

**ECONOMICS AND
SECURITY**

169 ESCTER 07 E bis
Original: English



NATO Parliamentary Assembly

**SUB-COMMITTEE ON
TRANSATLANTIC ECONOMIC RELATIONS**

**THE RISE OF THE EAST-ASIAN ECONOMIC
SYSTEM: IMPLICATIONS FOR EUROPE AND
NORTH AMERICA**

REPORT

***PETRAS AUSTREVICIUS (LITHUANIA)
JOHN BOOZMAN (UNITED STATES)
CO-RAPPORTEURS***

TABLE OF CONTENTS

I.	INTRODUCTION.....	2
II.	A REGIONAL MACRO AND MICROECONOMIC PROFILE: ECONOMIC INTEGRATION AND DIPLOMATIC AMBIGUITY	3
III.	THE UNITED STATES AS AN ASIAN POWER	8
IV.	EUROPEAN RELATIONS WITH EAST ASIA: BUILDING A LAND BRIDGE AND A SHARED COMMITMENT TO MULTILATERALISM	10
V.	REGIONAL ECONOMIC INSTITUTIONS AND THE “ASIAN SPAGHETTI BOWL”	15
VI.	CONCLUSION: THE ASIAN SECURITY ORDER AND ITS IMPLICATIONS	16
	APPENDIX 1.....	19
	APPENDIX 2.....	20
	BIBLIOGRAPHY	21

I. INTRODUCTION

1. For the past two years, this Sub-Committee has closely examined the emergence of China as a global economic powerhouse and as a developing country. The thinking behind the project was that one could not begin to consider the changing international commercial and financial order without first assessing the impact of China's emergence. The work of the Sub-Committee in this period has opened up a range of new and interesting economic and geostrategic questions of great importance to the transatlantic community. For this reason, this year the Sub-Committee has decided to take one step back from China and look at the East Asia region as a whole. This year the Sub-Committee visited Japan as part of this effort.

2. This report accordingly aims, not only to help place the "China question" in its proper regional context, but also to explore a number of systemic changes in that part of the world that are profoundly shaping the global economic and geopolitical order. Indeed, East Asia is in the midst of a profound tectonic shift of global import. Of course, China's rise may be the most important element of this transformation; but there are other related developments that are of great consequence. Trade and investment patterns in the region are shifting very quickly, and Asia has become an even more important part of the global economic and security order as a result. This brings about all manner of spill-over effects on the transatlantic economic system, and some might even argue that it raises questions about the ongoing relevance and function of a transatlantic economy.

3. Asia's rise is due, in part, to the apparent triumph of liberal economic policies and the relatively unhindered flow of capital and goods across the region's borders. Again, this regional trend has global implications. Asia is now playing a central role in global commodities, consumer goods and raw material markets, and rapidly changing supply chains that are fundamentally altering supply chains in both Europe and the United States. East Asia has also become a chosen model for other developing regions because so many countries in the region have managed to bolster poverty-alleviating growth through sound economic policy.

4. The region's security order has also undergone a sea change. Indeed, the end of the Cold War may well have been as consequential for East Asia as it has been for Eastern Europe. Like Europe, Asia was long divided between Communist and non-Communist regimes. The Soviet Union, China and the United States all played a part in reinforcing these ideological divisions through the economic and strategic alliances that they forged throughout the region. Yet, the region lacked a coherent security order. Not surprisingly, two brutal if nonetheless limited wars were fought in Korea and Vietnam in the post-war years because of this security vacuum.

5. This old security order is no longer operational, but it has not yet been fully superseded. Asia's strategic landscape is very much in a state of flux. There remains an element of Cold War rivalry, which is most evident on the Korean peninsula and across the Taiwan Straits. But there are also emerging regional institutions, some of which are consciously patterned on the European model, which are reinforcing co-operative relations and regional integration (Dick K. Natno). Some of these actively engage Europe and the United States, while others aspire to a kind of Asian exclusivity. None of these organizations cultivate the deep security relations that NATO has managed to build in Europe, nor have they achieved the level of integration that the European Union has attained on the continent. As a result, the region is characterized by far greater rivalry, suspicion and strategic uncertainty than Europe. Not surprisingly, the countries of the region have a far more acute sense of danger than do many Europeans and Americans.

6. These countries also have strikingly different political systems and are marked by important cultural differences. A significant disparity of wealth exists both within and amongst the region's countries, ethnic tensions abound, and history is read very differently by the region's societies. The region is also characterized by nuclear asymmetry rather than balance, and there remain a number

of outstanding and highly emotive territorial disputes (Christensen). There are a myriad of old and new conflicts involving India and China, China and Japan, Japan and Russia, Russia and China, China and Vietnam, Japan and North Korea, China and South Korea and China and Taiwan (Niquet). Some of these have the potential to produce conflict. Japanese and Chinese warships and aircraft, to take one example, conducted manoeuvres at close range around the contested Senkaku/Diaoyutai island chains after the Chinese began exploratory oil drilling in the area (Green). Contemporary Europe is fortunate to have neither a strategic flashpoint like the Straits of Taiwan nor a pariah state in its midst bent on acquiring weapons of mass destruction like North Korea. Yet, there are also myriad signs of improvement, due in no small part to East Asia's growing economic integration and the related dialogue amongst the region's key actors.

7. Developments in East Asia are also relevant to this Sub-Committee for another reason. The countries of NATO and the European Union, although exclusively Euro-Atlantic or European in character, simply cannot ignore Asia for a range of economic, diplomatic and security reasons. Although NATO has not come to any final decision about how to deepen relations with some of the democratic nations of Asia – Japan, South Korea and Australia in particular – there is no doubt that closer co-operation with these countries is coming, even if this co-operation remains informal. Moreover, NATO is now deployed in the Asian country of Afghanistan. By default, this has endowed it with something of an Asian vocation, even if many would argue that this vocation is temporary and simply due to the unique circumstances surrounding the situation in Afghanistan. The Chinese have no doubt taken note of NATO's Asian presence, but so too have other Asian states.

8. Japan's Prime Minister as well as its Defence and Foreign Ministers have all visited NATO headquarters in recent months and all have spoken of Japan's quest for closer dialogue with NATO based on common values like freedom, democracy, human rights and the rule of law. Japan is now supporting the work of a Lithuanian Provincial Reconstruction Team operating in Afghanistan and has provided refuelling support to Allied navies operating in support of Operation Enduring Freedom in the Indian Ocean ("Visit to Tokyo, Kyoto and Osaka," NATO PA Secretariat report 145 ESCTER 07. See also speech by Prime Minister Shinzo Abe to the North Atlantic Council, January 2007). Strategic co-operation is also deepening among the region's democracies. Japan and Australia, for example, signed a Joint Declaration on Security Cooperation this past April which identified the two countries' shared values and shared security interests and promised enhanced security co-operation between these Pacific states and with the United States ("Asia's Democratic Alliances" *Wall Street Journal*, March 13, 2007). Japan itself is taking a fresh look at the limits its Constitution imposes on military-security operations in the new strategic setting, and there are some who would like to amend the Constitution to accord Japan a greater role in projecting security.

