less resolved, without the participation of the major East Asian countries. Despite this, the countries of the region have not been major actors in shaping the institutions and rules of the international system. They often lack the weight and status in international organizations they should have based on population or economic size. In some cases, such as China and Taiwan in the World Trade Organization, they have lacked representation. Where they have representation and status, they are rarely *deman-deurs* or agenda-setters.

The Trilateral Commission Special Study Group on East Asia and the International System is based on the assumption that East Asia will continue to rise in global importance and that the international system will have to be adjusted accordingly. The project is intended both to underscore East Asia's *importance and to help establish a process through which leading thinkers from emerging East Asia and the traditional Trilateral countries jointly explore issues raised by East Asia's greater role in the international system. This process should both facilitate Trilateral understanding of the interests, priorities, and sensitivities of emerging East Asia and strengthen East Asian input into thinking about global issues. It should lead to the full integration of East Asia beyond Japan into Trilateral activities.**

* In 2000, the Japan group in the Trilateral Commission was widened into a Pacific Asia group. The new group held its first regional meeting in Seoul in November 2000.

One might question why the traditional Trilateral countries should encourage a transformation that promises to reduce their own global influence. The rise of East Asia is a phenomenon that, if it could be suppressed at all, would be at great cost for both the traditional Trilateral countries and East Asia. There are absolute benefits for both in East Asia's rise as long as adjustments can be carried out smoothly in an evolving international system.

The Study Group held two workshops in Seoul (November 1998) and Beijing (October 1999). These workshops involved a considerable number of participants from non-Trilateral countries of East Asia together with individuals from traditional Trilateral countries (see Appendix). At the Trilateral Commission annual meetings in Berlin (March 1998) and Washington (March 1999), one session was devoted to Study Group-related issues and Study Group participants met for discussion among themselves on the side of these larger meetings. Draft papers from Study Group participants came before the Trilateral Commission annual meeting in Tokyo in April 2000, and many Study Group participants served as panelists in the related discussions.

A number of papers were prepared in the course of the Study Group's work. Four of them have been drawn together in this publication. Charles E. Morrison, Coordinator of the Study Group, worked with each of the authors and also prepared this brief introduction.

- The first essay following this introduction focuses on deeper economic integration in East Asia and its implications for the international economic system. In the wake of the financial crisis of 1997-98, while the Study Group was operating, a sea change took place in East Asian perceptions of the international economic system that is causing a determined thrust toward deeper East Asian integration. This first essay analyzes how deeper integration is taking place and raises key questions about its effectiveness and broader international impact. The conclusion of this essay is basically optimistic. No crisis economy in East Asia turned inward despite the painful adjustments required in the wake of the financial crisis, and this commitment to openness should be embedded in any new regional institutions.
- The unprecedented tranquility and prosperity which East Asia has enjoyed since 1975 is largely attributable, the second essay argues, to an implicit "Grand Bargain" struck between Tokyo, Beijing, and Washington during the 1970s and 1980s, through a process of extensive dialogue and mutual accommodation. The bargain covered Taiwan, the security architecture of East Asia, third-country issues,

economic relations, and human rights and governance. The 1990s saw increasing pressure on this Grand Bargain, for various important reasons. Has the Grand Bargain now outlived its usefulness? This essay concludes that it is far too early to jettison arrangements that have brought unprecedented stability to the region. By expanding the earlier accommodations to address an altered set of issues, the leaders of the region can build on the Grand Bargain and go beyond it.

- Another key part of the East Asian success story, the third essay argues, was the "ASEAN Formula," the approach to regional relations and economic engagement of the founding members of the Association of Southeast Asian Nations—Indonesia, Malaysia, the Philippines, Singapore, and Thailand. While their regional cooperation was based on a minimalist approach which respected sovereignty and privileged non-interference, ASEAN helped maintain international order in Southeast Asia. The other dimension of the ASEAN Formula was economic engagement with the world. The essay argues that, in light of the malaise created by internal changes and the fall-out of the Asian economic crisis, the ASEAN Formula needs to be reworked to be made relevant to the Southeast Asian realities of the twenty-first century.
- In the brief fourth essay one of the most distinguished participants in the Study Group discusses the building of a viable East Asian security order in a globalizing, post-Cold War world. Elements of a new regional security framework for East Asia are beginning to take shape. Like the Cold War order in East Asia, this new framework continues to feature the deep involvement of the United States, enabled by its alliance relationship with Japan. However, indigenous actors are playing a much larger role and East Asia has a distinctive pattern of regional relations in a more decentralized global security framework. Given the great diversity in the region, the "integration" model embodied by NATO and the European Union is not workable in East Asia; nor is the outdated balance-of-power model. This essay argues for an eclectic "multi-layered network model." The first layer consists of a series of bilateral arrangements to take care of concrete security needs. The second layer is a regional framework for consultations on issues affecting common security interests.

The remainder of this introduction focuses on two important matters that highlight the importance of the East Asia and the International System project: the perception gap between Trilateral and East Asian understanding of the international system and the recent growth of East Asian regionalism.

It should be noted that Japan plays a dual role as both a traditional Trilateral country and an East Asian country. In general, through the rest of this introduction, East Asia refers to the developing countries of the region, excluding Japan. However, many of the perceptions described here for East Asia's emerging economies have significant force also in Japan or did in the recent past. Japan's dual role is not an easy one, particularly in recent years as Japanese are rediscovering their East Asian identity. Of all the traditional Trilateral countries, Japan has the greatest stake in the comfortable integration of East Asia into an international system perceived to be of mutual benefit to Trilateral and East Asian countries.

A. DIFFERING PERCEPTIONS OF THE INTERNATIONAL SYSTEM

Underlying many of the issues associated with East Asia-Trilateral relations are differences in prevailing perceptions of the nature and legitimacy of "the international system." Despite the frequency with which this term is used in the Trilateral world, it is rarely defined or given careful thought. Generally it is used as a synonym for the institutions and patterns already governing the relations among the major Western powers and is regarded as fair and of universal validity. The authoritative voice for determining righteousness in the international system is the "international community."

For emerging East Asian countries, however, the same system is basically a Western system, originally created by and for the transatlantic powers with the recent, but perhaps not fully integrated, addition of Japan. At the apex of this system as the main global agenda-setters are the Group of Seven and the Permanent Five of the UN Security Council, each with only one Asian member. Although much modified over the decades, the historical roots of the present system lie in the same state system responsible for colonial conquests, unequal treaties, and other forms of humiliation that remain potent memories in much of East Asia. As such, the international system is rarely endowed with the same legitimacy and moral authority as in the Trilateral world, particularly as interpreted by the "international community," a term that in East Asia often appears to refer mainly to dominant Western public and political opinion.

As a practical matter, emerging East Asian countries usually find it in their interests to accommodate themselves to the dominant international norms and rules. However, while seeking benefit and legitimacy from participating in the system, there is also strong suspicion that the system operates to the relative benefit of its creators and constrains the ability of

late-comers to assume equal status. Similarly the changes in the system, which typically flow from changing needs and norms in the traditional Trilateral world, are frequently viewed with suspicion as efforts to move the goal posts.

This can divert debate away from the merits of participation in terms of the contemporary international scene and national interests. For example, it is often pointed out in developing East Asia that the Western powers expect East Asian countries to abide by standards that they did not impose on themselves during their own earlier periods of economic growth and political development. This is true, but it also focuses on a historical equity argument at the expense of analysis of whether the standards themselves would be beneficial or not for East Asian countries in the contemporary context.

Differing perceptions can be illustrated by popular East Asian and Trilateral reactions to two events that occurred during the work of the Study Group: the Asian economic crisis and the Kosovo intervention.

In the case of the economic crisis, Western public commentary, particularly in the early stages of the crisis, tended to treat it as if the affected countries and their economic circumstances were homogenous, and to look for causes in such common features of the East Asian systems as corruption, cronyism, and institutional lacunae. Familiar with the effective operation of the international financial system in the Trilateral world, explanations in the popular media focused on what was wrong with East Asia. The Asian model or models of development were suddenly regarded as fatally flawed. More attention was given to risky borrowing than to risky lending. Unfettered capital flows were generally accepted as inevitable and beneficial rather than as part of the cause of the catastrophe.

In contrast, East Asians knew that these features of Asian systems had been there all along during the many years of high growth. It seemed incongruent that the very systems that had been so much praised in the Trilateral world as paragons of growth up to 1997 were now the target of such criticism. In seeking answers to what had gone wrong, East Asians looked to features in the external environment that had so quickly exposed the weaknesses in their domestic systems, particularly the huge and panicky capital movements. Some sinister explanations of the crisis—including the notion that the United States had orchestrated it to cut rising East Asian economies down to size or that hedge fund executives had engineered the crisis for their own profits—enjoyed significant popularity. For some East Asians, such explanations took the Asian models off-the-hook as the culprit of this drama.

Debate surrounding a premature proposal emanating from Japan for an Asian monetary fund was affected by the differences in perception. The proposal was opposed by the United States, where there was concern that it would undermine international disciplines and delay needed reforms in the affected Asian economies. In contrast there was considerable support in the affected Asian economies, which viewed the prospect of access to additional Japanese capital as highly desirable to help counter capital flight.

In the case of Kosovo, Trilateral debate gave little opportunity for thought about any possible reactions from East Asia. In this region, however, there was a notable mistrust of and discomfort with the humanitarian rationale behind the NATO intervention, although individual country reactions varied with religious affinities. The norms of sovereignty and non-interference in the internal affairs of other countries are widely appreciated in a region where many countries have been subjected to foreign military interventions. Aside from the general attachment to this norm, the Kosovo intervention demonstrated the unequal structure of global power and influence in the international system. East Asian countries tended to see the intervention as almost entirely an American-driven and executed affair, discounting allied pressures and presence. The U.S. bombing of the Chinese embassy in Belgrade reinforced this perception.

China makes clear its strong preference for a more multipolar system. While many smaller East Asian countries have U.S. links and welcome the continued presence of U.S. forward forces in the region to balance the larger local powers and compensate for their own weaknesses, they strongly prefer the U.S. presence to be a passive one in the absence of a threat of international aggression. To them Kosovo suggested that the Americans might play a more active role in backing human rights concerns with sophisticated military muscle. The later reluctance of the United States to become militarily involved on the ground in the 1999 East Timor crisis helped to counterbalance this impression of an interventionist-minded superpower. The East Timor crisis generally reaffirmed the non-interventionist norms of the East Asian states. The pressure for intervention largely came from outside the region, and the Asian states were reluctant to send forces despite the Indonesian desire for non-Western peacekeepers once outside intervention was inevitable.

B. EVOLVING EAST ASIAN REGIONALISM

A lasting effect of the Asian economic crisis and the Western triumphalism associated with it was to help bring East Asian countries, including Japan, closer together. The lack of a regional mechanism for intergovernmental dialogue and cooperation has been a distinctive feature of East Asian international relations. During the Cold War years, regional cooperation mechanisms were found only in parts of Southeast Asia or for quite specific functional tasks (such as the provision of development capital through the Asian Development Bank). With the end of the Cold War, Asia-Pacific regionalism (including the Americas and Oceania) emerged with the Asia Pacific Economic Cooperation (APEC) process, established in late 1989. The subsequent Asia-Europe Meeting (ASEM) established an interregional dialogue joining East Asia with the European Union. By the year 2000, however, East Asian attention had shifted toward the development of an institutional expression of East Asia's own identity. This potentially has important implications for the dialogues with other regions and the global system.

APEC and ASEM owe their existence to a combination of political and economic drivers. Despite their promise, both have struggled in recent years to maintain the momentum of their earlier years. A string of annual APEC meetings from 1993 to 1996 focused on vision, principles, and action plans that increasingly focused on trade. This process produced a bubble of expectations that were difficult to sustain when concrete, "WTO Plus" results were needed. Efforts to accelerate trade liberalization and facilitation on the basis of concerted, voluntary unilateral and collective actions (such as "early voluntary sectoral liberalization") met resistance from special interest groups, encountered disputes about burden-sharing, and were hampered by a growing mood of skepticism about the benefits of globalization. APEC's inability to respond effectively to the financial crisis added to the disappointment. The continual widening of the organization (from the initial twelve members in 1989 to twenty-one a decade later) reduced internal "like-mindedness" and tended to blur the focus. APEC recovered some momentum in 1999 and 2000 by reducing expectations to the level of more realistic consensus-building in the area of trade and emphasizing areas more amenable to cooperation. The political value of APEC was reinforced by the important bilateral "side meetings" among leaders at its September 1999 Auckland ministerial and leader meetings, and a special informal session there on East Timor. Indeed the fortuitous coincidence of the APEC meetings in Auckland with the East Timor crisis helped produce a degree of international and

regional consensus and cooperation that would otherwise have taken much longer to achieve.

ASEM, which held its inaugural leaders meeting in 1996 and has had subsequent leaders meetings in 1998 and 2000, has also had difficulty sustaining interest and momentum in the wake of the economic crisis. However, since ASEM is an inter-regional dialogue, it required its East Asian side to organize and coordinate, and thus became an incubator for broader East Asian regional cooperation. ASEAN reinforced this by establishing a regular ASEAN Plus Three (China, Japan, South Korea) dialogue as a part of its summits. An East Asian vision group, consisting of two individuals from each country and analogous to APEC's former Eminent Persons Group and ASEM's Vision Group, was commissioned by the ASEAN Plus Three countries at the November 1998 Hanoi summit. This group reports to the leaders at the 2001 summit. Like APEC, it appears that some form of freer trade arrangement is likely to be a centerpiece of the East Asian movement. At the same time, smaller East Asian groupings and bilateral schemes are proliferating. The leaders of the three Northeast Asian countries held an unprecedented joint breakfast meeting alongside the ASEAN Plus Three Summit in Manila in November 1999 and agreed to joint research on economic cooperation. There are also numerous proposals for bilateral free trade agreements both within East Asia and between East Asian countries and outsiders.

These steps have not yet found concrete expression in an East Asian institutional identity, but this is only a matter of time. Meanwhile, the emerging movement toward East Asian regionalism has received relatively little attention in the Trilateral world outside Japan despite the important issues it raises. What should be its underlying vision and the scope and nature of its activities? How can the East Asia group avoid falling into the same institutional traps that have afflicted APEC and ASEM? Should its efforts be conducted on the same basis of informal consultation and cooperation that was pioneered in the "ASEAN Way," or is such an approach under-institutionalized and ineffective in addressing concrete issues? How will East Asian regionalism relate to subregional efforts, such as ASEAN, as well as to the larger regional and inter-regional institutions such as APEC and ASEM? Will East Asian regionalism be compatible with and supportive of global institution-building?

This last question relates directly to the theme of the Study Group. East Asian and Asia-Pacific regionalism has evolved thus far within the context of global norms and institutions. In *fact*, a claim can be made that compared to European or North American regionalism, the regional cooperation institutions of East Asia and the Pacific have done no vio-

lence to global norms and rules. This is likely to remain the case at least in the near-term future since East Asia is diverse and thus there is little common ground beyond the minimal global norms to serve as a basis for intensified cooperation within the region. In this sense, it is unlikely that an East Asian institutional process would establish a new set of norms in competition with those prevailing in the world at large.

However, the establishment of an East Asian or Northeast Asian institution might affect the international system in several ways. First, for the same reason that East Asia is unlikely to move beyond the universal, minimal norms of order, it could well be a conservative voice in the evolving international system. The influence of a conservative approach would be strengthened through East Asian coordination and organization. There is also a possibility that the East Asian countries more likely to support more intrusive forms of international norms and institution-building (these include the Philippines and Thailand) would moderate their support in the interest of group unity. Japan's policies on such issues could also be powerfully affected. Thus there is a potential for increased divergence and tension between East Asia and the West over the appropriate norms and rules for the international system.

Second, East Asian regional cooperation could serve important regional order-keeping functions. Many global regimes are weak and require reinforcement at the regional level. Even in the internet age, geography is meaningful, and neighboring countries are most likely *to* perceive a direct stake in each other's well-being. This sense was reinforced in the East Asian region by a perceived lack of concern by the United States and Europe about the impact of the financial crisis on the region, as contrasted with the significant regional contributions to the international financial support packages.

Rooting regional security more in indigenous institutions and depending less on outside powers (notably the United States) is probably much further in the future. The key security relationships are currently found in the Japan-China-U.S. triangle. China's rapid rise is occurring in a region that lacks firmly established, integrating institutions like the European Union that help build trust. Asia has no security community in the transatlantic sense of a zone of peace in which resort to violence has become virtually unimaginable. The building of *such a community could* be the outcome of the now nascent forms of regional cooperation. This would be a truly historic contribution to regional and global order, but since it involves shifts in basic attitudes and political institutions, it is clearly a long-term task. In the meantime, there is a need to establish a more politically viable set of understandings among the large powers as

to how to manage their own relations and build cooperation in the handling of regional order problems.

Finally, the growth of East Asian regionalism underscores the continuing need for reinforcing connections across the Pacific to the Americas and across the Eurasian landmass to the European Union to prevent misunderstanding and maintain inter-regional links. East Asians are understandably concerned about the potential reaction of the United States to exclusive forms of East Asian regionalism since the United States opposed both Malaysian Prime Minister Mahathir's East Asian Economic Caucus proposal of the early 1990s and the 1998 version of the Asian monetary fund. While American officials have said that U.S. concern has declined with the firmer establishment of Asia-Pacific processes, the Asian monetary fund proposal illustrated the continuing potential for misunderstanding in the absence of consultations. European-East Asian dialogues can help reinforce the notions of open regionalism in both areas.

C. EAST ASIAN PARTICIPATION IN THE TRILATERAL PROCESS

The work of the Special Study Group reinforces the sense that as the linkages of East Asian countries with the international system have intensified so too have the linkages within the East Asian regional system. There is no natural leader in this regional system. Japan remains by far the largest and most technologically advanced economy, but it has either been constrained or constrains itself from seeking a strong leadership position. China is by far the region's largest nation, but it has many domestic priorities and is still only partially integrated into the international system. The ASEAN group has taken much of intellectual leadership for establishing institutional processes and has historically the longest and most intimate contacts with the Western powers. Because of its geopolitical position, South Korea may play a leadership role in developing forms of Northeast Asian cooperation.

These observations underline the importance of reaching beyond Japan in connecting East Asia to Trilateral dialogue and research. East Asia is an essential partner in a continuing effort to build international cooperation in the management of global problems.

II. DEEPER INTEGRATION IN EAST ASIA: IMPLICATIONS FOR THE INTERNATIONAL ECONOMIC SYSTEM

Wendy K. Dobson

A. INTRODUCTION

A sea change in East Asian perceptions of the international economic system is causing a determined thrust toward deeper East Asian integration through regional financial and trade institutions. The financial crisis of 1997-98 brought this sea change in perceptions in its wake. The crisis revealed weaknesses in the international financial architecture at the same time that it bared weaknesses in domestic policies and institutions in East Asia. Many East Asians felt the existing international financial system failed to provide them with adequate prescriptions or aid at a time of great need. In response, governments are intensifying regional policy cooperation and have begun to develop regional institutional capacity to head off future financial crises and manage them if they occur. This change in perceptions of the international economic system has been reinforced by paralysis in the World Trade Organization (WTO). The failure of governments to launch a new round of multilateral trade negotiations at the November 1999 WTO ministerial meeting in Seattle—the remarkable "battle of Seattle"—is helping propel regional approaches to trade liberalization.

Deeper integration in East Asia is a potentially substantial development, which will influence the future shape of the international economic system. Section B of this essay reviews the primary factors contributing to the financial crisis and discusses the implications for policymakers in East Asia, in a context of diminished confidence in global institutions. The emphasis is on macroeconomic policy management, structural reforms, changing incentive systems, overhauling crisis management, and the next steps for trade liberalization. East Asians have drawn their own lessons from the crisis which differ from the mainstream consensus. Section C

analyzes how deeper integration is taking place. Three trends are identified: proliferation of bilateral and regional free trade arrangements (FTAs), development of regional financial arrangements (RFAs), and movement toward regional crisis prevention and management mechanisms. Section D raises key questions about the effectiveness and broader international impact of deeper integration in East Asia. To be effective, these arrangements will require commitment to rules and regimes that will enhance prospects for growth and stability albeit at the cost of some independence in domestic policy. Section E offers some concluding thoughts. No crisis economy in East Asia turned inward despite the painful adjustments required in the wake of the financial crisis, and this commitment to openness should be embedded in new regional institutions.