II. A REGIONAL MACRO AND MICROECONOMIC PROFILE: ECONOMIC INTEGRATION AND DIPLOMATIC AMBIGUITY

9. Simply in terms of population, East Asia is a force to be reckoned with. Its 2,1 billion inhabitants account for a third of the global population. East Asia's Gross National Income (GNI) is larger than that of NAFTA (North American Free Trade Agreement), while North East Asia alone (Japan, China and Korea) has a GNI larger than that of the EU. Moreover, Asia's growth rates are far greater than that of either the EU or NAFTA (Taniguchi). China's Gross Domestic Product (GDP) in 2006 was US\$2.8 trillion while Japan's was US\$4.4 trillion or nearly double that of China despite a much smaller population (Walker and Batson).

10. For decades during the Cold War, when China was not a player in global commercial markets, the United States was the dominant external player in East Asia. It was the principal source of much of the region's investment capital and was also the leading export market for many

of the region's key economies. Since the Asian financial crisis of 1997, the situation has changed markedly. East Asia's exports to the United States, as a share of total exports, have fallen to less than 20%. The European Union has become the region's largest export market and, in 2003, China passed Japan as East Asia's main regional export partner (Smith et al.).

11. Intra-regional trade in Asia was once structured simply as part of the production chain to supply the United States and other OECD (Organisation for Economic Co-operation Development) countries. Today, however, more than half of regional exports go to other regional actors, and China, rather than Japan, is now the most important market for many East Asian countries. ASEAN's (Association of Southeast Asian Nations) external trade may still be oriented toward the United States, but this is changing quickly, as trade between it and China has gone from US\$27 billion in 1996 to US\$78 billion in 2003 (Smith et al.). Although many ASEAN exports to China feed directly into China's export industries, an ever-growing share is actually meeting Chinese consumer demands. This is also true of Chinese exports throughout Asia. Close statistical analysis of trade data points to the emergence of a self-reinforcing, region-wide export and growth dynamic in which GDP cycles are more highly correlated with one another than with the United States or the European Union. This is true even for developed global players like Japan (Smith et al.).

12. Emerging Asia's share in world trade has grown quickly over the last quarter century and much of this is due to ever mounting intra-regional trade. This trade in turn is driven by intra-industry trade linked to greater vertical specialization and the spread of production processes across borders. This is leading to strong growth in intermediate goods trade among emerging Asian economies although the EU, the United States and Japan remain the main export markets for final goods produced in the region. Supportive macroeconomic policies, microeconomic incentives for targeted industries and low import barriers have all helped stoke trade growth (Zebregs). It is the expectation of some international analysts that this interdependence could provide the foundation for improved regional security and a climate that might encourage greater Chinese moderation and further political reform.

13. Indeed, the rise of mutually reinforcing trade and macroeconomic links are effectively putting regional players into the same "economic boat". This will invariably reinforce a sense of shared fate and mutual interest that will have implications for how the West deals with the region. And it is not only China that is growing quickly. Dynamic growth rates are also evident in Indonesia, Malaysia and Vietnam (The World Bank, March 2006) while Japan has clearly emerged from a decade-long recession in large part due to regional economic dynamism as well as internal structural reforms ("Visit to Tokyo, Kyoto and Osaka," NATO PA Secretariat report 145 ESCTER 07).

14. These high growth rates are not only reinforcing regional economic integration, but they are also critical elements of poverty reduction throughout the region. According to World Bank studies, the percentage of the East-Asian population in poverty, defined as an income of US\$1/day, fell from 9.1% in 2004 to 8% in 2005. This is just one of many statistics that point to a broad, although sometimes uneven, decline in poverty throughout the region. Countries like China, Vietnam and Indonesia are now targeting more neglected sectors to broaden even further these trends and the regions' governments continue to see expanded trade as vital to development policies and poverty reduction (The World Bank, March 2006).

15. Financial flows throughout the region are underpinning these trends. While US investment in the region has been rather static in recent years, Japan, Taiwan, South Korea and ASEAN have dramatically boosted investment, and this has reinforced the region's ever denser and ever more self-sustaining production networks. These relations are fostering an unprecedented degree of regional economic interdependence.

16. China, Japan, South Korea and Taiwan today account for roughly 40% of the US merchandise trade deficit and all are recycling their export earnings, in part, by purchasing US debt, which is another way of propping up the value of the dollar or dampening down the value of East Asian currencies. These loans have thus helped sustain Asian exports to the United States. Foreign exchange reserves are high throughout most of the region due to soaring exports and current account surpluses, although China has seen the most striking increase in reserves. American critics, particularly in the Congress, are charging that China is artificially depressing the renminbi's value to keep exports high. This has sparked trade tension between the two countries. To say that there is a degree of financial interdependence between East Asia and the United States would thus be an understatement. Still, many analysts were shocked when a significant fall in the Chinese stock market, set off by suggestions that Chinese officials would crack down on stock market manipulation, triggered a panic equities sell-off in the United States and Europe this past March. It was yet another sign of the ever denser links between East Asia and the rest of the world.

17. Japanese officials are concerned by the monetary debate that is unfolding between China and the United States. Japan, like China, has accumulated an enormous holding of American dollars and their purchase of American treasury bills has helped prop up the dollar. The Japanese government is thus wary of any threat to dump dollars on the open market, as this would destabilize the international economy and affect the value of Japanese exchange holdings. One reason that the euro is less widely held in Asia and less widely demanded is simply that the Maastricht criteria limit the amount of European debt available on the market. The Japanese are concerned about the views of some in the United States Congress regarding the dollar-renminbi exchange rate. While it is true that the renminbi is undervalued, the threat of US tariff retaliation would nonetheless be destabilizing. Japanese officials believe that the United States should not resort to draconian trade sanctions to deal with this problem, while the Chinese should slow their accumulation of foreign exchange, in part, through increased public spending. The Japanese also understand Chinese caution. A rapid renminbi appreciation could quickly boost food imports into China and exacerbate very difficult socially explosive conditions in China's vast hinterland, which has been rocked by social unrest in recent years ("Visit to Tokyo, Kyoto and Osaka," NATO PA Secretariat report 145 ESCTER 07).

18. There are also initiatives underway to deepen Asian financial co-operation. Specifically, systems have been put in place to provide liquidity to countries in the region that might suffer an attack on the currency. This so-called Chiang Mai initiative initially reflected ASEAN's utter dissatisfaction with the IMF's response to the last region-wide financial crisis in 1997. The initiative emerged under the ASEAN plus Three format (ASEAN plus China, Japan and South Korea) and has represented an effort to monitor capital flows, encourage regional surveillance, build swap and repurchase networks and train personnel in international financial management. This initiative unfolded after strong US objections to a Japanese proposal to create an Asian Monetary Fund. Given the high levels of reserves on which participating countries are sitting, this initiative has attracted a great deal of attention from the international financial community and it is likely to prove an important hedge against external shocks to the participating countries in the region ("The Chiang Mai Initiative," Institute of International Economics). In November 2006 a new task force was established under ASEAN plus Three to study ways in which this system of bilateral swaps can be truly multilateralized. By 5 May 2007 the bilateral swap network had increased to US\$80 billion consisting of 16 bilateral Swap Arrangements among eight countries. The problem today, however, does not lie in the kind of current account deficits that triggered the last crisis, but in the excessive surpluses that lead to currency misalignments, overdependence on exports, restricted domestic spending and the mirror opposite effect in the United States, which has become too dependent on non-trading sectors like real estate. This may not be sustainable, and many economists would like to see a degree of rebalancing (Giles).

19. Europe, of course, is not unaffected by this. The fact that Asian currencies have fallen relative to the dollar has made it more difficult for European firms to exploit the euro's own slide, simply because they must also compete with Asian companies enjoying the trade benefits of somewhat debased currencies.

20. Although Japan has put itself back on a growth track in recent years, there are myriad indications that it has ceded a degree of regional commercial leverage to its Chinese neighbour. Japan has lost market share to China in the manufacture of a range of electronic goods like PCs, mobile phones and DVD players, and China could surpass Japan soon in notebook PCs, LCD displays and digital cameras as well. China has also displaced Japan as the country enjoying the largest trade surplus with the United States. That said, Japanese and Chinese industries are more complementary than competitive. Indeed, most of the displacement in Japanese industries due to Chinese competition has taken place at the lower end of production where the Japanese do not have a competitive advantage. Japanese firms are also taking advantage of the myriad opportunities that exist in the Chinese market and have been selling great quantities of capital goods, in particular, in that market. Japanese firms are also building manufacturing facilities in China and are sourcing from low-cost Chinese suppliers, which helps keep Japanese firms competitive ("Visit to Tokyo, Kyoto and Osaka," NATO PA Secretariat report 145 ESCTER 07).

21. These two traditional rivals, China and Japan, are thus growing ever more economically interdependent. In the first half of this decade, Sino-Japanese bilateral trade volume expanded at roughly 30% per year, totalling US\$130 billion in 2003. The United States remains Japan's most important export market, but China is second and has been growing rapidly. Indeed, Chinese demand has been a critical element of Japan's economic recovery and, by extension, an engine of global growth as well. China accounts for 25% of Japan's imports, while Japanese direct investment in China has been surging. The Chinese, in turn, are beginning to invest in Japanese firms, in part, to gain access to their technology and distribution channels (Eckhardt). This suggests that the two countries are building a better economic foundation for a co-operative relationship, despite a range of outstanding political and strategic tensions.

22. Nevertheless, there remain several trade-related disputes in agriculture and in manufacturing sectors, in which Japanese firms are being replaced by Chinese ones. The Japanese are also concerned about intellectual property protection in China. This problem, as well as a range of political and security tensions, such as recent anti-Japanese riots in that country, have inspired some Japanese businesses to make sure that they do not put all their eggs in the Chinese basket. Rising Japanese investment in countries like Vietnam partly reflect this need to hedge against political and legal risks in China.

23. That said, the mutual benefits of these burgeoning trade and investment relationships far outweigh the costs to certain sectors, and invariably this is changing the way Japan and China look at each other, or at least rendering mutual perspectives more complex. Growing economic ties between China and Japan could provide a vital axis for broader regional integration. Yet, as suggested above, political rivalry and distrust persists. There is a range of political sticking points that both sides must patiently address before there will be sufficient trust to significantly improve this important if nonetheless very delicate bilateral relationship.

24. Undoubtedly the annual visits of former Japanese Prime Minister Koizumi to the Yasukuni Shrine in Tokyo, where the remains of several convicted war criminals are interred, and a recent flap about Japanese history textbooks have clouded the political relationship. Indeed, the wounds of the Second World War are still not healed in Asia, and Chinese leaders have readily exploited Japanese insensitivity for domestic political purposes. Japan's current Prime Minister Abe has sought to quell the controversy, and has intimated that there are no compelling reasons to continue the visits to the shrine. Still, the visit of Shinzo Abe to China two weeks after his selection as Japan's Prime Minister followed by Chinese Premier Wen Jiabao's visit in April and his address to

the Parliament gave an important sign that both sides recognize the need to improve the relationship (Moffet and Leow). Even if both sides are able to put the Yasukuni controversy behind them, however, there are still persistent historical problems that plague the relationship, as well as an enduring competition for leadership, if not outright hegemony in the region. Japan's close strategic relationship with the United States, for example, also generates no small amount of tension.

25. Beyond the controversies over history, which are hardly limited to Japan and China, the business climate in Asia has improved dramatically and this is necessarily an important element of the rapidly evolving diplomatic landscape of the region. Companies throughout East Asia have been growing stronger in recent years, and in many respects, the financial crisis of 1997 is a distant memory. South Korea and Thailand, for example, have experienced significant declines in corporate indebtedness, and the rate of Return on Assets (ROA) has largely recovered since the financial crisis. Corporate profitability has improved at slower rates, however, in countries like Indonesia and the Philippines. Technological developments in East Asia have progressed markedly; the level of technological advancement in the region's developing countries is far higher than the developing world as a whole. The number of patents registered at the United States Patent Office by emerging East Asian economies has risen from 197 per year in 1981-1984 to 1,235 in 2001-2004, a very substantial increase, and one that is far greater than in any other developing region. Taiwan produces 30 patents per 100,000 inhabitants, or roughly the rate of Japan and the United States, while South Korea, Hong Kong and Singapore generate patents at roughly half the rate of developed OECD countries. China, Indonesia, the Philippines and Thailand lag behind in per capita patent production, but the rate in China is rising rapidly from a very low base and, of course, the sheer size of its population obfuscates the growing importance of the strides it is making in innovation (The World Bank, March 2006).

26. As suggested above, China is usurping Japan as the regional engine of trade and investment flows throughout Asia. This is not simply an economic phenomenon, as it is allowing China to put its mark on the politics of regional trade and integration. Although China has recently acceded to the WTO, it is currently playing a low-key role in that institution. China also prefers a regional trading system, whereas Japan, for many years, attached greater weight to global WTO talks than to regional integration strategies. That said, Japanese officials have recognized that it is not enough to wait for a global deal, and they have signed a slew of trade agreements with neighbouring countries. A plethora of bilateral free trade and economic partnership agreements are also generally opening up trade within the region and providing the region's more advanced countries with access to countries rich in resources. Some fear that these arrangements are less effective than pan-regional or global arrangements. Japan has negotiated Free Trade Agreements with Singapore, Malaysia and Thailand, and further openings are being sought with other ASEAN countries. This is a pattern that is occurring throughout the region and the ratio of intra-regional trade has already surpassed that of NAFTA and is almost equal to that of the EU (at 15). Trade with Asia including Australia, New Zealand and India now accounts for 50% of Japan's trade ("Japan's EPA/EFTA"). Still, East Asia-EU trade and East Asia-US trade are also on the rise.

27. China's rise is what is most profoundly redirecting trade throughout Asia. Taiwan and South Korea, for example, were once assembly centres for Japanese and American companies, but now they are off-shoring assembly-line work to China. China is rapidly become the centre of gravity of regional economic activity and this has implications both for the United States and Japan, both of which may be losing a degree of regional leverage as a result. These ever more integrated trade relations could possibly ameliorate the region's diplomatic and security landscape.

28. For China, these trade patterns mean that its own stake in regional stability and integration is mounting. Over 40% of its industrial production and more than half of its manufactured exports originate from foreign companies. In high-tech industries, FDI (Foreign Direct Investment) accounts for 50% of Chinese industrial activity, while the figure for the communications sector is 70%

(Eckhardt). This suggests that China is still not a genuinely mature economic powerhouse and that it remains very much dependent on regional and global investment and markets. China consequently holds an extremely high stake in preserving stable investment and trading relations with its partners, in the region and beyond, in order to move to a higher level of development. For some analysts, this alone provides reason for optimism about China's growing stake in a stable and open regional order. Security sceptics, however, warn that this rosy scenario should not be accepted as an article of faith. China's rising wealth will also provide the foundation for a sustained military build-up that could fundamentally alter the regional and indeed global security landscape.