B. THE FINANCIAL CRISIS AND ITS IMPLICATIONS

East Asians were early and natural globalizers in that market forces encouraged cross-border networks through which goods, services, capital, information, and people have flowed. Two "new" factors, however, have been added around the world—technology and policies. The information and communications technology (ICT) revolution is changing the ways business is done. ICT has been applied first and fastest in the financial sector. Private capital now flows rapidly around the globe. Capital markets are now the channels for transmitting economic disturbances across borders and regions. In this kind of world, countries that attend diligently to the fundamentals (in the past that would have implied exchange rate stability) can be overwhelmed by short-term capital surges and reversals. Hence, the role of policy—to build infrastructural public goods, to reduce obstacles to cross-border flows, and to improve the safety and soundness of financial systems.

Until recently, East Asian integration, both within the region and with the rest of the world, was largely market-driven. In 1998, intra-regional trade flows (including Australia and New Zealand) accounted for over 44 percent of the regional total¹ (see Table II-1 on page 29). In 1994, the stock of FDI in the emerging economies originating within the region (including from Japan) ranged from as high as 80 percent in China to as little as 30 percent in the Philippines (see Table II-2 on page 30). Production networks of both indigenous firms and multinationals underpin these linkages. The latter slice up the value chain, allocating production to locations with comparative advantage and outsourcing the production of both goods and services within the region (Dobson and Chia 1997;

Feenstra 1999). These activities increase the openness and integration of the economies but also increase vulnerability to external shocks.

1. Primary Factors Contributing to the Financial Crisis

A common cause of the East Asian crises was high ratios of short-term private sector debt to international reserves (Rodrik and Velasco 1999; Dobson and Hufbauer forthcoming). The financial crises were characterized by significant volatility in short-term capital flows, particularly bank debt (see Table II-3 on page 31), from or to (in the case of capital flight) international financial centers. International capital had been plentiful for several reasons. Rates of return in the OECD economies fell in the 1990s as inflation and interest rates dropped, making rates of return in emerging markets relatively more attractive to investors. In the OECD economies, intensifying competition in the financial sector spurred consolidation, creating global mega-firms, particularly among the banks. With OECD populations aging, wealth management funds are proliferating, as are new financial instruments. Geographical diversification is a way to manage the risks these large capital pools face. Modest portfolio reallocations by global mega-firms can have significant impacts on liquidity and currency volatility in emerging markets. Although it is well-known that residents of emerging market countries also contributed to financial volatility through capital flight, magnitudes are difficult to measure due to data limitations. The crises in different countries were triggered by different combinations of macroeconomic policy mistakes, structural weaknesses, and incentive problems:

- Macroeconomic policy in the crisis economies in Southeast Asia (Indonesia, Malaysia, Thailand, Philippines) was characterized by fixed-but-adjustable exchange rate pegs that were incompatible with monetary policy independence and capital mobility (the open economy trilemma²). Central banks maintained formal or de facto pegs long after they should have been revised to reflect changing economic fundamentals. Currency crises subsequently turned into banking and economic crises, in part because borrowers in foreign currency and investors alike assumed there was neither exchange-rate nor interest-rate risk. Defense of the pegs required high interest rates that pushed highly leveraged business borrowers into insolvency, taking jobs, income, and output with them.
- Structural weaknesses increased vulnerability. Domestic financial systems, dominated by banks and debt finance, were slow to adapt to the added externally generated risks of mobile capital. Lacking access to

other forms of domestic finance than bank debt, many corporations became highly leveraged during the high-growth years. Some borrowed heavily abroad in unhedged foreign currencies. Some governments also biased policies and incentives to favor foreign over domestic capital (for example, Thailand taxed foreign capital more lightly and South Korea restricted FDI inflows but encouraged foreign debt).

- Existing incentive systems contributed to debtor and creditor moral hazard. Both debtors and creditors assumed that either the national central banks or the IMF (or both) would act as lender of last resort in a crisis. On the creditor side, the 1988 Basel Capital Accord was responsible for a short-term debt bias. The risk weight on short-term interbank lending, for example, required lending banks to allocate only 1.6 percent of capital requirements to such loans (Furfin 2000). On the debtor side, central banks had previously bailed out banking systems when they got into trouble and were expected to do so in future.

During the crisis, international crisis management reflected a one-size-fits-all approach, yet the private sector nature of the crisis and the implications of bank-dominated financial systems and highly leveraged business systems naturally raised questions about alternative measures such as capital controls and a regional lender of last resort. The IMF role is being re-evaluated. Much has since been done to create frameworks at the multilateral level that will increase the safety and soundness of the international financial system. National bank regulators cooperate globally at the Bank for International Settlements (BIS) and other regulators cooperate in designing guidelines of best practice in the Financial Stability Forum (FSF). But skepticism persists about how well these innovations serve the interests of East Asians in reducing their vulnerability to international economic shocks.

2. Implications for Policymakers in East Asia

The crisis of confidence in global institutions has a number of implications—with respect to macroeconomic policy management, structural reforms, reforms of incentive systems, crisis management, and trade liberalization—for policymakers in East Asia, for regional cooperation, and for the international system.

a. Macroeconomic Policy Management

Most market-based East Asian economies (with the exception of the Philippines) had established strong macroeconomic policy records characterized by low inflation, stable interest rates and exchange rates, and

fiscal prudence. After the financial turmoil subsided, high interest rates came down and exchange rates stabilized, but large debt overhangs and fiscal imbalances persist as financial and non-financial firms are restructured and recapitalized or closed. Thus, one of the main concerns in the immediate future is the impact of fiscal consolidation on investment. Furthermore, since the crises, most of the region's central banks are managing floating exchange rates (with the exception of China's, Hong Kong's, and Malaysia's fixed-rate regimes). Managed floating allows central banks to rebuild their foreign reserves (see Table II-4 on page 32), one factor (but not the only one) that is recognized to have discouraged speculators from attacking Taiwan and Singapore during the crisis. Managed floating is also a way to resolve the open economy trilemma; accepting the mobile capital that is attracted to good performers, but stabilizing exchange rates to preserve export competitiveness.

Some consensus is emerging that a combination of managed floating and temporary capital controls is a feasible and appropriate set of measures to respond to financial volatility, at least in the absence of more far-reaching institutional changes (such as monetary integration that would eliminate exchange-rate volatility). Critics of one-size-fits-all argue that temporary capital controls and private sector solutions to restructure unsustainable debt profiles would have been more appropriate in the East Asian crises (Wade and Veneroso 1998; De Gregorio et al. 1999). Indeed, temporary prudential capital controls have gained more respectability in the wake of the Malaysian experience. But even the Malaysians stress that such controls must be well-designed and used with great care to buy breathing space for structural reform, since they can be costly. Controls on outflows can undermine confidence in a financial system by trapping capital and unintentionally spurring capital flight. Controls on inflows, such as taxes on international transactions, can raise the cost of borrowing and lengthen its term.

b. Structural Reforms

Weak financial systems and weak corporate governance were two major sources of structural weakness. As economies become more complex, they need stronger financial systems that permit savers and investors to interact with confidence with borrowers and issuers not known to them. This requires strong banks, diversified institutional frameworks that supply financial instruments of longer duration, such as bonds and commercial paper, and transparent information flows and payments and settlement arrangements that make deep and liquid financial markets possible.

Stronger systems will require stronger supervisory oversight and enforcement of prudential standards, creation of adequate infrastructure, accounting and legal frameworks that promote transparency, and better corporate governance that promotes integrity and fairness. In East Asia there are several constraints. One is the lack of trained manpower. Others are the lack of independent supervisors and vested interests in existing systems. East Asian financial sectors have improved, but still trail best international practice.³

One of the quickest ways to improve practices and to provide new skills and modern risk management products is to increase foreign participation in national financial systems. Foreign institutions fan the winds of competition and innovation; they diversify the financial system and introduce institutions that reflect the stringent regulatory regimes of their home countries. Foreign participation is increasing in an ad hoc way in Thailand, South Korea, and Japan as authorities look to foreigners to help recapitalize and modernize their financial institutions, but there is still a long way to go.

The magnitude and nature of corporate distress indicates that better bankruptcy procedures are also required to speed restoration of corporate financial health. Beyond that, more transparent corporate governance seems to be needed, particularly for firms engaging in international business, with better representation of the interests of minority shareholders.⁴

c. Changing Incentive Systems

This issue is at the heart of debates about financial architecture because of concerns about moral hazard—market participants taking greater risks if they think they will be bailed out than they would if there were no such expectation. On the one side are advocates of leaving markets alone. They emphasize the basic principle of a well-functioning economy—that those who take risks should be allowed to gain or lose (International Financial Institution Advisory Commission 2000). They believe that market forces, not central banks or the IMF acting as lender of last resort, should resolve financial crises. On the other side are those who believe that leaving adjustment to the markets alone exacts too high a social cost. But if official institutions intervene, their interventions must be carefully designed and applied (Council on Foreign Relations 1999). Accepting the second position, creditor moral hazard can be reduced by removing distortions (such as those in the 1988 Basel Capital Accord that bias credit allocation decisions towards short-term debt) and by creating a transparent framework for their involvement in crisis resolution (Dobson and Hufbauer forthcoming). Borrower moral hazard can be reduced by, among other

things, strengthening the oversight and transparency of domestic financial systems so that financial institutions improve their ability to evaluate and monitor risk.

d. Overhauling Crisis Management

Overhauling crisis management machinery requires first that governments decide what the IMF, which is at the heart of the global financial system, should do. Even the advocates of market-led adjustment accept that an international institution is necessary. A consensus is emerging that the IMF should become more focused on crisis prevention through its basic surveillance mandate and on crisis management as a facilitator and arbiter among governments and private sector players (Kohler 2000). Supplying unlimited liquidity should not be at the heart of its mandate. Instead, it should provide "working capital" to keep an economy functioning while it restructures its obligations and fixes policy errors (Dobson and Hufbauer forthcoming).

e. Next Steps in Trade Liberalization

It is widely recognized that the international financial system has become more crisis-prone, but few of the host of measures being taken internationally and domestically to enhance its safety and soundness aim to reduce the openness that has been achieved. At the same time, the international trading system—long a source of openness and stability—seems to be losing its liberalizing momentum. The give-and-take of tariff reductions on goods and services has been exhausted. Since the end of the Cold War, trade policy in the United States has drifted. The president lacks fast-track authority (whereby Congress authorizes the executive branch to negotiate trade agreements and agrees to approve them on an up-or-down vote) considered essential for U.S. participation in multilateral negotiations. Differences among major governments prevented the launching of the WTO millennium round of multilateral negotiations in Seattle in 1999. The presence of thousands of demonstrators protesting the WTO's perceived role in "globalization" did not help. But the central lesson is that the OECD countries' commitment to trade liberalization is flagging. They have plucked the low-hanging fruit in previous rounds. Now they must address entrenched domestic interests if they are to tackle agricultural trade and such sensitive topics as the environment, labor standards, and social issues.

East Asia's export-led growth has been highly dependent on trade liberalization in the major OECD economies. If this source of growth momentum declines or is uncertain, other sources must be found. One is

growth in domestic demand. The other is to accelerate the APEC-sponsored liberalization process by pursuing bilateral and regional FTAs. The only WTO members who are not part of a regional trade arrangement are Japan and South Korea. Long committed to the WTO for historical reasons, Japanese policy began an unprecedented shift in 1998 when Japan initiated several bilateral negotiations. By late 2000, studies of and commitments to negotiate FTAs had proliferated in the region. The two trade approaches are not mutually exclusive. Lack of U.S. participation and leadership at the global level is seen to make the second route imperative, both as a contingency plan and as strategic pressure on the U.S. Congress and the new U.S. President.⁵

1. Summary

East Asians have drawn their own lessons from the crisis which differ from the mainstream consensus. They place greater emphasis on the region's diversity of economic systems and levels of economic development in considering how to reduce the risks of integrating into the world economy. They emphasize tendencies toward greater leveraging (given the dominance of banks in immature financial systems), relationship-based transactions (given the role of corporate and family groups), and producer-oriented and interventionist industrial and financial policies. While many recognize the need to remove structural obstacles to the operation of market forces, these are changes that cannot realistically be made overnight.

East Asians are pursuing their own trading arrangements and debating financial arrangements that include building the infrastructure for more efficient intermediation of their own substantial savings. They are developing their own policies to reduce vulnerability in world capital markets such as managed floating exchange rate regimes, the use of temporary prudential capital controls, a regional lender-of-last-resort capability, and closer macroeconomic policy cooperation.

Their choices will have an impact on the international economy. Non-discriminatory trade arrangements will enhance the international system. Regional financial arrangements will not necessarily have discriminatory implications, but they could create distortions in international capital markets. These arrangements and their implications are the subject of the rest of this essay.

C. HOW IS DEEPER INTEGRATION TAKING PLACE?

East Asian skepticism about the mainstream consensus is buttressed by their growing economic clout in the world economy. They account for a third of world output and they are leading traders. Their central banks own much of the world's international reserves; Japan and China alone account for roughly \$450 billion (*Economist* 2000). These strengths can be turned to advantage in reducing their vulnerability to external shocks— and in reshaping the international system. How will these initiatives play out? How should they play out so that they benefit both the region and international system?

The crisis was a catalyst for regional financial initiatives both for "plumbing" (infrastructure) and architecture. With respect to the plumbing, since much of the region's substantial savings are intermediated in world money centers, substantial infrastructure is required to strengthen the region's ability to intermediate savings more efficiently.

With respect to the architecture, cooperative regional mechanisms are needed to promote closer monetary cooperation and possibly regional monetary integration. The rationale for closer regional financial cooperation is developmental. Bad macro performance, as well as structural weaknesses in national financial systems, can spill over to neighboring economies through interest rates and capital flows, through exchange rates and capital and trade flows, as well as through migratory flows. It helps to have a hand on the policy levers of one's neighbors through surveillance discussions or through attempts at closer macroeconomic cooperation and technical assistance for institution-building. Investments in closer relationships also pay off in terms of early warnings of future crises and in cooperative management of crises.

ASEAN is East Asia's longest-standing regional grouping. It has had considerable difficulty in achieving closer economic cooperation because of its traditional principle of non-interference. In the 1990s it negotiated the ASEAN Free Trade Area (AFTA). Implementation has slowed to a crawl since the crisis, however, because of Indonesia's political and economic turmoil and because of Malaysian resistance to tariff reductions in the auto sector. More recently ASEAN has initiated a study of deeper integration with the Australia and New Zealand Closer Economic Relationship (CER). The "ASEAN + 3" grouping (the ASEAN 10 plus China, South Korea, and Japan) is developing closer cooperation on a range of regional issues. But the "3" are the prime movers.

A steady impetus for trade liberalization and development has also come from the non-governmental sector. Track Two forums date back

more than thirty years to the founding of the Pacific Trade and Development (PAFTAD) network. This network of trade and development scholars has provided intellectual leadership through its regular conferences and through the participation of its members in other groups such as the PECC (Pacific Economic Cooperation Conference). PECC also has a long history of serving as a network and forum for scholars, the private sector, and governments. It contributes useful analytic inputs and periodic blueprints for liberalization of trade and FDI. Another forum is PBEC (Pacific Basin Economic Committee) which is composed of private sector members. ABAC (APEC Business Advisory Committee) is an official part of the APEC system and provides private sector advice to APEC Leaders.

Comparable Track Two financial groups do not yet exist. One of the reasons is that there is no accepted leader because of the historical legacy of mistrust among Japan, China, and South Korea. Japan has the largest economy but lacks an internationalized currency and the strong financial institutions that are required to intermediate mobile capital efficiently.

Instead, official regional financial institutions have evolved largely from initiatives involving the United States. Prior to the crises, there were two official regional financial institutions. One is the APEC Finance Ministers (which some would not see as regional). It deals with a plethora of issues from social safety nets to capital flows. The second official grouping is a network of central banks, the Executives' Meeting of East Asian and Pacific Central Banks (EMEAP) which Japan and Australia organized in the early 1990s. This group has no secretariat and is organized each year by one of the participating central banks. Despite its informality, it has a solid record of technical cooperation to develop best practice templates and the infrastructure necessary for closer central bank cooperation in the region. Its technical groups are closely patterned on the lines of those at the BIS, which implicitly provides mandates, structures, and benchmarks that work well. In addition, some monetary authorities are working intensively to develop bilateral cross-border clearing and payments mechanisms. In their initial stages, these arrangements are hub-and-spoke in nature, but as more bilateral linkages are built they will mature into broader networks that will increase the efficiency of financial transactions within the region.

Since the crisis, the Manila Framework Group (MFG) has also met regularly. It was proposed by the United States and convened a number of APEC members (including some non-Asians) before the 1997 APEC Leaders' Meeting in Vancouver to address crisis issues and to fill the vacuum left by the failure of Japan's Asian Monetary Fund proposal. MFG has also initiated regular macroeconomic surveillance discussions at the

senior official level and discusses international financial architecture issues such as the dollar-yen fluctuations and the role of HLIs (highly leveraged institutions or hedge funds).

More recently East Asians have become increasingly serious about the ASEAN + 3 grouping. This is the same grouping originally proposed some years ago by the Malaysian Prime Minister as the potentially exclusive East Asian Economic Caucus. Reintroduced in a more neutral way in the wake of the crisis, ASEAN + 3 has held leaders' summits and work is underway, chaired by a former South Korean foreign minister, on a "vision" for the group. The potential agenda of the ASEAN + 3 is ambitious, with trade, finance, early warning mechanisms, and human security among the top items on its list. Membership is still an issue, with respect to Taiwan and other countries around the Pacific. As indicated earlier, the moving forces behind this grouping are the Northeast Asians—Japan, South Korea, and China. They have the financial clout and the resolve to develop their own mechanisms for preventing and managing future financial crises; their leaders recognize, for very different reasons, the need for contingency plans in the event of continued paralysis at the WTO.

In the wake of the financial crisis and the failure at Seattle, three strategic directions are being pursued that will influence the international economic architecture:

- bilateral and regional free trade agreements (FTAs) to build free trade in the region;
- regional financial arrangements (RFAs) to reduce vulnerability to capital flows and exchange rate volatility; and
- regional economic crisis prevention and management mechanisms that build on the region's financial strengths.

1. Trade: Bilateral and Sub-Regional FTAs

A number of trade-liberalizing initiatives are in various states of play (see Table II-5 on page 33), ranging from the well-established AFTA to serious study of a Japan-South Korea FTA. These could eventually be linked into a region-wide arrangement. They can be grouped into a taxonomy of objectives including (a) reduction of barriers between close neighbors, (b) exploitation of commercial objectives between distant neighbors, (c) amalgamation of existing groupings, and (d) strategic initiatives among like-minded economies (neighbors or not).⁶ The full implications of potential arrangements may not be fully understood by their proposers, so considerable study is probably required before formal negotiations

begin. For example, free trade arrangements make little economic sense between two economies with complementary industrial structures. The gains from liberalization are to be realized not only from reducing tariffs but also from reducing the many technical barriers that prevent specialization and intra-industry trade. This is especially true in services. In addition, such agreements will not be WTO-compliant unless they aim to free up trade in essentially all sectors on a non-discriminatory basis.

As Table II-5 on page 33 indicates, the list of proposals is a long one, but only a few have been implemented. Two countries, Singapore and Japan, are the major movers. One of Singapore's objectives in pursuing FTAs with New Zealand, Japan, and non-neighbors such as Canada and the United States is to create an incentive for its foot-dragging AFTA partners to become more serious about faster implementation of AFTA. Japan sees FTAs as a source of *gaiatsu* (foreign pressure) to bring about much needed domestic reforms. Japan is also concerned to break out of its sense of isolation, created by the severity of its own domestic crisis and by its inability to project effective leadership in the regional crisis. Discussions with Singapore are moving quickly in part because agriculture is an insignificant item in bilateral trade. While the Singapore-New Zealand agreement is between two very small economies, the agreement between Singapore and Japan is potentially significant, judging by the report of an official binational study group that is laying the groundwork for negotiations.⁷ This report recommends negotiation of a free trade agreement (reduction of tariff and non-tariff barriers; creation of dispute resolution mechanisms; inclusion of goods, services, investment, intellectual property, government procurement, and competition policy). It also contains proposals to break new ground through bilateral cooperation on a wide range of "new" issues in electronic commerce, multi-media, science and technology, and trade and investment promotion.