III. THE UNITED STATES AS AN ASIAN POWER

29. US policy makers see East Asia as an area of vital strategic and economic interest and consider their own country a Pacific power. Indeed, the United States maintains a significant military presence in the region. There are some 100,000 US troops on active deployment in the Asia-Pacific region, and its Pacific Fleet is the largest to ply Pacific waters (Natno). These forces are an expression of America's policy of extended deterrence, which underpins its contribution to regional security. The United States maintains a full range of conventional and nuclear strike forces and defensive capabilities to endow this security commitment with credibility (www.state.gov). The United States also maintains a number of important bilateral alliances with Asian countries that some have characterized as a "wheel and spoke system". This is very different from the NATO structure that is genuinely multilateral in character.

30. The United States has long encouraged its East Asian partners and important countries of the region, like China, to adopt liberal and open economic policies. In many respects, that policy has been partly vindicated not only with regard to China, where US leverage is obviously more limited, but also with the countries that have closer strategic ties to the United States. East Asia, of course, has become an economic dynamo, a global economic player and an engine of global economic growth at a time when a number of OECD countries have been growing relatively more slowly and have not been able to generate the kind of demand needed to boost global growth. Asian growth has been driven by liberal domestic economic reforms, open trading regimes, and vast financial flows all of which the United States has encouraged and generally sees as a vindication of its approach.

31. Thomas Christensen, a China specialist, has characterized American policy toward East Asia as an almost paradoxical compromise between two seemingly opposed perspectives on American foreign policy: a zero-sum outlook and a positive-sum perspective. These approaches represent two very important and yet often conflicting strains of the American foreign policy culture. In the case of East Asia, however, American policy has synthesized elements of both in what many might see as a largely successful engagement with the region that has helped make Asia more stable, more prosperous and more capable of having a positive effect on the international system as a whole. That view, however, is not universally held among the very divided US foreign policy community.

32. The zero-sum perspective, held by many so-called realists as well as neo-conservative analysts like John Mearscheimer and Robert Kagan, suggests that any policy that abets the rise of Communist-led China in economic or military terms represents a net loss for the United States in security terms (Kagan). These analysts believe that the United States has essentially taken its eyes off Asia as a result of the September 11 attacks and the Iraq war and, in so doing, provided space for China to assert an ever-greater degree of influence over the region. In the interregnum, China has developed its economy at a rapid pace, funded an impressive military build-up, developed new tools to assert itself effectively if more subtly in the region and essentially challenged American power in East Asia. This kind of analysis would see as significant the fact that Chinese defence spending could be as much as three times larger than official statistics indicate.

The Department of Defence, which tends to hew to a zero-sum line, noted in its annual report on China that the United States still lacks a clear picture of that country's military build-up and strategic aims, although it is clear that the People's Liberation Army is seeking to improve capabilities in space and in information and high technology warfare (Bennett). This lack of transparency raises questions about China's ultimate motives and, indeed, has been a source of concern not only in some American circles but also throughout the region ("Visit to Tokyo, Kyoto and Osaka," NATO PA Secretariat report 145 ESCTER 07).

33. In any case, advocates of a zero-sum approach suggest that the United States needs to develop its network of bilateral alliances to contain China, place strategic military considerations above economic ones, maintain a strong military presence in the region, and refrain from certain types of economic relations with China that might bolster its military power. Thus, while positive-sum advocates might welcome regional dialogue initiatives like the ASEAN plus Three formula as a vehicle for building peaceful and mutually beneficial relations among former enemies, zero-sum analysts tend to see it as a means by which the Chinese will seek to weaken US leverage in Asia while increasing their own – something it has already done within the Shanghai Co-operation Organization, which engages Russia and several Central Asian states and which has subsequently advocated the closing of American bases in Central Asia. Chinese efforts to squelch the idea of an East Asian Summit, engaging countries like Australia and New Zealand, and its apparent opposition to an ASEAN plus Six formula, are seen in a similar light (Christensen).

34. The positive-sum outlook, which some might characterize as a liberal internationalist view, is almost diametrically opposed in its assumptions, in its interpretation of events, and in its policy prescriptions. For those viewing developments from this perspective, China's rise is virtually a foregone conclusion. A strategy of pure containment would simply make a Chinese-American conflagration something of an inevitability and stretch American resources to the breaking point in what would ultimately be a futile effort. These analysts suggest that, rather than focusing on containing China, American policy should work with its allies and partners in the region to condition China's rise in such a way that China is ever more disposed to contribute to regional stability and prosperity, simply because this is in its interest as well. The advocates of this policy believe that a policy primarily focused on isolating and containing China by military, diplomatic and economic means would be perfectly counterproductive and increase the likelihood of conflict. To conduct US policy based on such assumptions, they argue, would result in a more hostile China, itself subscribing to a zero-sum outlook and thus disposed to oppose American and Western interests virtually for the sake of doing so and with little regard for systemic stability. Positive-sum critics of their zero-sum counterparts argue that the potential for miscalculation would be far greater were both the United States and China to pursue policies predicated on such unmitigated rivalry. The costs of such miscalculation could be extraordinarily high (Christensen). A similar argument has been made by the Chinese historian Lanxin Xiang who has warned that an active containment strategy directed against China would result in a self-fulfilling prophecy of a hostile China at a moment when China is seeking to integrate itself into the international community as a normal state (Xiang).

35. In fact, US policy in East Asia over the last decade has combined elements of both containment and engagement. This complex and sophisticated approach colours not only American policy toward China *per se*, but toward East Asia as a whole. Even over the course of the Bush Administration there have been shifts in emphasis in the American approach to the region. The former Deputy Secretary of State, Richard Armitage, for example, emphasized Japan's potential as a global partner in promoting regional and global stability based on democratic and market values. His successor, Robert Zoellick, was more focused on reinforcing China's stake in global stability and the global economy, which he and his supporters argued would begin to shape the domestic political structure of China. The 2006 US National Security Strategy synthesized elements from these two approaches so that America's approach focuses on common values and interests with Japan and common interests with China. The National Security Strategy

identifies Japan as a critical partner in global affairs and calls for a hedging strategy toward China that balances engagement with dissuasion (Pryzystal and Saunders).

36. Of course, the United States maintains important, indeed vital, military relations with a number of countries in the region, including Japan and South Korea, and attaches a great deal of weight to these relations. It has actively encouraged Japan to assume greater military responsibilities and Japan has willingly complied, in part, out of concerns about China's military build-up and North Korean missile and nuclear tests. Japan's Prime Minister Shinzo Abe recently told the North Atlantic Council that Japan should co-operate more closely with NATO, particularly in support of external operations (*Atlantic News* No. 3837). There are, however, clear constitutional limits to what Japan can achieve. The United States also supplies military equipment and security guarantees to Taiwan. It is allied with both Australia and New Zealand and enjoys a strong security relationship with Thailand, although the military coup there has led the United States to reduce military aid to that country (AFP, 29 September 2006). In the wake of the tsunami disaster, in which US forces provided vital emergency assistance and created a great deal of goodwill throughout the region, the United States has sought to deepen relations with Indonesia, the world's most populous Muslim country (Lobe). US-Vietnamese relations have improved dramatically in recent years as well. Further afield, the United States has a long history of military co-operation with Pakistan, has recently improved relations with India and has identified building this partnership as a goal shared with Japan (www.state.gov). From the Chinese perspective, this string of US strategic ties sometimes has the look and feel of encirclement. It might even suggest to some that the United States has embraced elements of a Cold War containment approach to China.