The Japan-Singapore bilateral negotiation, because of the new ground it proposes to cover, could provide a flexible structure for future Japanese bilateral negotiations as well as provide a useful WTO-consistent model that others could adapt. Of course, much depends on what is actually produced by the negotiations now underway. First, Japan is hampered by its agricultural and forestry lobbies. Omitting these sectors from negotiations could set a dangerous precedent that would probably doom other Japanese initiatives. Second, a key aspect of the study group report that could set another precedent is dispute settlement. One recommendation—for inter-governmental consultation on interpretation of the agreement and for monitoring progress on bilateral cooperation—is unlikely to be controversial. Another recommendation to formalize the two coun-

tries' respective Alternative Dispute Resolution mechanisms is a creative and relatively uncontroversial one. But the key recommendation is for "Government-to-Government dispute settlement procedures." It is more troublesome because it is essential to the credibility of the framework— yet it is the least explicit.

2. Monetary Integration: Regional Financial Arrangements (RFAs)

The road to monetary integration is a very long one but governments have decided to begin the trip. Regional financial arrangements began informally in the ASEAN economies when several central banks agreed to currency swap agreements in 1996-97. These agreements had relatively little effect during the crisis. Cooperative arrangements took a major leap forward when the idea was expanded and formalized among ASEAN + 3 central banks in May 2000. ASEAN + 3 central bank governors and finance ministers agreed to work out currency swap arrangements among central banks in Northeast and Southeast Asia. This initiative, called the Network of Bilateral Swap Arrangements (NBSA), means that a country could call upon Singaporean, Japanese, and Chinese foreign exchange reserves in a crisis. Such an arrangement will replace a looser scheme of repurchase agreements to augment liquidity, and bilateral arrangements between Japan and South Korea, and Japan and Malaysia. Details are being worked out for quick activation and disbursement of swaps. Decision-making structures and a system of monitoring and surveillance of member economies are being created. While operations are some way off, the magnitude of resources (upwards of \$60 billion) suggest the mechanism could have considerable clout.

Work is also underway on arrangements to increase the region's ability to intermediate its substantial savings. Some EMEAP central banks are working on bilateral payments and clearance mechanisms for specific financial instruments that could eventually grow into regional networks.

The economic feasibility of region-wide monetary integration is under study. Existing studies suggest that the degree of economic integration necessary for smooth adjustment to external shocks under a unified monetary regime does not yet exist. Bayoumi and Eichengreen (1994) identified Japan, South Korea, and Taiwan to be one possible regional grouping and Hong Kong SAR, Indonesia, Malaysia, Singapore, and possibly Thailand to be another. Note that China was not seen to be part of any grouping. Kwan (1998) studied the possibility of monetary union using the yen as the common currency. Kohsaka (1999) found that the East Asian economies adjusted to simulated aggregate supply and demand shocks in a manner similar to the European economies, the implication

being that the risks in the Asian economies, dissimilar as they are, are not much different than those now confronting the Europeans.

These theoretical analyses say little about institutional and political feasibility. To realize the benefits of monetary union, countries must have similar macroeconomic policy objectives. Their central banks should have some institutional similarities and be independent of political pressure. They should have similar economic structures; trade and capital markets should be closely integrated and labor must be mobile. While trade and investment flows increasingly link the Asian economies, financial intermediation is still underdeveloped; labor *movements are* restricted; central banks are not independent; and governments still guard national sovereignty closely.

There are some intermediate options, however. One is to work towards monetary integration involving subsets of economies with similar industrial structures and institutions. Another option is to introduce an intermediate exchange rate regime such as a common basket peg (Williamson 2000) or an Asian currency unit, ACU (Ito et al. 1999). Indeed, former President Estrada of the Philippines has already called for the ACU. In the intermediate exchange rate regime, economies would choose an appropriate basket of currencies based on trade shares with their major trading partners and peg to that and to each other's currency. The common basket peg would suffer from some of the same problems as *de facto* pegs in that the yen and U.S. dollar shares would be large in such a basket. The ACU is more flexible in that, like the ECU before it, each country would peg to this common currency unit.

In summary, while region-wide monetary integration is not in the cards in the short term, some significant steps towards closer monetary cooperation have been taken by policymakers that will strengthen regional financial infrastructure and build shared understanding necessary for collective efforts to prevent and manage crises.

3. Regional Crisis Prevention and Management

Prescriptions for future crisis prevention and management in the region allow for more public intervention in the short term and a determined long-term effort to deepen financial integration and cooperation through regional financial agreements. Malaysia's experience with selective and temporary capital controls has provided support for short-term intervention by small open export-oriented economies with floating exchange rates that are overwhelmed by international capital flows. Many economies are practicing managed floating, allowing them to build up reserve positions that speculators have to respect. Macroeconomic moni-

toring and cooperation includes early warning indicators and mutual surveillance of economic performance and policies. Assistance is being organized for countries that get into trouble because of external financial shocks. The Miyazawa Plan, which replaced the Asian Monetary Fund proposal, assisted a number of crisis countries and has plans to guarantee foreign borrowing by some countries. Many structural weaknesses remain, however, particularly in domestic financial systems and corporate governance. They will take time to fix and need to be addressed and monitored on an ongoing basis.

D. QUESTIONS ABOUT EFFECTIVENESS AND BROADER INTERNATIONAL IMPACT

East Asian integration had a defining impact on the world economy in the past decade as the region became an economic growth pole in the world economy. Will deeper integration in East Asia have a further defining impact on the international economic system and its institutions? The foregoing analysis suggests four concerns that need to be addressed.

- *Are bilateral and regional FTAs simply filling the liberalization vacuum created by multilateral paralysis in the WTO, to be abandoned if WTO momentum is restored?*

Early restoration of WTO momentum would slow the regional trend. But this seems unlikely because of the depth of disagreements among the large players and between the developing countries and the industrialized countries. What seems more likely to slow the regional trend is confusion in Japanese trade policy. A policy shift is evident, but omitting agriculture in the Japan-Singapore agreement could be an ominous sign for other arrangements. Enthusiasm for these bilateral agreements will also depend on business support. If a plethora of bilateral trade agreements sprout, each with its own rules of origin and dispute settlement procedures, business may press for reduction of barriers across larger areas to simplify these arrangements or for a return to the WTO.

- *Will regional surveillance mechanisms "add value" in preventing international crises?*

Experience has shown that effective surveillance relies on peer pressure during good times and requires "interference" (i.e., constructive criticism of each other's economic performance and policies as well as conditions

in return for aid) in times of trouble. Peers must be willing to supply constructive criticism and those in potential or actual difficulty must be willing to accept objective analysis. Unless governments are willing to enter into this kind of give and take, the regional mechanism will simply become another overlay of *officialdom*.

- *Will East Asians do things differently than the rest of the world? Will they attempt to restrict the operations of certain international private sector financial players such as the highly leveraged institutions? Restrict offshore financial centers? Make more use of capital controls? Impose weaker conditions on troubled economies than those employed by the rest of the world?*

Substantially different approaches to financial development or to crisis management will invite arbitrage and create distortions in open capital markets. Weak conditionality will simply delay the required strengthening of domestic financial systems. East Asian economies did not turn their backs on world capital markets in the recent crises; but international experience demonstrates that strong financial and corporate governance systems are essential to withstand external financial shocks.

- *How durable will the ASEAN + 3 political and institutional framework be for crisis prevention and management?*

The ASEAN + 3 initiatives will have to be integrated by skillful leaders and brought to life by some sort of administrative mechanism. European experience strongly suggests the importance of a political framework for economic integration. Asia's history and diversity are such that there is no grand vision comparable to the Franco-German vision of integration to end European wars. The Asian custom of consensus and incrementalism suggests the need for strong leadership from a country such as Indonesia or Thailand, or from a coalition of leaders with legitimacy, support and longevity. Gyohten (2000) proposes an intermediate step to address these difficulties. He suggests launching a core group of economically homogeneous (market-oriented) countries such as Japan, South Korea, Singapore, Australia, New Zealand, Hong Kong, and Taiwan (the latter two if China agrees) to demonstrate how regional cooperation might work, before attempting closer cooperation among a more heterogeneous group.

The administrative issues are not insignificant ones either. How will monetary cooperation and other forms of economic cooperation be integrated into a coherent whole? Can this be done incrementally and in a pragmatic way? East Asian aversion to international bureaucracy is evident in the minimalist arrangements for APEC. Yet implementing a grand

design for integration such as Europe's required a "center" with permanent expertise as well as a strong political consensus.

China will be a major factor in the answers to these questions in three respects. First, China will have to decide where it will focus once WTO accession is concluded. Will WTO obligations *crowd* out regional matters? Second, stable relations among China, Japan, and the United States will be necessary for a regional initiative to be successful. If this trilateral relationship destabilizes, regional efforts will be submerged by geopolitical issues. Since the 1997-98 crises, support from the Northeast Asians— South Korea, Japan, and China—has been the driving force behind ASEAN + 3 initiatives. Despite old antagonisms, leaders of the three economies have demonstrated their commitment to cooperate on regional issues. The third respect in which China matters is internal. China faces daunting challenges to transform its huge state-owned enterprises (SOEs) into profitable enterprises. The continued problems of the SOEs will influence China's efforts to modernize its financial institutions and build a safe and sound private banking system. Exacerbation of internal problems will divert China's attention from international pursuits and affect the region, particularly through increasingly close intra-regional trading arrangements—and through the financial system if there is a significant effective devaluation of the Chinese currency.

E. CONCLUSION

A sea change has occurred in East Asia. Deeper integration—beginning with trade and financial arrangements and with mechanisms to prevent and manage financial crises—could have profound impacts on the world economic system. It would be a mistake to underestimate the effects of the financial crisis and the difficulties of the WTO on Asian determination "never again" to be as dependent on outsiders as at the outset of the 1997-98 crisis.

The way forward will be uneven and uncertain, as most efforts of this nature tend to be. It is unlikely that any one or two Asian leaders will have the legitimacy to provide a blueprint or overall leadership that were critical factors in Europe's deeper integration. An incremental process based on consensus is more likely. Such a process is bound to be time-consuming and inward-looking, but it would be a mistake to compare it unfavorably with the vision that propelled European integration after devastating wars.

Deeper East Asian integration does not occur in a vacuum. Both Europe and the United States, which have managed the world economy for the past fifty years, are likely to perceive discriminatory arrangements as a direct challenge to which they may react in unpredictable and possibly undesirable ways. A tripolar world could be unstable, as games among three players are thought to be.⁸ So it will be important that East Asians view their process in a broad strategic context. Priority should be accorded to the necessity to explain and interpret proposed arrangements to the European Union and the United States. Indeed, consideration should be given to including the United States to avoid a repetition of the negative reaction accorded the EAEC proposal in the early 1990s.

Closer regional monetary cooperation, if it is successful, will have a major impact on the leadership role and prescriptions of the IMF. Regional trading arrangements will reduce the clout of the WTO as the global trade negotiation forum. But these organizations should not be duplicated on a regional basis. Instead, both the IMF and the WTO are likely to evolve into coordinating mechanisms among the exchange rate, financial and trade arrangements in the world's three major regions. They will be the generators and arbiters of universal principles, norms, rules, and standards.

To ensure regional arrangements are building blocks rather than stumbling blocks in the global system a few basic principles are essential. The first is to preserve the principle of open regionalism. The second is to be open to the region. Australia and New Zealand are increasingly closely integrated with their neighbors, as is evident in Table II-1 on page 29. They should be included in an ASEAN + 5. Third, trade agreements among neighbors, or with more distant economies, should be WTO- and APEC-consistent. Fourth, financial arrangements and macroeconomic cooperation should be linked to the IMF. World capital markets are so tightly intertwined that arbitrage will occur and distortions will be created if certain markets try to operate with different rules. Effective regional surveillance will help to bring peer pressure to bear in efforts to prevent crises. But financial crises will still occur and they will be systemic in nature, requiring either a global institution with resources and management capability or very well-developed global coordination mechanisms among regional institutions.

In conclusion, observing these principles will enhance the international acceptance and effectiveness of East Asian regional initiatives. No crisis economy turned inward despite the painful adjustments required in the wake of the crisis, and this commitment to openness—which has served the region so well over the years—should be embedded in any new regional institutions.

TABLE II-1
Distribution of Export Markets, 1998
 (percentage shares)

Importer / Exporter	China	South Korea	Japan	Hong Kong	Taiwan	Indonesia	Malaysia	Philippines	Singapore	Thailand	Australia	New Zealand	East Asia 12	Rest of World	World
China	0.0	3.4	16.2	21.1	2.1	0.6	0.9	0.8	2.1	0.6	1.3	0.1	49.3	50.7	100.0
South Korea	9.0	0.0	9.3	7.0	3.9	1.3	2.7	2.1	3.1	0.3	2.1	0.2	41.0	59.0	100.0
Japan	5.2	4.0	0.0	5.8	6.6	1.1	2.4	1.9	3.8	2.4	2.1	0.3	35.5	64.5	100.0
Hong Kong	34.5	1.0	5.3	0.0	2.5	0.3	0.8	1.0	2.3	0.8	1.3	0.2	49.9	50.1	100.0
Taiwan	0.8	1.3	8.4	22.4	0.0	1.2	2.1	2.4	2.9	1.7	0.2	1.5	44.9	55.1	100.0
Indonesia	4.2	5.2	17.7	3.4	3.4	0.0	2.7	1.2	10.8	1.5	3.8	0.2	54.2	45.8	100.0
Malaysia	2.7	2.3	10.5	4.6	4.1	1.4	0.0	1.6	16.9	3.2	2.3	0.3	49.9	50.1	100.0
Philippines	1.2	1.7	14.4	4.5	6.0	0.4	3.9	0.0	6.2	2.1	0.6	0.1	40.9	59.1	100.0
Singapore	3.7	2.3	6.6	8.4	4.3	0.0	15.2	2.2	0.0	3.8	2.9	0.3	49.8	50.2	100.0
Thailand	3.2	1.1	13.7	5.1	3.2	1.8	3.3	1.4	8.6	0.0	1.8	0.2	43.5	56.5	100.0
Australia	4.2	6.9	19.5	4.0	4.8	2.4	2.0	1.2	3.7	1.4	0.0	6.3	56.4	43.6	100.0
New Zealand	2.9	3.1	13.3	2.7	2.3	0.7	1.8	1.2	1.5	1.1	20.9	0.0	51.6	48.4	100.0
East Asia 12	7.7	2.7	7.9	8.5	4.0	0.9	2.9	1.6	4.1	1.7	1.9	0.6	44.5	55.5	100.0
Rest of World	1.2	1.1	3.5	1.0	1.0	0.2	0.4	0.3	0.9	0.4	0.8	0.1	11.1	88.9	100.0
World	2.8	1.5	4.6	2.9	1.8	0.4	1.1	0.6	1.7	0.7	1.1	0.2	19.5	80.5	100.0

Source: International Monetary Fund, 1998.

TABLE II-2
**Origin of FDI Stocks in Selected East Asian Economies,
 1980 and 1994**
 (percentage shares)

	United States	Japan	Other East Asia	Others	Total
China					
1986	16.8	10.7	61.7	10.8	100.0
1994	8.1	8.0	74.0	9.5	100.0
Hong Kong					
1986	53.7	21.0	2.1	23.2	100.0
1994	31.6	32.5	10.1	21.8	100.0
Taiwan					
1980	35.0	18.6	30.3	16.1	100.0
1994	26.1	28.2	21.0	24.7	100.0
Indonesia					
1980	4.7	37.5	13.7	44.1	100.0
1994	4.4	15.8	36.6	43.2	100.0
Malaysia					
1980	10.3	25.7	23.7	40.3	100.0
1994	6.2	33.7	36.8	23.3	100.0
Philippines					
1980	54.6	16.8	5.4	23.2	100.0
1994	38.2	18.2	10.9	32.7	100.0
Singapore					
1980	22.5	11.7	19.6	46.2	100.0
1994	17.9	21.5	13.0	47.6	100.0
Thailand					
1980	35.6	28.9	17.5	18.0	100.0
1994	17.1	30.9	33.0	19.0	100.0

Sources: Dobson and Chia (1997:8); APEC Economic Committee (1995); and unpublished data from Industry Canada.

TABLE II-3
Net Capital Flows to Emerging Markets, 1990-2000
 (billions of US\$)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000 ¹
Total Private Capital Inflows (net)	47.7	123.8	119.3	181.9	152.8	193.3	212.1	149.2	64.3	68.3	118.5
Bank Loans and Other (net)	11.9	55.6	32.7	11.5	(35.5)	55.4	16.3	(57.6)	(103.5)	(71.8)	(50.1)
Portfolio Investment (net)	17.4	36.9	51.1	113.6	105.6	41.2	80.8	66.8	36.7	21.6	40.2
Foreign Direct Investment (net)	18.4	31.3	35.5	56.8	82.6	96.7	115.0	140.0	131.0	118.5	128.4
Net Official Flows	26.6	36.5	22.3	20.1	1.8	26.0	(0.9)	24.4	41.1	9.4	(2.4)
				Total Flows, 1990-2000			Average Annual Flow		Average Deviation ²		
Total Private Capital Inflows (net)				1,431.2			130.1		43.4		
Bank Loans and Other (net)				(135.1)			(12.3)		43.8		
Portfolio Investment (net)				611.9			55.6		28.6		
Foreign Direct Investment (net)				954.2			86.7		15.3		
Net Official Flows				204.9			18.6		18.1		

Source: International Monetary Fund, 2000.

1. 2000 numbers are estimates

2. Over these eleven years the actual flow of "Bank Loans and Other" in a particular year was, on average, \$43.8 billion above or below the average annual flow. The actual flow of portfolio investment was \$28.6 billion more or less than the average annual flow. The actual flow of foreign direct investment was only \$15.3 billion more or less than the average annual flow. The average deviation in the flow of "Bank Loans and Other" is also the only average deviation larger than the associated average annual flow.

TABLE II-4 East Asian Economies: Changes in Reserves, 1992-2000
(billions of US\$)

Year	Crisis Countries ¹	Other East Asian Emerging Market Economies ²
1992	18.1	6.6
1993	20.6	16.6
1994	6.1	47.3
1995	18.5	27.6
1996	5.4	44.8
1997	-30.5	46.7
1998	52.1	18.2
1999	44.5	15.9
2000 ³	17.2	32.9
2001 ³	20.3	40.2

Source: International Monetary Fund, 2000.

1. Indonesia, Korea, Malaysia, the Philippines, and Thailand.

2. Korea, Singapore, and Taiwan Province of China. No data for Hong Kong SAR are available.

3. 2000 and 2001 numbers are estimates.

TABLE II-5
**Bilateral and Regional Trading Arrangements,
APEC Members, 2000**

Study

Japan-South Korea (1998)

Japan-Mexico (1998)

Japan-Canada (1999)

"P-5" feelers (U.S., Singapore, New Zealand, Australia, Chile) (1998)

Northeast Asia research initiative (China, South Korea, Japan) (1998)

AFTA-CER Task Force

Singapore-Canada (2000)

Singapore-U.S. (2000)

Korea-Chile (2000)

"Asian" FTA (2001)

Negotiation

Singapore-Japan (2000)

Agreement Signed

Mexico-EU (1999) Singapore-New Zealand (2000)

Agreement Implemented

AFTA (1993) Canada-Chile (1996)

Source: Author

NOTES

1. This number comes from the IMF data used to construct Table II-1. World Trade Organization data indicate intra-Asian destinations accounted for 44.6 percent of total exports in 1998, down from 50.9 percent in 1995.
2. The open economy trilemma recognizes that an economy can tolerate only two of three objectives: mobile capital, exchange rate stability, and monetary policy independence. It must give up one of these objectives to ensure achievement of the other two.
3. South Korea has created an independent supervisory agency but has left some key functions in the Finance Ministry. Thailand and Indonesia have left supervision in the central banks, neither of which is independent (Claessens 1999).
4. Highly leveraged firms, dependent on domestic and foreign borrowing, have slowed recovery. Debt restructuring takes several forms: through negotiations between creditors (usually banks) and debtors in restructuring or workout arrangements, through bankruptcy proceedings, through transfers of bad assets to state-owned asset management agencies and through the outright nationalization of banks weighed down by non-performing loans. Asset management organizations are now significant holders of corporate assets in Indonesia, South Korea, and Malaysia (Claessens 1999).
5. Hufbauer (2000) lists the political issues that make the United States, not the EU, the major stumbling block to launching a new global round.
6. This taxonomy builds on work of Robert Scollay.
7. See Government of Japan and Government of Singapore, *Japan-Singapore Economic Agreement for a New Age Partnership*, Joint Study Group Report, September 2000.
8. See Fred Bergsten, *The New Asian Challenge*, Working Paper No. 00-4 (Washington, D.C.: Institute for International Economics, 2000).