37. On the other hand, the military dimension of the US approach has helped foster conditions that have encouraged China itself to improve relations with its neighbours. Rather than relying on a policy of military threats and ideological hostility to discourage its neighbours from engaging with the United States, something that has proven totally counterproductive in the past, China has recently sought to deepen its own commercial, diplomatic and cultural relations throughout the region through friendly ties, multilateralism and ever-closer economic links, including the construction of a free trade area. This has been mutually rewarding and has helped significantly to ease tensions throughout the region. Of course, this partly represents Chinese efforts to counter American influence in the region. But it is doing so in a manner that is largely conducive to regional stability and prosperity - ends that are also shared by the United States and, indeed, by Europe as well. US Assistant Secretary of State, Christopher Hill, has explicitly welcomed this development, suggesting that "China's success in extending its political influence in the Asia-Pacific region and throughout the developing world is... a logical evolution, closely tied to its emerging economic clout, and certainly is not a zero-sum game for the United States" (Christensen). US security guarantees remain very credible and inject a much needed degree of certainty and stability to the region, which gives it the breathing space to focus on issues of mutual interest rather than sheer rivalry. Thus America's policy of military alliance and security guarantees, combined with active engagement with China, has helped foster an environment conducive to positive-sum calculations on the part of the Chinese as well.

IV. EUROPEAN RELATIONS WITH EAST ASIA: BUILDING A LAND BRIDGE AND A SHARED COMMITMENT TO MULTILATERALISM

38. Europe has an ancient and complex relationship with Asia that is at least partly predicated on the common land mass linking the two continents. The Silk Road, along which travelled merchants, immigrants and traders, first solidified a set of economic ties that were vastly expanded during the age of oceanic exploration and the latter period of European colonialism. These ties were partly severed by the rise of anti-colonialist forces throughout Asia, as well as the dislocations of the 20th century (Linn, Tiomkin). The end of European colonial systems and the decline of Europe's capacity to project military power globally marked a first important change. The United

States ultimately replaced Europe as the dominant Western player in Asia and, for the region's non-Communist countries, served as the "indispensable power". At the same time, Asia's new Communist regimes abandoned rational pricing structures and thus undermined the foundations for international trade and genuine economic development. Europe did have strong trading relations with Japan and South Korea as their economies took off, but China had essentially cut itself off from the world economy.

39. The end of the Cold War and the abandonment of centrally planned economies sparked a revival of European-Asian trading and investment ties. This revival is ongoing and is transforming the economic geography of the Eurasian land mass. EU relations with India, China and Russia are deepening rapidly, and the EU itself is becoming more of a player in Asia by dint of its economic rather than military weight. These growing ties and the contiguity of the two continents suggest at least the potential for broader integration over the long term. The potential impact is significant. The Eurasian landmass including the sub-continent today is home to two-thirds of the world's population and generates half of its income (Linn, Tiomkin).

40. Europe comes to Asia with a surfeit of what Joseph Nye calls "soft power" (Nye). In some senses, the European model of multi-national integration and multilateral foreign and security policy resonates in contemporary Asia, precisely because nationalism and a lack of regional co-operation have been the source of so many of the region's historic problems. The European project provides one of the most compelling narratives for those in Asia aspiring to transcend old hostilities and build the foundations for a higher order of Asian stability and prosperity. But the European model, of course, can be interpreted and exploited symbolically in all kinds of ways (Reiterer). Asia lacks the kind of ideological, cultural and political coherence that has made the European project so successful.

41. The European Commission is seeking to strengthen its political and economic presence across the region "commensurate with the growing global weight of an enlarged EU". The EU engages the region through both bilateral and multilateral means. The EU and member states engage in fora like the ASEAN Regional Forum and the Asia-Europe Meeting (ASEM) process. That process is premised both on multilateralism and interregionalism - two postures with which Europe is intimately familiar and which provide the basis of its approach to the region - in fairly stark contrast to the United States (Bersick). The EU also maintains bilateral relations in the region and has established a privileged "strategic partnership with China that is designed, in part, to transcend very real ideological differences" (Meeting with EU Ambassador to China, September 2006). Between 1995 and 2005 the EU accounted for 31.4% of all foreign direct investment in ASEAN countries as opposed to 13.7% for Japan, 19.5% for the US and 0.8% for China. The EU ranks just behind Japan and the United States in the list of ASEAN's most important trading partners, although China is rapidly gaining market share (ASEAN Secretariat).

42. The EU-Japanese relationship has also changed in recent years. Japan's rapid rise from 1970-1990 precipitated a rather intense commercial rivalry although the EU's trade deficit with Japan mounted significantly. Trade disputes were largely focused on varying standards and a range of other non-tariff barriers. Eventually, an institutional framework for dialogue was created, and this has helped to regularize the dialogue and to foster closer relations. Today the EU-Japanese relationship is characterized more by co-operation than competition. Japan and the EU collaborate on a range of international issues including development aid, competition policy issues, and science/technology issues.

43. Japan and the countries of the EU are the two largest aid donors in the world. Japanese aid policy has focused primarily on East and South-East Asia but it is playing an increasingly active role in Africa as well as in Central Asia (<http://web.worldbank.org>). Indeed, Japan is beginning to raise its profile in Central Asia. It has participated in a "Central Asia plus Japan" dialogue, and at a meeting of Foreign Ministers from the region convened in Tokyo last year, participating ministers

reconfirmed that it is immensely important that Central Asian countries continue to intensify their endeavours toward democratization, promotion of market economy, improvement of the standard of living, eradication of terrorism and poverty, and protection of human rights. Japan's goal in the region, and for Asia generally, is to advance broad international co-operation rather than allow the emergence of exclusive zones of influence. This is certainly complementary to Europe's goals for the region ("Japan's Policy Toward Central Asia," Press Release, Embassy of Japan in the United States, June 6, 2006).

44. Both the EU and Japan see foreign development assistance as a foundation of their respective foreign and security policies and have worked to co-ordinate their work in these areas. Global warming is also a key priority area, and at the EU-Japan Summit this past June both sides agreed to work with the developing world in this area (Joint EU-Japanese Government Press Statement). An EU-Japan business dialogue is seeking to identify other ways in which the commercial relationship might be enhanced. The EU continues to have a significant trade deficit with Japan, which has been running at roughly US\$30 billion per annum ("Visit to Tokyo, Kyoto and Osaka," NATO PA Secretariat report 145 ESCTER 07). The EU has also expressed concerns about Japan's perennially low interest rates, which have kept the yen low and undercut European price competitiveness (Walker and Perry).

45. The Chinese as well have very readily publicly applauded Europe's commitment to multilateralism, precisely because this accords well with China's strategy for acceding to great power status. Beijing has very successfully cultivated the notion of a peaceful rise in the context of good neighbourly relations and has openly contrasted the more multilateral elements of its approach with some of America's more unilateral positions in recent years. It lauds the European model, precisely as it can be understood as an alternative to the American approach to international relations (Rachman). In some respects, this is a game of smoke and mirrors, but the Chinese have far more neighbourly credibility than they once did, and this is reflected in the East Asian willingness to engage more deeply with it. That said, few of China's neighbours want to be put in a position to choose between China and the United States. Japan has been particularly wary of this and has sought to broaden regional fora like ASEAN plus Three so that China's relative weight in these organizations is somewhat diminished. Japan would like India, New Zealand and Australia fully engaged in what would become an ASEAN plus Six process that would enhance the weight of democratic societies in that organization.