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III. EAST ASIAN SECURITY AND THE INTERNATIONAL SYSTEM

Michel Oksenberg and Charles E. Morrison

A. INTRODUCTION

Since 1975, East Asia has enjoyed unprecedented tranquility and prosperity. An important contributor to this success was an implicit "Grand Bargain" struck between Tokyo, Beijing, and Washington in the 1970s and 1980s. Key elements of this bargain, however, are now coming under serious challenge, threatening the simultaneously constructive relations within the China-Japan-U.S. strategic triangle that have been central to regional order and progress for over a quarter century. Relations among these countries are fraying.

Despite the accomplishments, the region stands at the precipice of an unprecedented arms race. Moreover, a serious breakdown of the regional order would have global implications. Until recently, the region's major patterns of alignment reflected competition and alliances arising outside the region. As an arena of international interaction, East Asia was more acted upon than an actor. But today, the region is no longer dominated by global bipolarity, and its patterns of cooperation and competition are no longer imported from other regions. If there is to be another conflict of global consequence, it will more likely arise in Asia than elsewhere: over Korea or Taiwan or perhaps even Kashmir.

A debate has erupted among analysts of East Asian security as to whether the Grand Bargain remains viable. Three schools of thought can be discerned: (1) It can be sustained in its present form with minimal adjustments. (2) It is salvageable, but only through fundamental and important adjustments. (3) It must be jettisoned in favor of new architecture. After briefly examining the arguments put forward by each of these schools, our essay recommends that the Trilateral countries consciously pursue the middle option—of making significant adjustments in the light of new realities rather than seeking to preserve or recklessly abandoning the Grand Bargain. The challenge will be to convince China, Russia, and

East Asia's middle powers that a revitalized security structure along the lines that we recommend will serve their as well as the Trilateral countries' best interests.

This chapter develops the argument in four steps. First, it swiftly sketches the Grand Bargain of the 1970s and 1980s. It then illuminates the underlying structure of power—the strategic chessboard of East Asia—in largely classic realist terms. The subsequent section then identifies sources of strain on the Grand Bargain: East Asia's altered strategic configuration, the changing norms of the international system, the revolution in military affairs (RMA), the preoccupation of the major powers with their own domestic problems, the trends of democratization and spread of market economics, and the region's economic growth followed by its 1997-98 economic crisis. We conclude by assessing the strategic options and recommending considerable adjustments for the Grand Bargain.

B. THE GRAND BARGAIN

During the 1970s and 1980s, through a process of extensive dialogue and mutual accommodation as well as some formal agreements, China, Japan, and the United States gradually reached an implicit Grand Bargain covering Taiwan, the security architecture in East Asia, third-country issues, economic relations, and human rights and governance. This bargain was never unchallenged, but we would argue that its basic elements were sufficiently understood and appreciated by the key decision-makers in the three countries to constitute sustainable parameters for the relationships among the three countries for most of the 1980s and 1990s.

1. Taiwan

The United States and Japan recognized the PRC as the legitimate government of one China, acknowledged that Taiwan was a part of China, and maintained a full range of unofficial relations with Taiwan. The United States abrogated its bilateral defense agreement with Taiwan, but it asserted a continuing interest in assisting Taiwan to maintain its capacity for self-defense. Sensitive to China's historical memories, the United States pledged that it would not maneuver to have Tokyo replace Washington as Taiwan's protector. The commitment of both Japan and the United States was to a process of peaceful reconciliation between Taiwan and the mainland, and not to the precise outcome. Neither Japan nor the United States sought to permanently detach Taiwan from the mainland.

In the meanwhile, China indicated patience over the evolution of the Taiwan issue, expressed a preference for peaceful reunification without

foregoing what it regarded as its ultimate right to reunify Taiwan by force, and acquiesced to circumscribed American arms sales to Taiwan.

2. Security Architecture

In the broader strategic realm, China accepted the continuation of the U.S. military presence in the western Pacific and the U.S. bilateral alliance with Japan and South Korea. The United States and Japan relaxed their controls over high tech exports. The United States and China developed military-to-military exchanges, and Japan wished to follow suit. By the mid-1980s, the United States and China were sharing intelligence about the Soviet Union, and the United States began to sell weapons to the People's Republic.

The shared concern among Beijing, Tokyo, and Washington **with** Soviet expansionism facilitated their strategic cooperation. Two other considerations were also at work. First, the leaders in all three capitals understood that Sino-Japanese animosity, Chinese concerns about Japanese technological superiority, and Japanese concerns about a unified China hostile to Japanese interests had been a major source of East Asian instability from the 1880s to the early 1980s. This animosity had forced the United States either to have a good relationship with Japan or China, but not both at the same time. In this sense, the new strategic configuration of the 1980s was unprecedented, creating a new foundation for stability in Northeast Asia.

Second, both the United States and Japan recognized the dangers posed by a weak and isolated China. The near anarchy of the Cultural Revolution and the dangers of a Sino-Soviet war reminded Tokyo and Washington of their interest in a unified and effectively governed mainland China. China's weakness in the past had invited major power competition for influence over it; its turmoil spilling over into surrounding regions. In the environment of the Vietnam War and its aftermath, the United States envisioned a world headed from bipolarity to multipolarity, and Washington believed that it could prosper in such a world. Both Tokyo and Beijing found the strategic design attractive as it allowed and even welcomed their increased influence.

3. Third-Country Issues

For this design to endure, Beijing, Tokyo, and Washington also recognized that third-country issues should not become a source of competition among them, as Vietnam had once been. In fact, the three used transitory issues in other locales to strengthen their fledgling relations. For example, the Nixon administration used the Indo-Pakistani war of 1971

for this purpose, and the Carter administration similarly used Indochina issues in 1978-80 to facilitate the normalization process. And during the 1989-93 Bush administration, the three cooperated in bringing peace to Kampuchea.

The Korean peninsula presented great dangers both because of the military capabilities of the local powers and because of the unpredictability of their behavior, particularly that of the North. But through the 1980s, Japan and the United States confined their relations to South Korea, while China's ties were with the North. All discouraged adventurism on the part of their own ally or friend, and none sought to provoke conflict with the other Korean state. In the 1990s, tacit cooperation among the three to maintain stability on the peninsula proved particularly crucial.

4. Economic Relations

Economically, as part of that bargain, Japan and the United States opened their markets to China, providing access equivalent to their GATT partners, and welcomed China into the World Bank, Asian Development Bank, and International Monetary Fund. China opened its economy to the outside world and embarked on a process of economic reform.

While the United States led in opening its markets and transferring technology, Japanese companies initially were the pacesetters in forming joint venture manufacturing facilities. China also quickly became the largest single recipient of Japanese foreign assistance. The European countries also helped ease Chinese entry into international financial institutions even though China's domestic economy fell far short of market economy criteria. Thus, although for somewhat different reasons and with distinctive emphases and constraints, all the Trilateral countries decided that China's rapid entry into the international economy was a very positive development and all sought to facilitate this process.

5. Human Rights and Governance

Finally in the area of human rights and governance, the Trilateral countries adopted roughly similar postures. They were not oblivious to the dictatorial and harsh nature of China's governance. But they concluded that China's leaders were moving in the right direction and should be given time to reform their system. The advice and encouragement to do so was given quietly so as not to affront Chinese dignity. Moreover, prior to the Tiananmen Square incident, the outside world was unacquainted with the names—the individuals—whose rights had been violated. The tragedy of Tibet was known, but the personal feel for the situation was absent. And in any case, the relationships with Beijing were so thin that

little leverage existed to advance the human rights cause. As a result, the implicit agreement in this part of the Grand Bargain was to temper Western criticism in exchange for implicit Chinese commitments to improve the situation. Until the Tiananmen incident, China seemed to be making significant progress along these lines.

C. THE UNDERLYING STRUCTURE OF POWER

The strategic significance of the Grand Bargain can best be appreciated in the context of the region's underlying structure of power. The East Asian security environment has been largely defined by the interactions among five major powers. Two of these, China and Japan, are indigenous to the region. Two others, Russia and the United States, are inextricably entwined with it. India is peripheral to the East Asian system, but it was of growing importance even before its explosion of a nuclear device. Several other countries, including the two Koreas, Vietnam, Indonesia, and Australia are important medium powers and have a capacity to influence the system. This underlying structure took shape at the end of the nineteenth century, with the erosion in British naval dominance of maritime East Asia, the ascendancy of Japan, the arrival of the United States as a Pacific power in the Spanish-American War, the collapse of the Qing dynasty, and the building of the Trans-Siberian railroad giving Russia significantly enhanced capacity to project power into the region.

Since that time, through its many vicissitudes, the regional system has exhibited a number of enduring characteristics. First, there are no permanent friends and no permanent enemies among the major powers. At some point in the past century each has been an adversary of each of the other four, and most have had periods of broad and constructive relations with each of the other four. The one exception is the Russo-Japanese relationship, which has remained strained until recently.

Second, the interests of the major powers intersect in a number of locales—Taiwan, the Indochina peninsula, the Straits of Malacca, the South China Sea, Central Asia, Xinjiang, Mongolia, Siberia, the Sea of Okhotsk, Manchuria, and Korea. The military history of the region can be written largely in terms of the conflicts that have engaged the major powers in these locales, with the focal point of tension changing over time.

Third, the major powers continually found themselves competing in some of these regions even as their interests converged elsewhere. For example, in the late 1960s, Russia and China were locked in confrontation and conflict along their border, but they shared an interest in eliminating the American military presence in Indochina. Today, American and

Chinese interests largely converge in South Asia and Korea but depart over Taiwan. The complex nature of the Asian strategic chessboard means the major powers tend to be partly friends and partly competitors, a situation their publics find difficult to grasp.

Fourth, the distribution of power and influence among the major powers has continually shifted. The greatest periods of uncertainty and danger occur with the rise or fall of a major power. Moreover, although it is quite difficult to measure power, throughout the century, the country that has been perceived as number one has tended to have an adversarial relationship with the second-ranking power or the country that is rising to become number two.

Fifth, the region has contained great diversity in terms of religions, levels of development, regime types, colonial experiences, and sources of national integration. Some countries have powerful and effective states; in others state-building is still occurring. Some countries have a well-developed sense of national identity and cohesiveness; others still lack these qualities and depend heavily upon coercion to hold together. These profound differences were among the factors that historically inhibited the development of regional organizations.

From the vantage of the East Asian chessboard, in short, the Grand Bargain terminated a century of debilitating competition among three of the major powers involved in the region—Japan, China, and the United States. They surmounted their differences and successfully coalesced in part to counter the destabilizing rise of Russia. Equally important, their cooperation also helped to reduce tensions over Korea, Taiwan, and the Indochina peninsula. It helped to maintain a strategic balance in the South Asian subcontinent. And the United States and Japan facilitated China's entry into the international community as an increasingly cooperative member of various regimes.

It would be difficult to exaggerate the benefits that the Grand Bargain brought to the global and regional strategic chessboards. However, as any strategic arrangement, it did have flaws. Since the Grand Bargain was reached, in part, to cope with the Soviet Union, Moscow had no stake in its survival. Moreover, while the arrangements made on behalf of Korea, Taiwan, and Indochina arguably improved the situation in each locale, the leaders of these places were not fully included in the decisions affecting their fate. To varying degrees, the arrangements were imposed upon them. Finally, as products of a particular configuration of power, the mutual accommodations and balancing arrangements were naturally vulnerable to disruption as the distribution of power among the participating nations changed.

D. CHALLENGES TO THE GRAND BARGAIN IN THE 1990s

The 1990s saw increasing stress on the Grand Bargain. Several major factors challenged the ability of the governments of China, Japan, and the United States to maintain the policy frameworks that had underlain the mutual accommodations reached in the prior two decades. These factors included the Soviet collapse, the changing norms of the international system, the revolution in military affairs, the domestic preoccupation of the major powers, the increasing pressures of democratization on foreign policy, and the region's rapid economic growth followed by the crisis of 1997-98.

1. The Soviet Collapse

Changes in Soviet policy in the Gorbachev era and then Russia's transformation initially had a beneficial effect. All four major powers in northeast Asia were at peace with one another. No fault line existed in the region dividing one power from another, and as a result, none of the major powers was in the process of recruiting allies and client states in opposition to a major rival. The power and influence of the major powers had altered significantly. The Russian capacity and will to project its power virtually collapsed.

With Russia overwhelmed by problems at home, the principal major-power relations narrowed to China, Japan, and the United States. The elimination of a common adversary weakened but did not eliminate the cooperative impulses among the three. For example, during the 1997 financial crisis, the three retained their basically constructive relations. Unlike the Great Depression of the 1930s, which both was caused by and intensified tensions among the major powers of Europe and the United States, the ensuing Asian recession did not result in "beggar-my-neighbor" policies. The leaders in Beijing, Tokyo, and Washington gave primacy to their common economic interests. However, in all three capitals, dissenting voices, less mindful of the strategic benefits that the Grand Bargain bestowed, began to challenge its rationale; in each capital, some argued that their country could improve its situation through a more independent course, particularly in light of what they perceived as increasingly hostile tendencies in one or both of the other two capitals.

2. Domestic Preoccupations in Beijing, Tokyo, Washington, and Moscow

In the 1970s and 1980s, in large measure due to the Cold War, the leaders of all four major powers often subordinated domestic political concerns to national security priorities. They also gave considerable personal attention

to strategic issues. But by the 1990s, the leaders of all four countries were more consumed by domestic political, social, and economic issues than two decades earlier. Moreover, they seemed to be politically weaker and less in control of their agendas. To be sure, these assertions are somewhat overstated; the differences are more of degree rather than kind. And the changes are more evident in some capitals than in others. Nonetheless, these observations seem roughly accurate as broad generalizations.

As a consequence, none of the leaders was as able or interested in understanding and accommodating the needs of their partners as in an earlier era. Contrast, for example, the Nixon-Tanaka-Mao/Zhou-early Brezhnev or Reagan-Nakasone-Deng-Gorbachev quartets to the Clinton-Obuchi/Mori-Jiang-Yeltsin/Putin quartet. The latter leaders became event managers. Their administrations seemed more concerned with the public relations and sound-bite dimensions of summits than the substantive and strategic issues. Nixon's 1972 visit to China and Deng's 1979 visit to the United States were far more substantive than Clinton's 1998 China visit or Jiang's 1997 visit to the United States.

Moreover when leaders or their national security and foreign affairs officials met, the tendency was to review the laundry list of bilateral issues of immediate concern. Extensive edifying and somewhat uncooked and unrehearsed discussions rarely took place about global and regional trends. The purposes of such talks are to nurture a greater sensitivity to each other's core political and security concerns and gradually to develop a shared strategic perspective. The Grand Bargain itself was achieved through just such a protracted process involving a series of dialogues and mutual accommodations.

Leaders in the four capitals increasingly viewed international relations through the prism of their domestic politics; their survival increasingly depended upon voter or public approval or at least on a support base of major constituencies. The Grand Bargain was developed in an era when foreign policy leadership was more highly and hierarchically concentrated in the executive agencies of government. But political decision-making processes were changing in complex ways in major capitals on both sides of the Pacific. While these changes have somewhat different origins and take quite different forms, they have the effect of weakening the ability of leaders to undertake and maintain firm commitments. The dominant issues also changed, away from the key parameters of strategic alignments and toward economic issues that often required considerable professional, technical, or legal expertise found in bureaucracies rather than leaders.

During the 1990s, Chinese leaders were politically weaker than in the Mao/Deng eras. The Chinese policy process has become more open and

less dictatorial. Until the late 1980s, Chinese policy on major issues, including relations with the United States and Japan, was the product of consultations and consensus-building among a small group of top leaders and their key advisors with final approval by the senior leader. The preeminent leader could expect the bureaucracy to obey. While elements of this style remain, Jiang Zemin was not as powerful as Mao Zedong and Deng Xiaoping at their heights, and political reforms have resulted in a more frequent and less arbitrary rotation of other offices. Moreover, more of the issues involving international relationships were technical and have important implications for China's new business elites. These were less amenable to strategic decision-making by leaders and tended to bog down in intra-bureaucratic wrangling. Even when top leaders did step in, as Jiang and Zhu have done on China's WTO accession issues, intervention frequently does not terminate debate, and foreign partners can not assume that the bureaucracy will fully comply with a leadership decision. These changes in turn prompt Washington and Tokyo to approach China's leaders with wariness, since it was not certain that they can fulfill their commitments. And Beijing looks upon the leaders in the United States and Japan with similar hesitancy, wondering if they could deliver their parliaments and bureaucracies.

3. Strategic Implications of Economic Development

Following an unprecedented boom from the mid-1980s to 1997, East Asia experienced its worst economic shock of the post-World War II era. This volatility affected the relative position of the larger powers and the perceptions of those positions. It also resulted in recriminations and significantly weakened the standing of regional economic institutions connecting Asia with Europe and the Americas.

The biggest transformation in the 1990s involved the relative balance between China and Japan. China's economic performance in the 1990s, in contrast to Japan's protracted stagnation, lent credibility to the view that China eventually would surpass Japan as Asia's most important country. Japan's problems seemed not merely cyclical, but deeply rooted in structural features of public policy and corporate governance that were slow in responding to pressures of globalization and in the rapid aging of its society. China faced some of the same issues, but it was at an earlier and very rapid stage in its development. China's double-digit growth rate in the early 1990s, the adoption by the World Bank of purchasing power parity as well as exchange rate indices of relative economic size (magnifying China's economic power), and China's relative immunity to the Asian economic crisis, in part because capital controls shielded it from the con-

tagion effect, all contributed to the perception of a rapidly rising China.

In fact, China faced many economic challenges: a slower growth rate, a heavy burden of non-performing loans mostly to inefficient state-owned enterprises, persistent deflationary pressure, weak or undeveloped regulatory systems, lower levels of foreign investment, difficulties in moving toward higher value added production and exports, expensive infrastructural requirements, and enormous environmental problems. But warnings by experts about these issues often were overlooked. Moreover, Beijing's responsible behavior in maintaining the foreign exchange value of the yuan, supporting Hong Kong's currency peg, and contributing to international financial packages for other Asian economies gained China increased respect and credibility in international economic circles.

To oversimplify, China's solid economic performance intensified the divergence in views within both Japan and the United States between those who saw China's rise as primarily a threat or an opportunity. This divergence of views made it more difficult to pursue a coherent and consistent policy toward China. Only the American President or the Japanese Premier could enunciate such a policy, but the uncertainty over the Chinese future plus all the other factors at work in the 1990s—conflicts over norms, the revolution in military affairs, leadership preoccupations, the implications of changing mainland and Taiwanese politics—worked against such leadership. In short, China's economic performance had made China policy a more salient and divisive issue both in Washington and Tokyo.

Meanwhile, the dynamism of the American economy underscored the centrality of the United States to the region's prosperity, while its continued military might and resolve sustained its power in the region. Joseph Nye's formulation that America is an indispensable power certainly was underscored in Asia in the 1990s.

In this context, the middle powers—Canada, South Korea, Taiwan, Indonesia and the ASEAN states, and Australia—acquired regional and global influence, in part because some had high growth rates and in part because the major powers were at peace. They were no longer being drawn into conflicts as allies, clients, or colonies of the major powers. And as a result, with the special exception of Taiwan, they were at the forefront in the formation of regional organizations.

4. Growing Regionalism

The region was increasingly interdependent, measured in terms of both trade and capital flows. Indeed, the region's economic growth was fueled by this interdependence. The developed economies (Japan, Taiwan, and South Korea) were major investors and lenders to China and Southeast

Asia. Partly as a result, regional organizations began to proliferate and prosper. Some were governmental, others non-governmental. None had exactly the same membership. Several included members from Latin America. But they all pointed in the same direction: the formation of a regional sense of identity and cooperation. Nothing underscored this trend more than the initiation in 1993 of an annual meeting of leaders of the Asia-Pacific region.

As pointed out in the introductory essay, Asia was a global latecomer in the development of regional institutions, but these also blossomed in the 1990s. The Asia Pacific Economic Cooperation (APEC) forum for broad regional cooperation was established in 1989, expanded to include China, "Chinese Taipei," and Hong Kong in 1991 and other countries later, and elevated to the leaders level in 1993. A regional security consultative forum, the ASEAN Regional Forum (ARF) was established in 1994. A plethora of less comprehensive intergovernmental and "track two" institutions and processes followed.

5. The Revolution in Military Affairs

Despite growing signs of regional cooperation and the termination of great power tensions, the region's prosperity and expanding government revenues enabled increases in arms expenditures, while growing military missions (such as surveillance of expanded economic zones) encouraged it. By the 1990s, East Asia had become the world's biggest international arms market. The imported weapons systems were becoming increasingly sophisticated. One incentive for the upgrade was the Persian Gulf War, won by the United States and its allies at very *little* cost in allied lives. It was even more on display in the Kosovo intervention, in which Serbia was defeated by the use of high-altitude bombing and cruise missiles (supplementing support for local partisans) with no NATO loss of life. These conflicts were watched closely in Asia, particularly by countries like China and North Korea, which feared that they might some day be engaged in conflict with the United States.

The introduction and use of new technologies on the part of Western powers fueled a perception in the 1990s that the relative military power of the United States was growing rather than decreasing. The numbers, on an exchange rate basis, were stark—the United States spends more on defense than the next five powers combined and three of those are U.S. allies. Non-Americans who saw the growing military power gap as a disturbing trend believed that it makes the United States more inclined toward interventionism (since its own physical risks are slight) and places their own countries increasingly at a strategic disadvantage. The cheapest and easiest way for less technologically advanced nations to

close this gap was through the acquisition of weapons of mass destruction and their delivery systems. This was an avenue North Korea chose to pursue with considerable success in increasing its bargaining leverage. But it also spurred *Japan and the United States to step up research cooperation* in theater and even national missile defense systems.

By the end of the 1990s, new weapon systems were being conceived for the Asia Pacific region to come on stream by 2010. The United States and Japan were poised to develop and deploy advanced theater missile defense (TMD) systems (possibly extending to Taiwan as well) within ten years. China had developed and is deploying intermediate and short-range ballistic missiles across from Taiwan. Its cruise missile capabilities were improving rapidly, and it has purchased advanced jet fighters and naval vessels from Russia. Taiwan was acquiring F-16 and Mirage jet fighters as well as enhanced radar and low-altitude anti-missile defense systems.

At least *as important was* the increasingly likely development and deployment of a National Missile Defense (NMD) system by the United States which would affect China's strategic deterrent capability and possibly stimulate the PRC to expand its offensive capability. While the East Asian countries most affected by the economic crisis generally slowed arms modernization in the late 1990s, China's gradual but persistent military modernization, Taiwan's proactive response to it and the American NMD program had all the characteristics of an incipient arms race.

This build-up was the inevitable consequence of technological advance. Weapons systems in place twenty years ago had become obsolete, while systems on the drawing boards at the time of normalization of Sino-American relations are on the production lines. Technology *was* simply overwhelming the mutual accommodations that Beijing and Washington had reached twenty years earlier. For example, the 1982 agreement governing sales to Taiwan contained a side agreement as part of the negotiating record that the United States would sell the closest successor weapon to those that had gone out of production. In the agreement, the United States also pledged to reduce the quantity and quality of sales as tensions diminished. And, as noted earlier, the United States sought to reassure a nervous Taiwan that future arms sales would not become an object for Beijing-Washington negotiations. They would proceed on their own merits, in light of Taiwan's needs for its self-defense, as specified in the Taiwan Relations Act. However, for much *of the* 1990s, tension in the Taiwan Strait increased rather than diminished due to provocative diplomacy both in Taipei and Beijing. As a result, the 1982 agreement and its ancillary understandings and possibly the entire framework for handling the U.S. arms sales to Taiwan issue came under challenge.

6. Taiwan's Democratization

No development has more strategic significance than Taiwan's democratization, which led to the defeat of the Kuomintang in the March 2000 presidential elections and the rise of a political party whose roots are indigenous. Clearly, domestic developments in Taiwan and Beijing have moved Taiwan to the front and center in Sino-American relations. Since the two countries see Taiwan through very different and contradictory lenses, there is a continuous, underlying tension over Taiwan that is not true of most other dimensions of Sino-American relations. When one side or the other attempts to shift the understanding of the Taiwan aspect of the bargain or when it is tested by Taiwanese leaders or developments, the Sino-American tensions can quickly escalate.

In recent years, democratic processes and the shift from mainland-origin to indigenous leadership in Taiwan have tested Sino-American and, to a lesser extent, Sino-Japanese relations more often and with greater urgency. So far crises have been contained, but this is no guarantee for the future. Because Taiwan has become more salient, especially for Beijing's leaders, Sino-American relations have become more urgent, dangerous, and tension-prone. This vastly increases the dangers for Japan, whose alliance relationship with the United States has been tightened under the new defense guidelines.

Both the American and Japanese publics have greater natural affinity for a democracy than for the mainland's dictatorship. Taiwan's rulers are now accountable to their citizens and an elected parliament. And in March 2000, the people in Taiwan narrowly selected a President, Chen Shui-bian, whose Democratic Progressive Party (DPP) platform supports Taiwan independence.

Chen's victory probably came despite rather than because of the DPP's stance toward the mainland. Nonetheless, Chen's ascent signals a profound change in the island's social and political profile. Throughout the 1990s, Taiwanese society drifted away from an identity with the mainland. The DPP's intellectual origins can be traced to the various resistance movements on the island against Japanese and Kuomintang (KMT) rule. The KMT, founded by Sun Yatsen in 1923, remained committed until recent years to the unification of China under its leadership; its links to the mainland were deep.

In the fundamental documents upon which Sino-American and Sino-Japanese relations were established, both Japan and the United States acknowledged the Chinese view that there is "one China" and that Taiwan is part of it. But Taiwan's democratically elected leaders are thus far unwilling to embrace this formula, at least in a form acceptable to the mainland.

The people on Taiwan, in effect, have selected leaders who do not accept a key element—perhaps the enabling element—of the Grand Bargain.

Beijing fears the accelerated Taiwan drift from the mainland will culminate in its permanent political severance from the mainland and, ultimately, its international acceptance as a full and separate nation-state. China's leaders also primarily blame the United States and secondarily suspect Japan for enabling the process to occur. The domestic political ramifications in Beijing of the Taiwan situation could also be serious, provoking a "Who Lost Taiwan?" debate.

Many sober analysts in Trilateral countries worry that a Sino-American conflict over Taiwan could result from miscalculations in Beijing over American resolve to assist Taiwan in case of an unprovoked attack, or missteps by a Taipei administration that erroneously concludes that it has unlimited American support. Indeed, even before Chen's election, the risks of conflict had gradually been increasing for several years. Reduced to its essence, the danger of miscalculation and war has been this: influential politicians in each Washington, Beijing, and Taipei all exhibit excessive confidence that they can adopt tough stances and engage in inflammatory rhetoric without serious risk because, in the end, their counterparts in the other two capitals will behave cautiously, and will understand and yield to the domestic political forces driving this posturing. This is a prescription for disaster.

The consequences of a Sino-American conflict over Taiwan would be almost too horrible to contemplate. Even limited Chinese military action—such as seizure of Taiwanese ships in the Strait or of lightly defended islands—would surely engender American military assistance to Taiwan, and/or a direct American response. The unpredictable dynamics of escalation would be unleashed, with the inevitable unknowns about the extent, duration, and intensity of the confrontation. While the United States would prevail, the cost to the United States would be enormous—to China even more so—and the prosperous and democratic Taiwan of today would be destroyed in the process. A protracted or severe conflict would prompt financial flight from the region, end East Asian prosperity, wreck China's progress of the last twenty years, generate Japanese rearmament, and leave a legacy of Sino-American bitterness that would plague the world for generations to come.

These dangers are recognized, most widely in Taiwan itself. In fact, recognizing the political and economic consequences of pursuing independence as well as his own limited mandate, the new Taiwan leader adopted a moderate stance both before and after his election. He pledged that he would not declare independence and he backed away from the

"state to state" characterization of mainland-Taiwan relations promulgated by his KMT but independence-minded predecessor, Lee Teng-hui.

Yet, Beijing remains suspicious of Chen's ultimate goals and has made clear its increasing frustration and impatience with Taiwan's unwillingness to enter into negotiations over reunification as opposed to increased dialogue and contacts. As a demonstration of sincerity, Beijing demands that Chen reaffirm a 1992 formula in which both sides accepted the notion there is "one China," as the basis for renewed cross-strait political dialogue. Taiwan's previous KMT leadership had subsequently interpreted the 1992 formula to mean, "There is 'one China' and each side retains its meaning of the term," an interpretation the new leadership is willing to embrace. But Beijing rejected this Taiwanese interpretation, indicating, as far as it is concerned, "There is 'one China' and there has been no discussion on the meaning and substance of the term." Chinese leaders, however, have stated that "one China" does not necessarily mean the People's Republic of China and in this sense have drawn an important distinction between Taiwan's situation and that of Hong Kong.

In short, for Beijing, Taiwan must accept the notion of one China embracing the mainland and Taiwan and it is the process of reunification that needs negotiation. To Taipei, such a discussion is an anathema and politically treacherous for Chen Shui-bian (who represents a minority faction within the DPP) since it would appear to accede to cutting off a future option of independence rather than simply not pushing forward toward a formal declaration of independence.

Many aspects of the current situation could prove positive and promising. The descending spiral of tension and possible conflict can be avoided if Beijing, Taipei, Tokyo, and Washington realistically recognize the dangers and avoid complacency. With vision, calmness, and restraint in all four capitals, they now have an opportunity to embark upon a more stable and beneficial path. Despite the stalemate over "one China," Beijing has been courting Taiwanese politicians (including DPP politicians). In January 2001, Beijing allowed direct trade, transport, and postal contacts between the mainland and the off-shore islands of Kinmen (Quemoy) and Matsu, despite its criticism that the "mini-three links" were insufficient.

These hopeful signs are balanced by signs of an inevitable confrontation, as some observers in each capital believe time is against a peaceful resolution. Beijing focuses on Taiwan's loss of Chinese identity and the island's increasing military and political external support. Taipei fears the mainland's accrual of military might. In this context, all the Trilateral countries must exert efforts to halt a drift toward conflict.

7. Changing International Norms

In two important respects, the conceptual basis of the Grand Bargain is also under challenge. First, in the 1970s and 1980s, the United States spoke warmly about the emergence of a multipolar world. Its leading strategic thinkers believed the world was headed in that direction, that a multipolar world would be more stable than the bipolar Cold War world, and that the United States had special attributes that would enable it to flourish in conditions of multipolarity. The vision left ample room for Japan, China, and Western Europe to assume a greater role in the decades ahead. Today, it is not clear that the vision of multipolarity still governs American thought. Indeed, many American strategists have advocated the use of their country's overwhelming current economic, technological, and military superiority to fashion global institutions that would perpetuate American dominance. Such a vision arouses a natural concern that the United States will seek to prevent China's emergence as a full and equal partner in world affairs.

Second, in the 1980s and early 1990s, many Asians felt that they had pioneered their own model for rapid economic and political development, *rooted* in indigenous Asian values and historical experiences. The economic performance of the region prompted resistance in many quarters to the American agenda of human rights, democracy, and free markets. But the economic crisis of 1997 stilled the "Asian values" debate (except for China's leaders), and emboldened the United States to press its cause with even greater vigor. The democratization of South Korea, Taiwan, Thailand, and Indonesia further added to American confidence in the universal attraction and applicability of its values and added to the worries of the leaders in Beijing who remained wed to another developmental path.

The NATO intervention in Yugoslavia and its justification on universal grounds underscored to China's leaders that a vast gap had erupted between their vision and that of the Trilateral countries concerning the evolution of the international system. China may be a rising power, but its leaders are committed to strict ideas of sovereignty and the preeminence of the nation-state. Meanwhile, the industrial democracies—the established powers, led by the United States—are the revolutionaries, seeking to erode the notions of sovereignty and giving power to regional organizations (such as NATO) to intervene anywhere for purposes they consider to be "humanitarian."

E. CONCLUSION: STRATEGIC CHOICES AND POLICY RECOMMENDATIONS

The central strategic question is whether the Grand Bargain has outlived its usefulness. Have the many changes made it irrelevant and irretrievable? Three basic views can be discerned in answer to the question, each with different policy implications for the Trilateral countries.

One view is that the underlying shared strategic interests that brought China, Japan, and the United States together in the 1970s and 1980s have not appreciably diminished, though perhaps the economic reasons for cooperation have increased in saliency, serving as a substitute for the prior focus on the Soviet Union. China's rise, clouded with uncertainty, and Japan's temporary economic difficulties have not altered the benefits to regional stability that a strategic partnership among the three brings. Proponents of this view would argue that the alleged strains upon the Grand Bargain are more perceived than real and that secondary issues have been allowed to clutter an agenda that should focus upon primary and vital interests. Further, they would say, a principal reason for the lack of strategic vision has been an unnecessary and even dangerous failure to sustain a meaningful and intense dialogue about a regional security architecture that would serve the interests of all the major powers. In short, adherents of this school call for a return to basics: a focus on major-power relations, renewed strategic dialogue, use of transitory issues to consolidate major-power relations, and vigorous leadership on national security issues.

A second school argues that the changes—especially China's rise—are fundamental. There is no way, they believe, that China can be effectively integrated into the global and regional system. They assert that China inevitably will challenge both the global and regional systems, and therefore that the United States and Japan should begin now to make preparations for the inevitable rivalry that looms ahead. To supporters of this view, whether the Grand Bargain once made sense is a moot point. To some in this school, it once had utility; to others, it created the conditions that present the Trilateral countries with the current dilemmas. But in either case, the attempt to return to it or even to adjust it to new circumstances is unrealistic and indeed dangerous. In short, proponents of this school seek what might be called a "new realism."

We find both positions to be inadequate. Russia's collapse; China's rise; the trends of democratization, marketization, and regional interdependence; Asia's growing importance in world affairs; and the revolution in military affairs do require substantial amendments and adjustments to the old formula. But it is far too early to jettison arrangements that have

brought unprecedented stability to the region. Indeed, the prescriptions that the "new realism" offer appear eerily similar to the failed "rim strategy" of the 1950s and 1960s—i.e., relying on security arrangements with Japan, South Korea, Taiwan, and Southeast Asian nations to contain and thwart China's alleged malevolent inclinations. The strategy failed when the strategic balance was more favorable to the United States and Japan than it is today. And the strategy rested on an American capacity to compel Western Europe and Japan to follow Washington's lead. That condition no longer exists. Moreover, the policy seems likely to lead to the very consequences that it seeks to avoid. It is too early to assume that China will be either a partner or a rival in the maintenance of a tranquil Pacific region.

Our preferred strategy is for the Trilateral countries and their Asian partners to refurbish the Grand Bargain. This entails expanding the earlier accommodations to address an altered set of issues.

1. Taiwan

First of all, changes in the Taiwan situation must be recognized by all the Trilateral countries, for its dangers threaten everyone. In the past, the United States carried the burden on the Taiwan issue almost alone. While the military dimensions remain the American responsibility, Western Europe and Japan should play a more active role diplomatically, politically, and economically. Hence, all the Trilateral countries should speak frankly to China's leaders about the consequences of an unprovoked attack against Taiwan, namely that the response would be China's diplomatic isolation and an outpouring of support for Taiwan. But Taiwan's leaders should also understand that a formal declaration of independence or the enshrinement of its status as a sovereign Taiwan state in its constitution or a new basic law would receive no support from any of the Trilateral countries. The responsibility of the Trilateral countries, each in its own fashion, is to foster an environment that will facilitate improvements in cross-strait relations.

Part of that responsibility must be to explain to China's leaders the implications of Taiwan's democratization. Because the original Grand Bargain was struck without prior consultations with Taiwan, Taiwan's past authoritarian leaders had no choice but to accept the arrangements that the major powers made on their behalf. That situation no longer exists. Many conversations will be necessary before the leaders in Beijing fully comprehend the implications of this change. It is clear that the leaders on Taiwan will have to secure the assent of their electorate to any accommodation they might reach with the mainland. For China's leaders to hear the message from other than Americans will improve the likelihood of its being understood.

Due to its historical legacy, the United States is inescapably more deeply involved in the Taiwan issue than other Trilateral countries. Washington's embrace of Taiwan's new administration should be conditioned by its performance. Will Chen's rhetoric, policies, and performance merit the external support that he needs? Rather than enacting the Taiwan Security Enhancement Act, which mandates increased Taiwan-American military cooperation, or deciding now, for example, to provide Taiwan with significant new weapons systems, it would seem prudent for the new Administration in Washington first to judge the temperament and disposition of its Taiwanese counterpart. After all, one boards a bus only after knowing its destination.

In short, precisely because management of the Taiwan issue is so central to the continuity of the Japan-U.S.-China constructive triangle and because that triangle is fundamental to regional and global peace, all the Trilateral countries should recognize their stake and make their positions clear to both Taiwan and Beijing. While the military dimension must remain an American responsibility, the Trilateral countries should shoulder a greater diplomatic burden than in the past.

2. Strategic Dialogue

We recommend reinvigoration of a wide-ranging strategic dialogue among the leaders of the region and their national security advisors. Opportunities must be given, in private and unrehearsed bilateral exchanges, for leaders not only in Beijing, Tokyo, Washington, and Moscow but also in Seoul, Taipei, and Southeast Asia to discuss their fears and aspirations. And the Europeans should be active as well. Much of the dialogue should center on how to balance and reconcile the strong desire to maintain sovereignty, national independence, and cultural distinctiveness with the equally strong recognition of the need to create more effective international, regional and national institutions to deal with the new set of problems arising from globalization of economies. No nation has a monopoly of wisdom on how best to address these conflicting objectives. And it is important for each set of leaders to sense that their views have been heard and respected. The strategic dialogue should not be seen as primarily a task for the leaders' foreign policy principals in Washington, Beijing, and Tokyo, as in the 1970s and 1980s. It should be expanded to various multilateral and bilateral occasions. The preeminent leaders of the major powers can not allow their domestic agendas to overwhelm them and divert their attention from strategic issues.

3. Korea

The Trilateral countries have a common and huge stake in maintaining stability and promoting peaceful evolution on the Korean peninsula. This was recognized in the financial commitments Trilateral countries made supporting the provision of light water nuclear reactors to North Korea by the Korean Peninsula Energy Development Organization (KEDO). Should North Korea unambiguously embark upon a path of domestic reform and opening to the outside world, the Trilateral countries—in cooperation with South Korea and China—must be ready to respond to the opportunities that present themselves. The Grand Bargain arose, in part, to facilitate maintenance of stability on the Korean peninsula. Following the dramatic North-South summit, the participating countries now may have the opportunity to extend its purpose to the incorporation of North Korea into the region as a constructive member.

4. Arms Control

In contrast to the Soviet-American strategic relationship or the European theater in the Cold War, arms control has not been on the East Asian agenda. Limitation of weapons acquisitions and deployments were not part of the Grand Bargain; arms control negotiations did not encumber the reaching of mutual understandings in the 1970s and 1980s. But it is no longer possible or desirable to keep these issues off the agenda. Indeed, their inclusion seems essential to avert a debilitating and destabilizing regional arms race that no one can win.