46. China has championed a plethora of other multilateral initiatives in Asia and has used the growing power of its economy to advance this process. It signed a Free Trade Agreement with ASEAN in 2001, which will take effect in 2010. It is also working within the Asia-Pacific Economic and Cooperation Forum (APEC), the Asian Development Bank and the WTO. It has played a vital role in the six-party talks on North Korea's nuclear programmes which, according to US negotiator Christopher Hill, have helped take the first step toward the "complete, verifiable and irreversible denuclearization of the Korean peninsula and the establishment of a more stable, peaceful and prosperous Northeast Asia" (<http://www.state.gov/p/eap/regional/c15455.htm>). The EU's primary goals with regard to China are to deepen the bilateral dialogue and to engage it more actively in global affairs, to support its transition to a more open and free society, to encourage its integration in the world trading system and to raise the EU's profile in China ("The EU's relations with China," <http://ec.europa.eu>).

47. Chinese officials are not likely to dwell much on Europe's democratic values, which they see more as a threat than a promise. Nor are they likely to recognize publicly that European integration was made possible, in part, as a result of the security umbrella that NATO and by extension, the United States provided Western Europe during the Cold War and the stability it lent to the continent during the delicate years of transition. South Korea, by contrast, may find particularly compelling Europe's vital role in creating a context for ultimate national reunification based on democratic principles. For their part, the Japanese might focus on how effectively the European project

reintegrated Germany into the European family of nations, and then provided a context for the creation of a German export dynamo. Finally, for the developing countries of South-East Asia, the European Union's role in galvanizing the economic and political development of former Warsaw Pact members brings a set of obvious lessons. Europe and Japan are increasingly co-ordinating their aid strategies to ensure coherence and effectiveness, and this too has an impact on Europe's image in Asia. In short, Europe means different things to different Asian countries. This is hardly a weak point for Europe and rather points to the degree of fracture within Asia itself.

48. East Asia is nowhere near creating the kind of Union first conceived by Europe's founders, but it is increasingly seeing the benefits of dialogue and collaboration in regional frameworks. Europe has become something of a model from which ideas can be borrowed, as well as a yardstick by which progress can be gauged (Reiterer). "Integrationism" has also conferred a degree of influence and prestige on Europe in a region that sometimes chafes at America's much needed, but not always comfortable, military presence and diplomatic style. If the United States remains a key protagonist in the region's tenuous balance of power, Europe offers an integrationist anecdote to the balance of power approaches, or at least offers ideas about how to "take the harsh edges off" power politics. Indeed, the EU sometimes seems to hold out an alternative model to Asia. Not surprisingly, this perception can stoke transatlantic friction, as was made evident in the debate over whether Europe should lift the embargo on arms sales to China.

49. Integrationist theory and practice indeed has its place in building a more peaceful and prosperous order. Many would nonetheless argue that, in Asia, hard military power must also be part of the equation, given the range of live tensions and fissures coursing through it. As suggested above, the EU was not the only force for integration in Europe. NATO played its part and was very much focused on matters related to the balance of power and the military dimension of achieving security. Asia remains riddled by national rivalries and hardly shares a common ideological foundation for political integration. The cautious construction of a stable security order without the creation of new regional hegemony is clearly a priority for many countries of the region. A shared desire for regional stability, economic development and a higher level of mutually beneficial trade and investment flows does provide an opening for deeper co-operation and achieving a higher degree of economic integration. This, in itself, represents a marked change from the overt hostilities of the Cold War. It could potentially grant Europe a special role to play because it has both mastered the language and practice of integration and become a consequential economic partner for Asia. But many in Asia also recognize that there is a central role for the United States in the region, both in economic and in security terms.

50. While high technology and commodities trade predominates over the sea lanes to and through Asia, oil and gas pipelines are reinforcing the land links between Europe and East Asia. Energy trade constitutes the most important and fastest growing economic connection between the two continents and is both a source of integration and rivalry. Russia has long supplied Europe with gas and oil via a network of pipelines, but new lines are being constructed to link China and Japan both to Russian and to Central Asian suppliers. Plans are on the drawing board to develop untapped hydroelectric resources in Central Asia to move energy both to Europe and the Far East. But there is an array of hurdles to developing these links, including poor infrastructure, lack of finance, regional security problems, regulatory problems, the competition for limited resources that could pit Europe against Asia, and the politicization of energy assets (Linn, Tiomkin). In some respects, there are three energy blocks forming on the Eurasian land mass. Europe is primarily a consumer block, as is the Far East, although both still have significant energy production, while a large stretch of countries that were once part of the Soviet Union lie between East Asia and Europe and constitute a block of suppliers, theoretically, at least, capable of playing the two importing regions against each other. It is precisely this prospect that is galvanizing Europe to develop a more coherent energy strategy, both through changes in internal market regulation and in external policy. Japan has also recognized the strategic importance of the countries of Central Asia and the Caucasus and is increasingly active in the region. It does not want China and Russia to be the sole

interlocutors of the region and is working with other Western countries to provide an alternative ("Visit to Tokyo, Kyoto and Osaka," NATO PA Secretariat report, 145 ESCTER 07).

51. Europe constitutes one of the three pillars of the global trading system along with East Asia and North America, and it has very substantial trade with both. Trade with the interior regions of Asia and Central Asia is far more limited due to the lack of transport infrastructure, the lower level of development of these regions, instability, corruption and border delays. Dealing with these problems will not only help link Central Asia to European and Asian economies, it will provide a new vehicle to advance commercial ties between Europe and the Far East. Both Europe and China are looking at ways to help improve the land links through Central Asia which, in turn, would open up land transport between the Far East and Europe. An agreement signed on 10 November 2006 in Pusan, South Korea, for example, provides for the creation of an "Iron Silk Road" – a rail link between the Caucasus and the Korean Peninsula. The development of the Trans-Asia Railway Network (TAR) will not only tighten links among the Asian and Central Asian partners, but ultimately will help build new links between the Far East and Western Europe (Peimani).

52. Air traffic between the continents has also expanded, while communication infrastructure is rapidly developing. Efforts are underway to secure better access to communication satellites and the internet in Central Asia. NATO itself has initiated a "Virtual Silk Highway" project to extend the reach of the internet to the South Caucasus and Central Asia. Again, efforts like this will help diminish the effective distance between Europe and Asia by lowering some of the myriad barriers that exist in the centre of this great Eurasian land mass.

53. As is the case for the North American-Asian relationship, there is no single organizational superstructure ordering European-Asian economic, security and diplomatic relations. There are rather an overlapping series of institutions and initiatives that impose a degree of structure on these relations and reinforce links to Europe. Among these are ASEM (the Asia-Europe Meeting), which engages all EU members, all ASEAN countries, and Japan, China and South Korea. The creation of the European Community in 1958 and the establishment of ASEAN ten years later played an instrumental role in eventually fostering region-to-region contact. Between 1967 and 1980, machinery was set up for regular institutional contact. A second phase between 1984 and 1990 broadened economic and political contacts. The third and current phase has gone further by creating the ASEM (Asia-Europe Meeting)¹, aimed at developing a multilateral framework for expanded co-operation on an equal basis. The EC-ASEAN institutionalized dialogue largely dealt with mutual economic concerns. However, in the early 1990s it became clear that the co-operation agreement contained four important weaknesses in terms of regulating contact between South-East Asia and Europe. First, there was no budget to support co-operation activities. Second, the focus was on trade and aid and neglected a range of other important issues. Finally, the agreement was signed during the final days of the Cold War and already, by 1990, the international environment had dramatically shifted, rendering elements of the agreement obsolete.