There should be no illusion about the difficulties entailed. There is no multilateral forum through which to address the issues involved, nor can one be formed. Until the Korean peninsula ceases to pose dangers of war, it is somewhat premature to place limits on deployment of weapon systems and forces that are intended for Korean contingencies. And the uncertainties over China's future course impel a hedge or insurance policy in terms of American preparedness and deployments that makes imposition of limits on American force posture difficult to conceive. We do not have specific proposals to make. Rather, we pose a series of questions that we think governments and strategists must begin to explore:

- What level and kind of American forward-deployed forces will be necessary to deter the reappearance of age-old Asian rivalries, once the risk of war on the Korean peninsula has abated? And where should they be deployed?
- What caps would Japan be prepared to place on its military strength, if other powers in the region (especially China) are willing to place verifiable limits on their weapons acquisitions and deployments?

- How can current dialogue processes be best exploited to encourage North and South Korea to reduce their military expenditures and alter the pattern of their deployments?
- If the United States, in close consultation with Taiwan, would halt or limit some of its weapons sales to the island, would Beijing be willing to halt development and/or deployment of systems that are particularly threatening to the island?
- Is the United States prepared to recognize the consequences of its possible NMD system upon China's sense of security? What compensatory moves would Washington be prepared to undertake or accept?
- What compensatory actions would China be prepared to undertake, were Japan and the United States explicitly to state that the Defense Guideline Review does not contemplate Japan providing logistical support to the United States in case of an American involvement in the defense of Taiwan? For example, would such a commitment elicit a strong Chinese endorsement for the continuation of the U.S. military presence in the western Pacific and of America's bilateral treaties even after peace comes to Korea?

The raising of these questions underscores the difficult diplomatic challenges at hand. But if these questions are shunned, we believe a regional arms race will prove to be unavoidable—especially if the Taiwan problem intensifies. And under those circumstances, the Grand Bargain would indeed be lost. Probably the United States is best positioned and has the greatest interest and responsibility to pursue these questions through a series of bilateral dialogues and arrangements with each of the countries involved. But any American effort must be reinforced through bilateral efforts of Japan with China, Taiwan with China, South Korea with the North, and the ASEAN states with China. To achieve a solution, each country would have to abandon its preferred position in order to reach a comprehensive series of agreements in which each country would feel more secure than it will if the arms race unfolds.

To repeat, this presents a conceptual challenge of great magnitude. It would build upon the Grand Bargain and go beyond it. If the leaders of the region can be persuaded to begin to think through these currently unanswerable questions, they would find themselves on an altered trajectory, having to consider how to create an improved regional security architecture through a series of new mutual accommodations.

IV. RETHINKING THE ASEAN FORMULA: THE WAY FORWARD FOR SOUTHEAST ASIA

Hadi Seosastro and Charles E. Morrison

Although often overshadowed by more populous and richer Northeast Asia, Southeast Asia is also of significance to the international system. With almost 500 million people and a substantial natural resource base, the region contains some of the world's fastest growing economies over the past quarter century. It has become a major producing and exporting region for a wide range of manufactured products from textiles to computer chips. The Asian economic crisis originated in one Southeast Asia country, and the world's most virulent computer virus to date was created in and unleashed from another. The region sits astride major communications and transportation links; the straits linking the Indian Ocean with the South China Sea are literally the energy and economic lifelines for Japan, Korea, and increasingly China. Their interruption through political or military action would not only be catastrophic for these countries, but for the international economy as a whole. The region's ten nations (eleven including East Timor) have a variety of political and economic systems and possess vast intra-regional (and often internal) disparities of development, complicating a complex inter-state system that reflects the nineteenth century boundaries set by European empires more than the region's historical or contemporary ethnic, religious, economic, or political patterns.

In the 1950s and 1960s, Southeast Asia was frequently referred to as East Asia's "Balkans," in reference to the frequently conflictual relations and explosive ethnic mixes in both its mainland and insular subregions. But by the mid-1970s and 1980s, despite a prolonged civil and "proxy" war in Cambodia, the region was considered one of the most promising in the developing world.¹ Its core countries (Indonesia, Malaysia, the Philippines, Singapore, and Thailand) frequently cooperated as the founding members of the Association of Southeast Asian Nations (ASEAN). For the most part, all five were politically stable; and four (except for the Philippines) were economic "miracles."

This stability and growth reflected two critical factors that might be referred to as the "ASEAN Formula." First, through ASEAN and "the ASEAN Way," the member-countries established norms of behavior toward each other that minimized inter-mural conflict, magnified their bargaining position vis-a-vis outsiders, and, at least to some extent, facilitated domestic regime survival. Like the China-Japan-U.S. "Grand Bargain" described in the previous chapter, the ASEAN countries, in effect, entered into a bargain with each other. The ASEAN bargain is not a matter of bilateral communiqués and understandings, but rather involves a multilateral understanding of the appropriate rules of international behavior enshrined in the modus operandi of a regional institution. The "ASEAN Way" evolved incrementally and informally among the ruling elites and came to be understood as involving consensual decision-making, sensitivity to each other's interests, and non-interference in each other's internal affairs. Even when they could not fully support each other, ASEAN countries went out of their way not to embarrass or hurt their neighbors.² Nor for many years did the ASEAN countries individually join new outside regional groups that might be perceived as diluting ASEAN's importance.

The other key element of the ASEAN success story was that despite differences in domestic political systems and despite the member-countries' long wariness of broader forms of regional cooperation involving advanced countries, all five original members embraced integration within the global economic system as a strategy for growth. Geography and pre-colonial as well as colonial history generally oriented them toward outward-looking commercial, financial, and cultural relations.³ While "globalization" efforts were never without controversy, the original ASEAN member-countries were among the first developing nations to shift from import-substitution to export-led growth strategies, to liberalize trade and financial systems on a global basis (often without explicit reciprocity), to welcome foreign direct investment and multinational corporations, and to engage in regional cooperation across the "North-South divide."

The ASEAN formula—shallow regional cooperation and deep global engagement—was spectacularly successful for many years. For three decades after the mid-1960s, Indonesia, Malaysia, Singapore and Thailand were hailed as paragons of economic and social progress. ASEAN itself was widely regarded as the developing world's most successful sub-regional institution. It not only helped contain potential conflict among its members, but shaped the manner in which outside powers dealt with Southeast Asia. Growth, association, and stability reinforced each other in a virtuous circle. The rapid economic growth of most of the original members added credibility and legitimacy to the Association; ASEAN's exis-

tence helped strengthen member-governments; and political stability and regional cooperation were conducive to investment and growth.

Their success encouraged the core ASEAN countries to undertake a series of ambitious new initiatives in the 1990s. These were intended to reinforce the ASEAN formula through enhanced cooperation, draw the remaining Southeast Asian countries into the ASEAN formula (particularly helping them with economic modernization), and develop relations in the broad Asia-Pacific region and with other regions on the basis of the ASEAN Way. These initiatives included the proposed ASEAN Free Trade Agreement (AFTA) and the expansion of ASEAN to encompass Vietnam, Cambodia, Laos, and Myanmar. The ASEAN countries had somewhat reluctantly joined the Asia Pacific Economic Cooperation (APEC) forum in 1989, but President Suharto seemed to throw caution to the wind in 1994 when he promoted APEC's "Bogor Vision," foreseeing free trade and investment in the broader Asia-Pacific region by 2020 (2010 for developed countries). In the same heady mid-'90s era, ASEAN or its members also spawned several new institutional processes beyond Southeast Asia, including the ASEAN Regional Forum (ARF) for security consultations, the Asia-Europe Meeting (ASEM), and the ASEAN Plus Three process for East Asian cooperation without North America or Oceania.

The hubris of the 1990s came to a sudden end. Longer-term sociopolitical changes that added to the diversity of Southeast Asia had already been slowly undermining the elite-based ASEAN Way and complicating the expansion of the Association, when the Asian economic crisis struck in mid-1997 with devastating effects on regional self-confidence. In turn poor management of the economic crisis delivered a coup de grace to the aging Suharto government in Indonesia, resulting in internal turbulence that three years later continues to overshadow the future of not just that country of 210 million people but the entire East Asian region. Today, ASEAN is in disarray. Some flatly declare it a failure. Such assessments are surely an over-reaction, but elements of the ASEAN Formula that worked in an earlier era and with a smaller membership clearly have come under increased questioning.

The ability of the ASEAN countries, working with the international community, to overcome their current problems and restore Southeast Asia to a path of political stability and economic growth has important implications for East Asia and the international system. This chapter describes the background of the ASEAN formula, sketches the initiatives of the early and mid-1990s, and examines the reasons for ASEAN's current malaise. It concludes by addressing the issues relevant to the future of ASEAN's interface with the international system.

A. ORIGINS AND ELEMENTS OF THE ASEAN FORMULA

The prospering image of Southeast Asia in the 1980s and 1990s would have been scarcely imaginable in the 1950s and 1960s. With a history of intense colonial competition from the sixteenth through the nineteenth centuries and suffering as a battleground during World War II, the Southeast Asian countries then faced uncertain futures. Even when independence had been achieved, there were active insurgencies in most countries based on ideological, class, ethnic, or religious conflict. Governments and national institutions had shallow roots. Economic take-off had not yet occurred. Even Singapore's economic prospects seemed dubious, shadowed by a steep decline in income related to the closing of Britain's colonial-era military base and by growing protectionism and nationalism in neighboring countries that threatened the city's traditional entrepot role.

The establishment of a strong, Western-oriented central government in Indonesia after 1966 and the creation of ASEAN the following year began to transform the image of Southeast Asia from that of a problem area to one with a core of stable and economically growing countries. ASEAN owed its birth and much of its evolutionary dynamics to the desire of the governing elites of the original member-nations to strengthen national governments and enhance international prestige at a time of significant change in large-power relations in their region. The common interest underlying the intra-ASEAN bargain was regime stability.

To consolidate its political position and restore economic health and social stability, the new Suharto government desperately needed to end its conflicts with neighboring countries and gain the political and economic support of the West. The governing elites of the other ASEAN founding countries wanted both to bolster this cooperative Indonesian regime, reinforce its relations with their main non-regional partners, and tie Indonesia into the consultative mechanisms they were already beginning to establish among themselves. They were also increasingly nervous about their international position, sensing a retreat of the Western powers in the wake of the Vietnamese war and the rise of the communist states. The perceived threat was not so much outright external aggression as a changing ideological balance of power that would undermine the domestic support and legitimacy of ASEAN's conservative rulers and largely capitalist economies.

In face of this threat, ASEAN was less an economic arrangement than a political pact among like-minded governing elites. They would cooperate for the purpose of shoring up their respective national governments, despite some differences of systems and interests. This cooperation was not at the expense of sovereignty, but it aimed to reinforce the sovereign

nation-states. Since most ASEAN countries had recently regained independence, there was a deep commitment to preserving sovereignty and a consequent unwillingness to move toward serious institutionalization or "integration." In practice, therefore, the relationships among the ASEAN countries differed from the members' other international relationships more in terms of style than in substance.

In line with the emphasis on sovereignty, the ASEAN Way consisted of three principles to guide inter-mural behavior: restraint, respect, and responsibility. The core principle of restraint obliged the ASEAN countries not to interfere in each other's domestic affairs. The principle of respect was demonstrated in communications and habits of consultation, in the course of which states can discuss problems and air grievances in private. As a manifestation of responsibility, ASEAN member-states were expected to be considerate of each other's interests and sensitivities.⁴

The ASEAN Way has constituted the code of conduct within ASEAN during its entire history. The members have largely avoided confrontations with each other, while the course of ASEAN cooperation and organizational development took a minimalist path.

The other aspect of the ASEAN formula—globalism—almost came naturally to the pragmatic, business-oriented ASEAN governments. Three of the original members—Malaysia, Singapore, and the Philippines—had experienced relatively smooth transitions from colonialism to independence, and the many cultural, educational, and commercial ties that had been forged in the colonial era continued after independence and even intensified in some instances. Despite some nationalistic rhetoric, their newly independent governments sought more to diversify their ties with a wider network of countries, particularly rising Japan, than adopt nationalistic policies. Thailand, which had never been a colony, shifted toward outward-oriented economic policies in the 1960s, encouraged by its political alignment with the United States. In contrast to its ASEAN counterparts, Indonesia had fought for independence and had nationalized foreign property during the Sukarno period. However, with a heavy debt burden from the previous regime and the inducements of substantial Western aid, the Suharto government made a conscious political decision during the late 1960s to reverse economic as well as political direction.

Despite their outward orientation, most of the ASEAN governments were cautious about broader forms of regional cooperation. From the time of ASEAN's creation, proposals for larger "Asia-Pacific" regional institutions occasionally appeared, mostly originating with intellectuals or politicians from Australia, Japan, South Korea, or the United States. While some Southeast Asians in intellectual, business, and even govern-

ment circles embraced such ideas, the dominant mood in governments was one of suspicion, fearing that broader cooperation would be dominated by the more advanced countries, dilute and weaken ASEAN's own fragile identity, and, in the Cold War setting, give the group a greater coloration of political alignment with the West. ASEAN opposition in 1980 to an Australian-Japanese initiative for a Pacific economic community consigned Asia-Pacific cooperation to second track processes for nearly a decade. While some ASEAN governments were attracted to the notion, the desire not to appear to disrupt ASEAN unity or consensual processes deterred any government from seriously pursuing such a course until the entire group was ready to accept it. This came only in the late 1980s.

B. NEW DEPARTURES: ASEAN IN THE 1990s

Despite ASEAN's minimalist character, it was widely regarded as the most successful experiment in regional cooperation in the developing world. ASEAN gave the impression of tremendous activity with literally dozens of working meetings each year, but many of these were informational exchanges or very circumscribed projects. The private sector, not intergovernmental agreement, was the driving force of the ASEAN countries' engagement with each other and with the rest of the world. However, the fact that the governments and leaders had cooperative relations with each other was immensely reassuring to the business communities and helped lay the foundation stones for more significant departures at the end of the 1980s and in the early and mid-1990s. These came against a backdrop of dramatic changes in the larger regional and global environment that provided new opportunities as well as great challenges. Singaporean political scientist Chin Kin Wah has listed the imperatives for institutional change at the end of the Cold War: the removal of political and ideological walls dividing ASEAN and the Indochinese states (providing new opportunities for cooperation), a new security environment, intensified global competition, the growing salience of post-Cold War issues such as democracy and human rights, and the need to engage increasingly influential NGOs in regional cooperation.⁵

During the first few years of the post-Cold War era, the ASEAN countries launched a surprising number of initiatives. These reflected both concerns within ASEAN about how to address the new uncertainties and confidence that ASEAN had sufficiently matured to undertake significant departures without harming itself. Ironically, none of the changes were thought of as affecting the basic ASEAN Formula. Rather they were

intended to reinforce the principles enshrined in the ASEAN Way as well as ASEAN's regional and global engagement.

1. Embrace "ASEAN Plus" Associations

One of the most significant changes came in ASEAN's posture toward wider regional and interregional relationships. In 1989 the ASEAN group finally responded positively to a second Australian-Japanese initiative that resulted in the creation of APEC. This shift reflected a belief in ASEAN that growing interdependence (as globalization was then called) impelled the ASEAN countries to embrace special forms of cooperation beyond the relatively narrow Southeast Asia framework. It also reflected increased confidence that ASEAN was sufficiently consolidated that its survival was not threatened by Asia-Pacific cooperation. Finally, it represented an acknowledgement by the more skeptical ASEAN members that they should not continue to block experimentation with broader forms of association that other countries found attractive.

In accepting the APEC concept, ASEAN's understanding was that the new process would operate in a similar manner to ASEAN itself; that is, on the basis of respect for sovereignty, voluntary cooperation and consensus-building. It would not be institutionalized and would not be a venue for negotiations and rule-building.⁶ As other members in APEC gradually pushed for institutionalization and actions to promote trade and investment liberalization and facilitation through concerted voluntary action (which had many earmarks of negotiations), some ASEAN countries, notably Malaysia and Thailand, felt that the original understanding was being violated.

Once the principle was established that ASEAN countries would engage in broader associations, ASEAN leaders began to propose other forms of regional and inter-regional association, in part to balance and complement APEC. The Asia-Europe Meeting (ASEM), first proposed by Singapore Prime Minister Goh Chok Tong, was established in 1996 as a comprehensive, inter-regional dialogue between the member-countries of ASEAN plus China, South Korea, and Japan on one side and the countries of the European Union on the other. ASEM involves summit meetings every other year. It also was the practical antecedent for the "ASEAN Plus Three" concept, although the origins of this concept are often traced to a controversial 1992 proposal by Malaysian Prime Minister Mahathir Mohamad for an East Asian Economic Group. The ASEAN Plus Three now has a "vision group" charged with suggesting the direction for this grouping (to report by late 2001). Like ASEAN and APEC, a free trade arrangement is envisioned.

2. Establish an ASEAN Free Trade Agreement (AFTA)

First suggested as far back as 1971 and announced in 1992, the AFTA sought to make a dramatic breakthrough in economic cooperation, until then limited to a modest preferential tariff scheme and largely unsuccessful industrial cooperation plans. The AFTA would phase down intra-regional tariffs to 0-5 percent and eliminate non-tariff barriers for a wide range of manufactured products. Realizing that the subsequent Asia Pacific Economic Cooperation (APEC) trade proposals would overtake AFTA, the original ASEAN members accelerated full implementation of their AFTA commitments from an initial target of 2008 to 2002.

Since intra-ASEAN trade is still only about 20 percent of the grouping's trade, the direct economic impact of the AFTA scheme is not large. However, it is intended as a training ground to help ASEAN industries adjust to more vigorous competition, thus facilitating ASEAN's adjustment to broader APEC and global freer trade. It is also intended to make the ASEAN countries more attractive for foreign direct investment in production and export platforms for the global economy. Thus conceived, AFTA is an accelerated arrangement of temporary duration until broader schemes are phased in. It is compatible with and supportive of global free trade, not a trade-diverting bloc. Nevertheless, the AFTA agenda will require an unprecedented degree of policy cohesion and coordination for ASEAN.

3. Complete the Dream of Including All Ten Southeast Asian Countries

During most of its existence, ASEAN was reluctant to admit additional countries, allowing only tiny Brunei to join in 1984. In the post-Cold War environment, however, the Association moved rapidly to incorporate Vietnam (1995), Laos and Myanmar (1997), and finally Cambodia (1999) in a short four-year interval. At the 1995 Bangkok Summit, attended by all ten leaders for the first time, Prime Minister Banharn Silpa-archa of Thailand argued that expansion would inject new vigor into ASEAN and give it greater international influence, even though he acknowledged that widening would slow deepening. At this point in the expansion effort, the ASEAN countries were quite confident that they could encourage the new entrants to become more like themselves; that is, facilitate their engagement in the global economy.

4. Address Security Issues

The 1992 declaration that ASEAN was ready to address security issues led to the creation of the "Special SOM," or senior officials meeting, as a new forum where representatives of the foreign ministry and defense establishments could meet for intra-ASEAN dialogue on security issues and coop-

eration. The ASEAN Regional Forum (ARF) was established in 1994 for multilateral security and political consultations with the major regional powers. Through ARF, ASEAN attempted to advance its security interests with the large external powers and navigate post-Cold War uncertainties.

* * *

These multiple new directions in the early and mid-1990s not only gave ASEAN an image of vitality when its main political project of the 1980s (its long effort to force the withdrawal of Vietnamese forces from Cambodia) had successfully ended, but also demonstrated that the Southeast Asian grouping was having a major impact on broader regional dialogue. Although accompanied by some limited institutional innovations in ASEAN decision-making, these changes still did not affect the consensual nature of ASEAN decision-making. Quite the opposite. As pointed out, ASEAN, in effect, was suggesting that the ASEAN Way (or bargain) be the basis for the broader dialogues within East Asia and the Asia-Pacific region, and between Asia and Europe. ASEAN's hubris in this regard was fed both by its indispensable role in APEC (no one else was willing to go ahead with Asia-Pacific regionalism without ASEAN's concurrence) and the economic successes of the member-countries. However, subsequent developments both within ASEAN and abroad suggest that ASEAN had seriously over-estimated its capabilities. Several developments raised serious doubts about the effectiveness of the ASEAN Way for external dialogue and even for ASEAN itself.