54. The OSCE has also extended its reach into Central Asia and to Russia's Pacific littoral. At the same time, the German Presidency of the European Council has announced that it wants a more structured EU presence in the region. There are also a host of sub-regional groups that straddle Europe and Asia, many of which engage former CIS (Commonwealth of Independent States) countries and their neighbours to the East. The World Bank and Asian Development Bank have actively promoted the formation of sub-regional groupings as a way of helping the developing countries of Asia reach out to their neighbours. Thus, while there is no overarching Eurasian institutional framework, there is a plethora of fora in which European and Asian officials are able to

¹ The original member states of ASEM are: on the EU side, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the UK. On the Asian side: Brunei, China, Indonesia, Japan, Malaysia, the Philippines, Singapore, South Korea, Thailand and Vietnam. At ASEM V in 2004, 13 new member states were admitted: the 10 new member states of the EU, and Cambodia, Laos and Myanmar.

exchange views, develop co-operative relations and facilitate new levels of trans-regional integration.

55. In recent years, Europe's Asian policy has become more complex as economic ties have deepened. The promulgation of European values, democracy and environmental issues has assumed a more prominent position on the agenda. Whereas the old EC-ASEAN agenda had been based on regulating trade contacts, with the political dimension being of secondary importance, the "new agenda" reversed these priorities, in part, due to the prodding of the European Parliament. "Fair trade", social legislation, the consolidation of democracy and the rule of law consequently emerged as new policy priorities for the European Union.

56. Asian states have sought to strengthen their links to a clearly more active and powerful European Union. This provided a number of states with a new source of leverage both *vis-à-vis* the two key regional powers, Japan and China, and *vis-à-vis* the United States.

57. The initiative for the creation of ASEM came from the Prime Minister of Singapore in 1995. The first biennial summit was held in Bangkok in 1996 and focused on trade, environment, illegal drug trafficking and terrorism. The second summit took place in London in 1998 on the heels of the 1997 Asian currency crisis, which emerged as the main topic of discussion. ASEM III, held in Seoul in 2000, was dominated by discussion of South and North Korean relations. On that occasion, ASEM also established a series of non-governmental networks of business people, academics and citizens to bolster the process. ASEM IV in Copenhagen in 2002 was generally considered an uneventful meeting and, as a result, the 2004 summit in Hanoi set the objective of "revitalizing and substantiating" EU-Asia links.

58. ASEM has several advantages. It formalizes contact between Europe and Asia and provides a platform for discussing matters of mutual concern. It is sufficiently flexible to allow participating states to broaden the dialogue when new challenges emerge. It is thus a key vehicle for developing an increasingly important set of relations while offering a unique platform for bargaining. There are also certain disadvantages. Firstly, as with most EU policy-making, co-ordinating common positions within the Union is very difficult. As a result, member governments and the Commission are sometimes pursuing mutually incompatible objectives and EU positions consequently represent lowest common denominator bargains. Secondly, there is a lack of agreement on the purposes of ASEM. EU members are very focused on human rights issues, while Asian participants adhere to the principle of non-interference and want to focus discussions on economic matters. There is thus a significant gap between expectations for ASEM and achievements. Finally, it should be noted that Europe does not play anything like the role the United States plays in the Asian security order and this, invariably, reduces its profile and leverage in the region.

V. REGIONAL ECONOMIC INSTITUTIONS AND THE "ASIAN SPAGHETTI BOWL"

59. As suggested above, the rise of regionalism is one of the most important developments in East Asia over the last decade. Asia has been a veritable cauldron of regional and bilateral trade agreements over the past fifteen years and the sheer complexity of these arrangements has inspired some to refer to it as a "spaghetti bowl". Organizations like ASEAN and ASEAN plus Three are facilitating dialogue and co-operation amongst key Asian countries that otherwise, and for historical and ideological reasons, might have found it difficult to forge co-operative relations. These budding multilateral frameworks are helping to ease tensions and advance regional economic and political dialogue. As suggested above, interregionalism has also shaped the region's links with other key global players in Europe and North America (Reiterer). These developments are evolving and they are not sufficiently advanced to overcome the still significant points of rivalry and fracture in the region.

60. From a Western perspective, regional integration in Asia is very much a two-edged sword. Much will hinge on whether a more tightly integrated Asia remains open to the rest of the world or becomes a kind of economic fortress. If the latter were to transpire, then this closed Asia would likely push the global trading order towards one fractured by major trading blocks in Europe, North America and Asia. Given the importance of European and North American markets to key Asian players, and given the general recognition in the region that trade openness stokes economic growth and is the best means of fighting poverty, the fortress Asia model will likely continue to be understood as a second best option, at least, economically.

61. On the political front, however, China's apparent preference to keep non-Asian countries like the United States at arm's length in regional deliberations suggests that a Chinese-dominated Asian diplomatic order might indeed represent a long-term Chinese goal. This has led to a complex game in which the democracies of the region are working hard to ensure that more democracies are engaged in this process. Thus Japan is pushing for an ASEAN plus Six process rather than an ASEAN plus Three in order to engage India, Australia and New Zealand in the deliberations. For its part, the United States is particularly supportive of APEC, which engages the US, Canada, Mexico, Russia, Chile and Peru in discussions with their Asian partners on matters of pan-Pacific interest. The proliferation of free trade and economic partnership arrangements discussed above are also part of this process and Japan, among others, has claimed that it is seeking to make this process compatible with the global WTO process. Some see this as a hedge should the global process break down but others argue that focusing on bilateral arrangements could lead to trade diversion and possibly weaken efforts to achieve global trade liberalization. Mounting regional economic interdependence could make some societies more amenable to the Chinese view, particularly if they do not feel menaced by China. But, as suggested above, most countries in the region are not likely to suspend their critical faculties and fully entrust their fate to Communist China despite improving and often very friendly relations. Tensions over Taiwan, continued repression within China, the uneasy Chinese-Japanese relationship, territorial disputes, China's opaque but very substantial military build-up, as well as its sheer size and weight, make most of the region happy to accommodate an American presence in the region, as well as a European economic and diplomatic presence. At the same time, they will relish the economic opportunities a growing China presents. East Asia will thus be very unwilling to face a hard choice between the West and China.

VI. CONCLUSION: THE ASIAN SECURITY ORDER AND ITS IMPLICATIONS

62. Europe and America each see Asia from different angles. The United States is looking across a vast ocean that is vital to its global trade, and over which its navy currently exercises preponderant power. It has built an array of alliance relations in the region originally as part of a global anti-Communist strategy. Yet those relations have become more complex in the post-Cold War, and its engagements in the region now involve efforts to contain global terrorist threats and the spread of weapons of mass destruction, and to discourage Chinese militarism. At the same time, of course, the United States has vital commercial and financial links throughout the region and its own economy has become very much bound to developments in Asia which, for its part, is less dependent economically on the United States than it once was. This, as well as China's rise, raises concerns in the United States about its long-term prospects in the region. But, for some, this is a concern mixed with optimism.