C. THE ASEAN MALAISE

The current malaise arises from longer-term trends in the ASEAN societies, unintended consequences of some of the ASEAN initiatives, and the 1997 economic crisis and its political consequences.

1. Changing ASEAN Societies

The years of rapid modernization and global engagement altered the composition and characteristics of the populations of the original ASEAN countries in ways that had implications for dominant political and social values (particularly in the cities), international relations, and ASEAN.

During the early years of ASEAN, the established ASEAN elites frequently enjoyed almost monopolistic control over the politics of their own societies. Individual leaders often retained their position for decades. In fact during the Association's first fifteen years, there was no

change in the top leadership in three of the five ASEAN countries—Indonesia (Suharto), the Philippines (Marcos), and Singapore (Lee Kuan Yew). In Malaysia and Thailand, the rotations were within small governing elites. As a consequence, relations among the ASEAN governments had a strong interpersonal character that facilitated longer-term group understandings, discouraged individual initiatives, and helped socialize new leaders to prevailing ASEAN norms.

However, even in the early years of ASEAN the societies and economies of the members were changing in ways increasingly at odds with the elite-based nature of ASEAN politics, and this has accelerated. The level and pace of development has varied within and between countries. Urbanized Singapore is the most *advanced* in moving into a post-industrial era. Malaysia, the Philippines, and Thailand have rapidly expanding urban centers and manufacturing sectors, while Indonesia is still the most rural and resource-dependent of the five original ASEAN members. Each has had its own pattern of development, but social development in all the core ASEAN members has been moving in the same general direction. In all of them over the past four decades there has been a sharp rise of educational attainments and in the size and diversity of the middle and professional classes. Women have fewer children and are much more likely to have their own professional lives. Literacy became almost universal at the primary level, and secondary and tertiary enrollment rates at home have jumped spectacularly, not to mention the tens of thousands of Southeast Asians studying overseas. Rising educational attainments are reflected in much higher rates of newspaper circulation, increased political participation, and an explosion in the number of small non-governmental organizations, particularly in urban centers.

The expansion of manufacturing has brought millions of new blue-collar Southeast Asians into modern, mostly urban workplaces where they become interested in issues such as minimum wages and working conditions. In comparison to the 1960s, today large numbers of Southeast Asians have worked abroad in service, construction, and entertainment industries. Philippine and Thai laborers began to go to other East Asian countries and the Middle East in large numbers from the early 1970s, while Indonesian workers began working in Malaysia (today this foreign work force numbers about one million). Television, non-existent or a luxury in the 1960s, is commonly available even in rural areas, and the urban educated classes often have access to international cable channels. In more recent years, there has also been a rapid expansion in the use of cell phones and computers with internet connections.

The domestic and international implications of these trends over the longer term are enormous. Generational, educational, and other life-style changes have weakened traditional political and other forms of authority. They favor the rise of new political actors including labor unions, NGOs, new business leaders, and some religious groups. Even the more democratic ASEAN societies in 1967 were dominated by small elites with a relatively narrow set of interests. Today's leaders must cater to a much wider range of values, interests, and views. Their political challenge is not so much one of suppressing rural-based insurgencies as it is managing diversity. Their bases of power lie more in political and social movements and communications skills, and less in coercive instruments of social control—the police or the military—whose political use is increasingly unacceptable even to their own members. These changes in political expectations are occurring more rapidly or more smoothly in some countries than in others, but they make more difficult international cooperation based primarily upon elite interaction. In Indonesia, the mobilization of ethnic groups and *oi* outside interests and support is even calling into question the geographical definition of the state.

These changes did not call into question ASEAN itself. Rather they raised doubts about the relevance of the traditional form of the ASEAN Way with its emphasis on non-interference, mutual support and sensitivity among leaders. This was highlighted by *social* reaction to the Association's expansion agenda in the 1990s.

2. Widening and Flexible Engagement

ASEAN's expansion was essentially a political act. Proponents saw it as symbolically important as a statement of Southeast Asian solidarity and strategically important by incorporating the remaining Southeast Asian countries into ASEAN rather than leaving them in a political vacuum susceptible to influence of powers outside the region. But the move was controversial within ASEAN's more pluralistic and liberal societies. This debate was sharpened by external criticism of extending ASEAN's umbrella to cover Myanmar and the 1997 internal coup against Cambodian First Prime Minister Prince Ranariddh during the period his country was being considered for membership, an event that called attention to the more volatile and authoritarian politics of the new candidates for membership. Particularly in Thailand and the Philippines (where authoritarian systems had been rejected in recent years) and among liberal civil society groups around the region, this widening of ASEAN to non-democratic regimes with oppressive human rights records was considered retrograde and embarrassing. Such groups rebelled against the non-interfer-

ence norm and argued that including the new members was desirable only if it entailed considerable intra-group scrutiny. Sympathizing with such arguments, Malaysia's former Deputy Prime Minister Anwar Ibrahim advocated "constructive intervention" and former Thai Foreign Minister Surin Pitsuwan urged "flexible engagement." These concepts would allow involvement in domestic developments in a member-country that affect the security and well-being of other members, ASEAN cohesiveness, and the security of the wider region.

3. Implications of "ASEAN Plus" Dialogues

ASEAN's move toward "ASEAN Plus" dialogues also accentuated pressures on the original ASEAN formula, in two ways. First, as pointed out, the member countries hoped that stylistically the broader dialogues would operate on the basis of the ASEAN Way. Second, multiple, overlapping dialogues tended to free the ASEAN governments from group consultations and encouraged more individualistic policies and partnerships with non-ASEAN members.

ASEAN's bigger dialogue partners have their own agendas. In APEC, ASEAN's minimalist approach to institutionalization and emphasis on "getting to know you better" came up against an Anglo-Saxon desire for results and "deliverables." ASEAN's concern about each other's sensitivities and thus avoidance of controversy has been at odds with the insistence of some European countries on introducing human rights issues, especially in Myanmar, into the ASEM and ASEAN-EU meetings. There have been periodic tensions in the ARF between ASEAN's desire, indeed political need, to manage the process and the impatience of other countries with what is seen as an overly cautious, overly Southeast Asian focus. In contrast, there have been fewer tensions in the ASEAN Plus Three process. Here the emerging relationships among China, Japan, and South Korea are so delicate that the ASEAN Way works well as an initial point of departure.

The ASEAN countries have acted as individual governments in APEC rather than as a caucus, and in ASEM the ASEAN countries are members of the larger East Asian group. APEC also divides ASEAN, excluding Cambodia, Laos, and Myanmar. Because of a moratorium on new members, it is unlikely to be extended to these countries anytime soon.

The end result is that while ASEAN remains the primary regional identifier for its member-countries, it is less of an exclusive identifier. Much greater freedom of individual action is allowed. Singapore in particular has been pushing free trade agreements with a variety of extra-ASEAN partners, further muddying a picture of overlapping interna-

tional arrangements. Ten years ago, such individual action would have been thought contrary to the ASEAN Way.

4. The Asian Economic Crisis

While the expansion was already straining some aspects of the ASEAN formula, the 1997 economic crisis "pulled the rug from under the feet of those who had been extolling the achievements of the ASEAN economies."⁷ The crisis revealed the fundamental vulnerability of the ASEAN countries to global forces and the total inadequacy of regional institutions, whether ASEAN, APEC, or ASEM, in the face of serious trouble. The economies of Thailand and Indonesia literally collapsed, and all the other core ASEAN countries were heavily impacted, even Singapore whose entrepot and service-oriented economy is heavily dependent on the economic health of its neighbors. Short-term capital (much of it local) flooded out of Southeast Asia, and stock markets and currency values plunged. The ASEAN currency swap agreement was not used in any systematic manner, and had it been tried, it would have been totally inadequate. ASEAN had neither the solidarity, nor the economic wherewithal, nor the tools to handle the crisis.

The region had nowhere to go except, hat in hand, to the major world economies and the global institutions, notably the IMF and World Bank. But from a Southeast Asian perspective, the results were disillusioning. The United States failed to contribute to the Thai rescue package, in sharp contrast to its response to the Mexican crisis in 1994-95. Japan was ready with funding, but Tokyo's initial efforts to set up an Asian fund were not effectively presented and were blocked by Washington. The IMF and World Bank did coordinate rescue packages, but operating on the basis of **the** "Washington consensus," these institutions imposed controversial austerity programs and demanded changes on specific policies that seemed to go far beyond their mandates. Although Malaysia successfully resisted an IMF agreement, Thailand and Indonesia were compelled to seek assistance on the IMF's terms, which were relaxed only as the IMF itself learned that the prescribed dosages of its medicine were not appropriate for its patients. Symbolic of the relationship with the global institutions was a widely circulated photograph of a humbled and seated Indonesian President Suharto signing an agreement in front of IMF Managing Director Camdessus standing with his arms crossed. Within less than a year from the beginning of the economic crisis, President Suharto's thirty-year-old regime came to an end.

The economic crisis called into question the global engagement aspect of the ASEAN formula. Globalization, which had previously been seen

largely as having positive impacts, was now seen as a two-edged sword. While public resentment built up, the governments in fact had little choice but to knuckle under to the terms for assistance set by the international financial institutions. Ironically, ASEAN sought to accelerate AFTA and embark on new forms of financial cooperation, hastening globalization but cloaked in the rhetoric of providing a basis to cope with globalization pressures. Rising resentment to globalization was evident in Prime Minister Mahathir's controversial move to control foreign capital movements and freeze the value of the ringgit, and in the 2001 election in Thailand of Thaksin Shinawatra on a platform promising economic relief and resistance to foreign economic domination.

The crisis has cast a long psychological shadow over the economic future of Southeast Asia as well as its political leadership, which may be reflected in future skepticism about liberal trade and investment flows.

5. The Indonesian Crisis

As Southeast Asia's largest and most populous country, Indonesia had a paramount position in ASEAN from the beginning. Although most ASEAN initiatives originated with other countries, they needed Indonesian concurrence and often some modification to go forward. In general, Indonesian leadership was exercised in a conservative but subtle, accommodating fashion with considerable sensitivity to broader regional interests. These gave its leadership role considerable legitimacy. Over time, Suharto also became the region's most senior figure in terms of age and regime longevity, adding to his informal position as the Association's leader and arbiter.

The collapse of the Suharto regime, followed by weak governments and chaotic politics under successors H. B. Habibie and Abdulrahman Wahid, has drastically altered this picture. Absorbed in internal problems, Indonesia has lost credibility as a regional leader. Moreover, both Habibie and Wahid demonstrated appalling inexperience and insensitivity in regional diplomacy by making controversial, scornful remarks about Singapore. No other ASEAN figure comes close to being able to claim the Suharto mantle. Indonesia, the Philippines, and Thailand all have very green leaders, while the more senior leaders, in Malaysia and Singapore, are experienced but represent smaller countries and are unsuited for regional leadership for other reasons.

6. East Timor

The East Timor crisis, a consequence of the general weakness of and disorder in Indonesia, was one more blow to Indonesian leadership and to

ASEAN. The brutal actions of Indonesia's army-backed militia precipitated international outrage, culminating in pressures that forced the Habibie government to accept outside intervention. The Indonesian government preferred involvement by other ASEAN members. Some of these, notably Thailand and the Philippines, did send forces, but the overall leadership of the international military operation was with Australia. This was humiliating for Jakarta and gave lie to the claims that the region was capable of resolving its own problems.

The international intervention in East Timor had very different implications for ASEAN than the previous international peacekeeping effort in Southeast Asia (in Cambodia) at the beginning of the 1990s. Cambodia was not then part of ASEAN, and the intervention in fact came as a consequence of ASEAN's diplomatic campaign. (The principle of non-interference did not extend to non-members). The East Timor intervention, in contrast, came about because of the failure of one of ASEAN's own members, Indonesia, to exercise control over its military. Not only had an ASEAN country failed to keep order, but ASEAN as an organization had done nothing on its own to help contain the unfolding disaster.

D. RETHINKING THE ASEAN FORMULA AND ITS REGIONAL AND GLOBAL FOUNDATIONS

In thinking about the future, it is important to recognize that over its thirty-four-year history, ASEAN has been highly successful. For many years, the ASEAN formula created a peaceful international environment and helped achieve high economic growth rates for a large part of Southeast Asia. It also magnified the international influence of its member-countries and established a modest degree of regional identity among ASEAN elites and professional classes. Moreover, ASEAN continues to meet and deepen cooperation. Work on the ASEAN Free Trade Area continues and has been accelerated. Thus despite the economic crisis, ASEAN has retained and arguably strengthened its commitments to open regionalism and the global trade and financial systems.

One can plausibly argue that ASEAN is even more needed today than at the time of its creation in the late 1960s. And it is needed for many of same reasons: to provide cooperative interstate relations in a complex, multistate region and to help the member-countries interface with the international system. Moreover, despite the creation of APEC and the likely establishment of an ASEAN Plus Three organization, there is no other institution in which the Southeast Asian states will feel the same

sense of equality and comfort. Moreover, compared to any other form of international association, ASEAN provides the most promising avenue to encourage social and policy changes among the newer members. Thus ASEAN continues to deserve the keen interest and support of outside countries, especially its neighbors in South and Northeast Asia and other Trilateral nations.

Nevertheless, current critical challenges require a rethinking of the traditional ASEAN formula and its regional and global foundations.

1. Intensified Regional Cooperation

The new realities already described in this essay render the shallow regional cooperation of ASEAN's earlier decades increasingly inadequate. As elaborated above, the pluralization of ASEAN internal societies and their growing interdependence are erasing sharp domestic-external divides and making the old government-elite-based form of the ASEAN Way archaic. ASEAN's agreed policy agenda, notably AFTA, requires enhanced cooperation. The expansion of ASEAN and proliferation of broader forms of East Asian, Asia-Pacific, and Asia-Europe regional association and inter-regional dialogue have eroded ASEAN's like-minded-ness, solidarity, and exclusivity. Today ASEAN contends with a much more complex world, internally and externally.

Two fronts are particularly prominent now in the longer-term struggle to redefine and update the ASEAN Way to best meet the contemporary needs of its members: the extent to which ASEAN should address political and human rights issues among ASEAN countries, and the extent to which ASEAN economic cooperation needs to be significantly deepened through policy cooperation and coordination. Updating need not require the abandonment of the principles of respect for sovereignty, non-interference, sensitivity, and responsibility, all of which are basic norms in international relations worldwide. It does involve the greater involvement of civil society institutions and parliamentarians, constructive forms of engagement where other ASEAN countries may be affected, tolerance of responsible criticism, and more significant policy cooperation and cohesion.

2. Continued Global Engagement?

If the global economic engagement that was the other aspect of the traditional ASEAN formula is to be sustained, particularly given the deep disruption linked to the 1997-98 economic crisis, Trilateral countries need to give more consistent attention to the ASEAN countries and to show a more sophisticated understanding Southeast Asia's political and social complexities. The United States and other key Trilateral countries need to

define their broader strategic interests in the region and develop and implement appropriate policies. It is telling that in the first few months of the Asian economic crisis, the United States contributed nothing to the Thai rescue, paid scant attention to the subsequent problems in Indonesia, and opposed the Asian monetary fund proposed by Japan. This vacuum helped give almost free rein to an IMF technical staff attuned to a different kind of debt problem in Latin America and Africa and lacking a sense of the strategic stakes involved. It was only when the crisis moved beyond Southeast Asia to Hong Kong and Korea that the highest-level American financial policymakers were galvanized into action.

In fact, frequently the Southeast Asian policies of key Trilateral countries have been too narrowly conceived, dominated by a single or very few issues driven by some domestic political or economic interest. The intense focus on East Timor, for example, has obscured broader Trilateral interests in Indonesia (with more than 200 times the population of East Timor). This is not to argue that the terrible humanitarian tragedy in East Timor and that new nation's enormous reconstruction needs did not or do not deserve significant attention. Rather we argue that Indonesia needs to be seen from a broader perspective that takes into account its central role in underpinning Southeast Asian political stability. Indeed, the right kind of Trilateral attention to Indonesia at an earlier stage could well have helped to avoid the worst aspects of the 1999 tragedy in East Timor.

3. The Continued Centrality of a Stable Indonesia

Indonesia is facing multiple crises involving its economic system, its political system, and even the geographical definition of the state. Indonesia's strategic significance is not only a matter of its position astride sea lanes between the Persian Gulf and Northeast Asia, nor the fact that it is the world's largest Islamic nation and probably the third or fourth most resource-rich country. From a Southeast Asian perspective, Indonesia's stability is key to regional order. It is difficult to exaggerate the difference for the region between, on the one hand, an Indonesia that is effectively governed, able to assure its people of improving living standards, and willing to assume a regional role of leadership; and, on the other hand, an Indonesia that is politically chaotic, economically stagnant, and almost exclusively focused on its own survival. A chaotic Indonesia has multiple negative effects: it reduces economic growth in its region; problems of piracy, illegal migrants, and refugees escalate; there is potential for spillover of ethnic violence; and it becomes nearly impossible to address important environmental problems of international significance, including haze, forestry destruction, biodiversity loss, and coastal pollution.

While the problems of Indonesia can only be effectively addressed by Indonesians, the Trilateral countries need a dialogue and strategy to assist Indonesia in the best ways possible. This should be the highest priority for Trilateral countries in their policies toward Southeast Asia. The dialogue will help Trilateral countries better understand the great difficulties ahead for Indonesia in managing the democratization process and restoring stability and growth. The strategy will include helping Indonesia with institutional capacity-building across a range of areas, from public institutions such as the justice system to the institutions of civil society.

4. Broad Trilateral Engagement

There needs to be an effective and strategically oriented engagement by Trilateral partners with the more advanced ASEAN countries on a whole host of other regional and global issues. These include:

- *The region's security problems.* The central security problems in Southeast Asia are not international but domestic. These are often too sensitive to address in the ASEAN Regional Forum (ARF) context. How might ARF or bilateral relationships change to help the ASEAN group address such issues (including human security issues) more effectively?
- *Effective strategies toward new ASEAN members.* The tendency in much of the Trilateral world has been to isolate and apply sanctions to countries such as Myanmar, where there are egregious abuses of human and civil rights. This risks making conditions even worse. In contrast, the tendency in some parts of ASEAN is to defend the current regimes and their practices regardless of how blatant the abuses. This whitewashing risks both tarnishing ASEAN in Southeast Asia and abroad and helping perpetuate practices that are anathema to the core ASEAN countries themselves. While differences in perspectives and national interests prevent fully coordinated strategies, there can be greater efforts among Trilateral and ASEAN governments to develop a consensus around broad directions and to pursue complementary efforts insofar as possible. These efforts need to be positive in the sense of assisting economic development, capacity-building, and good governance, as well as tough where gross violations of internationally recognized human rights are occurring. The case of Cambodia does show that effective influence by a broad segment of "the international community" can make a difference.
- *Dialogue on global issues.* The ASEAN countries are major and legitimate actors on many important global issues, including the future of

the world's trading and financial systems, the preservation of critical eco-systems, the reemergence of infectious diseases, and drugs. Although these issues are addressed in such forums as APEC, ASEM, the ASEAN Post-Ministerial Meeting, and ASEAN Plus Three, these efforts continue to lack a consistent and strategic focus.

NOTES

1. Zbigniew Brzezinski described the conflict as a "proxy" war to call attention to its Sino-Soviet dimensions. Vietnam, a Soviet ally, supported the Hun Sen forces, while China and the ASEAN group provided support for the resistance forces, including the Khmer Rouge.
2. Singapore, for example, abstained rather than join the majority in UN voting criticizing Indonesia's intervention in East Timor, even though Singapore officials were distressed by the intervention. Muslim Malaysia and Indonesia worked to support the Philippines' territorial integrity in the face of a separatist Muslim threat in the south. Even criticism of Indonesia's failure to staunch devastating fires (that darkened the skies of neighbouring countries for days) was muted. The Malaysian government once suppressed an academic study of the health problems related to the fires on the grounds that it was harmful to ASEAN relations.
3. See Shamsul A. B., "The Making of a 'Plural' Malaysia," in D. Y. H. Wu, H. McQueen, and Y. Yamamoto, eds., *Emerging Pluralism in Asia and the Pacific* (Hong Kong: Hong Kong Institute of Asia-Pacific Studies, 1997).
4. See Hadi Soesastro, "ASEAN in 2030: The Long View," in Simon Tay, Jesus Estanislao, and Hadi Soesastro, eds., *A New ASEAN in a New Millenium* (Jakarta and Singapore: Centre for Strategic and International Studies and Singapore Institute of International Affairs, 2000).
5. Chin Kin Wah, "Consolidation and Institution Building," in Stephen Leong, ed., *ASEAN Towards 2020: Strategic Goals and Future Directions* (Kuala Lumpur: Institute for Strategic and International Studies, 1994).
6. Gareth Evans described APEC as "four adjectives in search of a noun." The absence of a "forum," "council," or "association" at the end of the name was a concession to ASEAN opposition to institutionalization. Another concession to ASEAN included an agreement that annual meetings would alternate between an ASEAN and a non-ASEAN country. ASEAN caution was demonstrated in ASEAN's 1990 "Kuching Consensus," which spelled out ASEAN's understanding that APEC was to be a minimalist undertaking, respect the differences in systems, and eschew mandatory directives or the creation of a discriminatory trading arrangement.
7. Jesus Estanislau in Tay, Estanislao, and Soesastro, op. cit., 2000, p. 67.

V. AN EAST ASIAN SECURITY ORDER FOR A GLOBALIZING WORLD

Hisashi Owada

The East Asian regional order has long been intertwined with the global system. In the colonial period, several European countries and the United States were major powers in the region. East Asia was also an arena of Cold War competition, although the presence of non-aligned countries, the Sino-Soviet rift, and the constitutional framework for Japanese military capability all moderated the more highly bipolar Cold War pattern found in Europe. To some, the 1989-91 collapse of one pole of the Cold War system held out the prospect of a unipolar world organized around the United States, thus absorbing East Asia within the global system. Others suggested that without a sense of competition, the United States would drastically reduce its involvement in East Asia and indigenous actors, principally China and Japan, would become the leading powers in the regional system. East Asian security would depend heavily on the nature of the relations between these two countries and their ability to cooperate in building and maintaining a new regional order.

Ten years after the end of the Cold War, East Asian international relations remain in transition. However, elements of a new regional security framework for East Asia are beginning to take shape. Like the Cold War order in East Asia, this new framework continues to feature the deep involvement of the United States in regional security, enabled by its alliance relationship with Japan. However, the emerging East Asian order is not organized around the United States as a single global actor as forecast by the unipolar model. Indigenous actors are playing a much larger role and East Asia has a distinctive pattern of regional relations in a more decentralized global security framework.

This essay begins with an analysis of what the "end of the Cold War" has meant for the world and for East Asia. Next it sets out five challenges that mark the current security landscape of East Asia. It then argues that an eclectic "multi-layered network" model—combining bilateral defense arrangements with a regional framework for consultations—provides the

best model for the region's future security framework. A final note discusses Japan-U.S. security arrangements in this context.

A. THE CHANGING GLOBAL POLITICAL ORDER

Obviously, the precipitous collapse of the Soviet Union, coupled with the end of Cold War confrontation, has brought about a sea change in the global political order. The divisive ideological confrontation between the East and the West has disappeared. Many nations around the world have chosen democratic forms of government and embraced market economic principles. Although the contours of the emerging world order are far from clear, three characteristics stand out.

First, it is highly unlikely that the new world order will be unilaterally managed and controlled by the United States. On the other hand it is also clear that the United States will play a central role, commensurate with its power and global interests. It can play this role effectively and in a sustainable manner only with the cooperation of other major powers. Thus, the new order will be based on the cooperation of large powers; that is, to a large degree, it will be a *pax consortis*.

Secondly, the end of the highly competitive bipolar Cold War system has resulted in reduced efforts by the larger powers to prop up the local order in areas of potential or actual conflict. There is an ominous prospect of mushrooming regional conflicts in the power vacuum created by the demise of the Cold War. These regional conflicts have diverse causes. In many cases they arise against the background of ethnic, religious, and other rivalries, often in the midst of chaos created by the collapse of government or societal disintegration resulting from internal strife and social inequality. In other cases, they are the result of hegemonic ambitions at the regional or subregional level to gain control over territory or natural resources. Yet, paradoxical as it may be, this proliferation of regional conflicts is to a large degree the consequence of the disappearance of the tightly regimented framework of two opposing blocs.

A third characteristic of the present international system is that, with the fast-growing process of globalization, global values based on human security and the dignity of individuals are increasingly competing with traditional national security values based on the sovereignty of states. In this new situation, the importance of human factors—such as the quality of economic management, the capability for scientific and technological advancement, and the capacity for societal cohesion—have become much more relevant to national stability and security. Thus, it can safely be said

that the time has come when we should pay much more attention to human development in economic and social terms, in order to attain peace and stability.

B. THE NEW SECURITY LANDSCAPE OF EAST ASIA

These developments in the international system are directly relevant to the challenges of building a viable East Asian security order. With the end of the Cold War confrontation, many countries are increasingly focusing on the primary task of their own nation-building. In this new international setting, the East Asian region is going through a fundamental transformation. The challenge is how to reshape the political and economic structure of the region in the broadest sense in the face of the sea changes taking place all over the world.

On the surface, the transformation in East Asia may not appear as dramatic or far-reaching as that in Central and Eastern Europe at the turn of the last decade. Nevertheless, the impact on East Asia of the structural changes in the international system is as powerful as the impact on Europe, or maybe more so, although the transformation may take place over a longer period.

Five major developments are currently reshaping the region—the economic crisis, the Indian and Pakistani nuclear tests, the new opening in the Korean Peninsula, emerging large-power relations, and changes in value systems. Each have a significant impact on East Asian security.

1. The Security Implications of the Asian Economic Crisis

Despite economic recovery in parts of the region in 1999-2000, the Asian economic crisis continues to present the most immediate policy challenges to governments and will have a long-lasting legacy. There are many theories as to what precipitated the crisis and why it proved so contagious. Obviously the inexorable processes of globalization played a large role. What is relevant to this essay is that the economic crisis not only had a traumatic effect on the economies of a number of East Asian countries, but the resulting social dislocation and political instability jeopardized the security environment of the region as a whole. Some countries have addressed the economic difficulties more successfully than others, but in all countries, the basic confidence of the people in their future economic and even political security has been seriously shaken. The crisis has revealed fundamental and often extremely difficult problems that have to be addressed in each socio-political milieu. Thus, the

biggest and most immediate challenge for these countries is to restructure their societies on the basis of good governance and social justice, so as to firmly establish a high degree of political stability and social cohesion.

These circumstances have brought domestic concerns to the forefront of public attention. Countries generally focus less on the security implications of the crisis, but these implications are another strong reason for the region and its Trilateral friends to maximize their efforts to establish appropriate and robust institutions to ensure longer-term economic, social, and political stability. Japan, as East Asia's richest country, clearly must play a leading role. Japan has provided colossal amounts of direct financial assistance to the affected countries through the Miyazawa plan. Japan has also intensified efforts for comprehensive cooperation for economic and social development, especially with ASEAN (as evidenced by the 1998 Obuchi initiative for the ASEAN Hanoi plan of action and Japan's commitment to the "ASEAN Plus Three" framework). However, the best contribution Japan could make to the stability and prosperity of East Asia would be through a sustained recovery of its own economy. This is particularly true in the context of growing regional and global concern about the sustainability of the remarkable post-Cold War U.S. economic expansion. But at the beginning of 2001, Japan's economic recovery and prospects for longer-term sustained growth remain to be demonstrated.

2. The Revived Threat of Nuclear Proliferation

The proliferation of weapons of mass destruction, a threat revived by the recent nuclear tests by India and Pakistan and by North Korea's missile and nuclear weapons programs, represents another significant challenge to the regional security order. For many years the region enjoyed relative calm, free from the threat of the use of weapons of mass destruction, especially nuclear weapons. The 1998 nuclear tests conducted by India and Pakistan dramatically changed the outlook by seriously undermining the international non-proliferation regime. East Asia is threatened by this lowering of the threshold against acquisition of nuclear weapons as an ultimate weapon that should never be used. Even more seriously, the nuclearization of the Indian subcontinent could trigger a wider chain reaction. The Indians long have made no secret that their real security concern is China, not Pakistan alone. If India's nuclear weapons program is to be understood in that context, the implications are enormous. In the worst case, a stepped-up effort by China to meet the challenge could drag East and South Asia into the quagmire of a new nuclear race. At the same time, China's own nuclear program is motivated by efforts to preserve a second-strike capacity against a perceived threat from the United States;

and thus China's efforts to balance the United States may have a further ripple effect on the nuclear weapons of the subcontinent.

This new situation, in which the specter of nuclear proliferation casts an ominous shadow upon the regional security outlook, could be further compounded by developments in the Korean Peninsula. While the continued tension on the Peninsula is a legacy of the Cold War, it is a persistent legacy. North Korea's nuclear development program and missile tests and sales influence regional security beyond the Korean Peninsula itself. The June 2000 North-South summit meeting and its aftermath, including significant improvements in Japanese and U.S. relations with North Korea, offer hope. But the challenge remains of containing the vicious circle of proliferation of weapons of mass destruction, including their delivery systems, in East Asia.

3. The New Opening on the Korean Peninsula

The dramatic encounter between President Kim Dae-jung of the Republic of Korea and General-Secretary Kim Jong-II of the Democratic People's Republic of Korea triggered euphoric resonances, especially for the Republic of Korea, for a new outlook on the Korean Peninsula. Given the long and bitter enmity, the very encounter was historic, but its true significance is as yet unclear. The new relationship brings a new fluidity to the strategic situation on the Korean Peninsula. The hope is for a smooth transition from confrontation to reconciliation and from division to unification.

While this prospect is uncertain in the immediate future, a cautious optimism about longer-term prospects is on the rise. This is understandable to the extent that the Korean situation is practically the only major remnant of the Cold War confrontation and as such should not have much chance of surviving indefinitely. What is beyond doubt is that the DPRK leader, confident in his control of the power hierarchy of the country, has embarked upon this new course in all seriousness, with a view to creating a new international environment in which the survival of his country and regime can be ensured. There is an opportunity to forge a new security framework on the peninsula that can consolidate the peace and stability of the Northeast Asian region through engaging the DPRK in a serious dialogue that will remove the military threat that she poses for her neighbors.

4. Major Power Relations and the Imperatives of Globalization

The power relations among major players constitute the immediate geopolitical context of the region. These players include the United States, China, Japan, and possibly Russia in a longer-term perspective. The power relations among them are extremely complex in as much as

their respective political agendas, economic interests, and historical legacies in the East Asian region are inextricably entangled.

However, it would be wrong and even dangerous to put an excessive emphasis on power relations of these major players in an age of rapid globalization and deepening interdependence. Present-day East Asia is not, and cannot be, nineteenth century Europe where a balance of power based on military strength predominated. A real danger in East Asia is precisely that the perception may take hold in key countries that competitive military power is the dominant feature of the region's international relations. Should that happen, this perception could become a self-fulfilling prophecy as the different players struggle to maximize their power.

The Sino-American relationship is particularly dangerous in this regard. There is intense suspicion in both these key countries that the other has hegemonic aspirations in the region, aimed at undermining its own position. This fear is compounded by the fact that the People's Republic of China is effectively the only major power that holds a view of the world public order which is diametrically opposed to the one held by the United States. Sino-American tensions over Taiwan stem largely from this factor. The issue could be relatively minor and manageable were it not for the basic mistrust that exists in Beijing and Washington, each seeing the Taiwan policies of the other as a manifestation of larger, competitive aspirations.

To succeed in constructing a durable peaceful regional order, it is critical that the major players discard the old balance-of-power paradigm. The new paradigm should emphasize the inevitable and rapid growth of common interests as a result of the accelerated processes of interdependence and globalization that affect the region. These then overwhelm the lingering notions of balance-of-power competition that were an important feature of an earlier period of international relations.

5. The Need for Consolidation of Common Values

Finally as a basic prerequisite for meeting successfully all these challenges, the East Asian region must strive to identify values that can be shared among themselves and with fellow members of the international community. These include respect for human rights, the practice of participatory democracy, protection of the environment, and promotion of open and fair competition in the free market. These values are becoming a major focus of attention in this region, as the nations of the region seek to create societies that are more secure in human terms, more stable, and more prosperous. One might argue that such values are not directly linked with the issue of security, but they in fact have huge implications

for the security of each country of the region.

After all, we are living in an era in which a transformation of the international system is taking place. The concept of sovereignty itself is undergoing a major modification. Accepted values common to humankind are emerging to demand universal validity as guiding principles of society that transcend national borders. A significant factor behind this development is the growth of the middle class in many countries of the region. The members of this social stratum tend to be highly educated and highly sensitized to issues relating to individual freedom and human dignity. They have the language skills and the access to technology that today make them not just members of their nations, but active participants in the global community.

C. A FUTURE SECURITY FRAMEWORK FOR THE EAST ASIAN REGION

It is desirable to focus more attention on the possible shape of a region-wide framework for ensuring security defined in this broad context that can effectively meet all these challenges.

The rationale for a broader multilateral security framework is the changed regional environment in recent years. Throughout the Cold War period, major power skepticism about the need for such a regional security framework contributed to lack of progress in this regard. Paradoxically, Japan-U.S. security arrangements may also have been a negative factor in the sense that the U.S. presence in Japan not only offered a security shield to Japan within the context of the East-West confrontation, but also provided a psychological safety net for the stability and prosperity of the East Asian region. The changed politico-security environment of the region requires a fresh look at a possible new security framework.

It is against this background that Japan has been cooperating positively with other regional partners in promoting movement in this direction through APEC and the ASEAN Regional Forum (ARF). Thus, ARF, especially during its initial stages in the mid-1990s, carried out pioneering confidence-building activities. However, recent trends in this forum show signs of stagnation, due to the lack of fresh imagination and political will to go beyond the stage of exchange of information as confidence-building measures. Bolder initiatives for a more structured approach are needed.

What kind of more structured framework would meet the security requirements of the East Asian region in this sense? Given the specific characteristics of the region, certain models are not workable.

The first model is an integration model, the type that the North Atlantic nations have in NATO and that Western Europe has in the European Union. The essence of this model is that it is based on firmly rooted shared values and interests. The integration model is almost impossible to realize in the Pacific Asia area, at least in the foreseeable future, given so many different aspects of diversity prevailing in this region.

A second model is the well-known balance-of-power model. Henry Kissinger, for instance, claims that: "Peace requires either hegemony or balance of power." This statement will be of limited general applicability in any case in the contemporary world. The hegemony model clearly does not offer a solution to the problems of East Asia. It is, moreover, dubious that a balance-of-power model is going to be a viable model in the East Asian context. The balance-of-power model can only work—if it can work at all in this age of remarkable interdependence—in an environment where the players are more or less alike in terms of their size, their perception of the nature of the game to be played, and their power to influence the events taking place in the theatre. These elements are conspicuously missing in East Asia.

This leads to a third model—a multi-layered network model. Admittedly, this is an eclectic model, but one that is much more feasible in the East Asian setting. The first layer consists of a series of bilateral defense arrangements to take care of concrete security needs.* The second layer is a regional framework for consultations on issues affecting the broad common security interests of the region. This second layer is a comprehensive network, taking cognizance of all the concrete bilateral defense arrangements. As a connecting link between the bilateral and broad regional layers, one could also envisage various sub-regional or mini-lateral arrangements.

The Locarno Pact for securing the post-World War I status quo in Europe can be cited as a useful example of how to conceptualize a multilateral security arrangement of this nature for the East Asia region. This 1925 Pact of Mutual Guarantee declared that all the parties collectively and severally guaranteed the status quo, renounced the use of armed force and committed themselves to the peaceful settlement of disputes among the partners. Such a format could offer a good starting point for the discussion of a new multilateral security framework for this region.

*During the Cold War period, a number of bilateral security arrangements were established in order to ensure stability. Some were created in the context of the Cold War confrontation. However, it must be emphasized that others—in particular the Japan-U.S. Security Treaty—had very little to do with the Cold War situation. The concluding section of this essay makes that point in more detail.

D. THE PLACE OF THE JAPAN-U.S. SECURITY ALLIANCE

The relevance and importance of the Japan-U.S. security alliance should be understood against the background of this emerging new security landscape of the region as a whole. Very often people think that the Japan-U.S. security treaty is like NATO in its nature and in its functions. Although the Japan-U.S. Mutual Security Treaty is bilateral while NATO is multilateral, it is often thought that both were the offspring of the Cold War confrontation and instruments for the global strategy of the United States to meet the Soviet threat.

The fact is otherwise. The Japan-U.S. Security Treaty was concluded in 1951, as part of the new Allied policy framework for ensuring peace and security in East Asia and the Pacific, under the scheme created by the San Francisco Peace Treaty. It is true that the Cold War had started and, more importantly, the Korean War was underway. But the concept of the Japan-U.S. Security Treaty had been born much earlier, and it was part and parcel of a more general Allied plan to ensure that Japan would be a positive element in regional peace and security. Another element, the Japanese Constitution, with its Article 9 renouncing the use of force as an instrument of policy, had already been adopted in 1947. At the same time, the Allies understood that Japan had the objective necessity of adequate security against possible outside aggression. The two requirements—renouncing the use of force and assuring adequate security—were not easy to reconcile in an environment that was still suspicious of and even hostile to Japan. The Japan-U.S. Security Treaty was created in the first instance to solve this dilemma by ensuring Japan sufficient defense capability through the cooperation of the United States. With or without the Cold War, that necessity was there. It is still there today.

The Japan-U.S. security relationship is also significant in that, from the beginning, it was conceived as an indispensable linchpin of the wider strategy of the United States for the maintenance of peace and security in East Asia. In other words, it not only gave the assurance of security to Japan in the narrow sense of the defense of Japan, but it also gave security reassurance to the other countries in East Asia by ensuring the presence in the region of the United States. This need also remains today. Overall, the Japan-U.S. security alliance thus continues to be a highly relevant feature of the emerging security order in East Asia.

APPENDIX

The Trilateral Commission Special Study Group on East Asia and the International System

The Special Study Group on East Asia and the International System began its work with brainstorming discussions on the side of the March 1998 annual meeting of the Trilateral Commission in Berlin. Next came the Study Group workshop in Seoul in November 10-12, 1998, hosted by former South Korean Foreign Minister Han Sung-joo and the Seoul Forum. The 1999 annual meeting of the Trilateral Commission was in Washington on March 13-15. On March 12, members of the Study Group met for a discussion among themselves over lunch and in the early afternoon. They then met with a wider group of interested Trilateral Commission members in the late afternoon. Three East Asians led a session in the larger Trilateral Commission meeting on March 14. A second workshop was held in Beijing on October 23-25, 1999, hosted by Zhang Yunling and the Institute for Asia-Pacific Studies of the Chinese Academy of Social Sciences, of which Zhang is the Director. A variety of Study Group participants led sessions of the November 1998 and October 1999 workshops, and a number prepared papers or discussion outlines for these sessions.

The 2000 annual meeting of the Trilateral Commission was in Tokyo on April 8-10. Earlier versions of some of the essays in this final Study Group report were discussed at the Tokyo meeting, and various Study Group participants led the related plenary and sub-group discussions. The Oksenberg and Morrison essay in this report is close to the version discussed in the 2000 Tokyo meeting. The Dobson essay is a different essay from the one discussed in that April 2000 meeting. The Soesastro and Morrison and Owada essays were prepared after the 2000 Tokyo meeting. Refinements of each of the essays in this report were largely completed in January or February of 2001.

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The Study Group carried on its work while the Trilateral Commission considered the widening of its Japanese group into a Pacific Asian group. This transformation was approved at the April 2000 annual meeting in Tokyo and the new Pacific Asian group had its inaugural conference in Seoul on November 11-13, 2000.

The following persons were involved in the work of the Study Group. The titles listed are those at the time of participation. Participants spoke for themselves as individuals and not as representatives of any institutions with which they are associated.

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