63. For its part, Europe looks at Asia across a vast and politically complicated land mass in which it increasingly discerns vital energy, trading and security interests. Europe's capacity to project military power in the region is limited and it frankly demonstrates no interest in doing so. That said, Europe too increasingly sees East Asia as an area of central economic concern. By extension, it also sees the Caucasus-Central Asian land mass as important to its own security and

well-being, not only because of its relative proximity, but also because it constitutes something of a land bridge to the Far East.

64. Although North America and Europe share a set of common values, and although these shared interests far outweigh differences with regard to the Far East and inner Asia, those differences are nonetheless worth mentioning.

65. Some of these differences arise out of these geographical and power projection asymmetries. For several key Asian states, America remains an irreplaceable ally and critical guarantor of security, while for others it is the "least distrusted actor" in the region and a key common denominator for many Asian countries (Christensen). Europe is not in a position to extend such guarantees to the region, but it offers a diplomatic style and a huge market that some in Asia find a welcome alternative to what they see as the overweening military-security focus of the United States. Some Asian leaders have quietly complained, for example, that US envoys have recently become so focused on terrorism that they seem to neglect other vital areas of shared interest. The US view is that sometimes the Europeans take their eye off the security ball when dealing with Asia. Europe and America need to be careful, therefore, that they are not pitted against each other in a way that might damage mutual interests. The Chinese arms embargo issue demonstrated a potential for this to happen, and it suggests that Asian policy ought to be a major focus of the EU-US dialogue and should not be excluded as a subject for occasional North Atlantic Council consideration.

66. There is great opportunity for Europe to complement the efforts of the United States in East Asia and vice versa. This does not require a perfect harmony of interests and, of course, there will always be some areas of disagreement and even healthy competition between the United States and Europe with regard to Asia. That competition, however, ought to be carefully managed, and this points to the need for a transatlantic dialogue on Asian matters.

67. Europe and North America should welcome the ever more important multilateral dialogue system emerging in Asia. It is helping to heal some, but certainly not all, of the fractures that have long divided the region. It is injecting greater transparency and assurance into regional relations and represents a positive means of accommodating a rapidly growing China, which is increasingly looking outward. These developments are helpful and are generally understood as such in the West, although there are certain dissenters in the ranks of zero-sum security analysts. But those dissenters should recognize that American power is helping to condition this process, rather than being undermined by it. American security guarantees are now underpinning the confident manner in which a number of regional actors are able to conduct their relations with China. American power thus helps condition China's engagement with these countries and helps place a premium on developing mutually beneficial policies, rather than fostering hostile suspicion. It is a delicate balance, of course, and one that may have to be adjusted as the situation evolves. But many regional trends do provide some basis for optimism. Taiwan will remain the most dangerous potential flashpoint and here, too, China and the United States must continue to play a delicate game of strategic ambiguity.

68. Although the proliferation of trade agreements in Far Eastern and South-Eastern Asia is deepening relations among the Asian partners and further entrenching economic

liberalism and openness, they are a second best option to broader liberalization under WTO auspices. A global liberal trading order will reduce the possibility of trade diversion and will make it less likely that the world slips into a block-driven trading order. The multiple bilateral trade arrangements coursing through Asia can sometimes lead to counterintuitive and inefficient trade patterns, and they therefore come at some cost in terms of trade diversion and in terms of administering these arrangements. North America and Europe should be encouraging their Asian friends and partners to make global liberalization the priority. Of course, this means that the transatlantic partners need to be setting an example themselves in the stumbling Doha Round talks. Much of the region continues to suffer from poverty despite rapid growth rates. This makes the case for more liberal trading arrangements even more compelling.

69. Energy represents another sector in which there is great scope for American and European collaboration with their East Asian partners. Competing claims on energy resources could constitute a source of friction and instability, particularly in an era of tight energy markets. Co-operative efforts are needed to ensure that energy is not used to drive a wedge between Asia, Europe and the United States. There is a great deal of scope for developing commonly accepted rules of the game. Greater co-operation is needed to foster energy-saving conservation, and this should also involve technology sharing and jointly funded research.

70. Finally, this type of collaboration is also needed in the area of environmental defence. Pollution levels throughout developing Asia are rising at an alarming pace due to rapid industrialization and a lack of proper governmental controls. The West needs to be fully engaged to help the region's countries remedy the problem and this is increasingly the focus of Western and Japanese aid to China, in particular. More work is needed to deal with this problem, which is global in its implications.

APPENDIX 1

Table 1. East Asia Economic Growth (in percentage)

	2004	2005	2006	2007
Emerging East Asia	7.5	6.8	6.6	6.3
Developing East Asia	8.5	8.2	7.8	7.5
S.E. Asia	5.9	5.1	5.3	5.7
Indonesia	4.9	5.6	5.5	6.2
Malaysia	7.1	5.3	5.5	5.7
Philippines	6.0	5.1	5.3	5.6
Thailand	6.2	4.5	5.0	5.2
Transition Econ.				
China	10.1	9.9	9.2	8.5
Vietnam	7.7	8.4	8.0	7.5
Small Economies	5.7	5.2	5.1	4.9
Newly Industrialized Econ.	6.1	4.8	4.9	4.6
Korea	4.6	4.0	5.0	4.8
3 other NIEs*	7.3	5.4	4.8	4.4
Japan	2.3	2.8	2.8	2.1

* Consensus Forecasts for NIEs other than Korea

Source: World Bank, *East Asia and Pacific Regional Update*, worldbank.org, March 2006

APPENDIX 2

Table 2: Comparison of Population and GNI (gross national income) in terms of ppp (purchasing power parity) 2001

	Population (million)	GNI (billion US dollars)
EU	377.0	9,163
NAFTA	414.4	11,638
ASEAN	525.2	1,860
North-East Asia (Japan, China, Korea)	1,453.5	9,944
East Asia (ASEAN + North-East Asia)	1,978.7	11,804

Source: World Bank: World Development Report 2002

BIBLIOGRAPHY

“ASEAN FDI Database, 2005,” ASEAN Secretariat.

“Asia’s Democratic Alliances”, *Wall Street Journal*, 13 March 2007.

“Development Assistance from Japan”, World Bank Tokyo Office,
<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/JAPANEXT/N/0,,contentMDK:20647244~menuPK:1685924~pagePK:1497618~piPK:217854~theSitePK:273812,00.html>

“East Asia Update-Solid Growth, New Challenges,” The World Bank, March 2006.

“Japan Hopes for Closer Collaboration with NATO”, *Atlantic News*, No. 3837, 16 January 2007.

“Japan’s EPA/EFTA”, Ministry of Economy, Trade and Industry of Japan.

“Japan’s Policy Toward Central Asia,” *Press Release*, Embassy of Japan in the United States, 6 June 2006.

“Joint Statement of The US-Japan Security Consultative Committee”, US Department of State, 1 May 2007, www.state.gov (“Joint Press Statement, Sixteenth EU-Japan Summit, Berlin, 5 June 2007”).

“Retired military aid picked as new PM as US cuts military aid”, *AFP*, 29 September 2006,
<http://asia.news.yahoo.com/060929/afp/060929031120int.html>

“The Chiang Mai Initiative”, Institute of International Economics,
http://www.iie.com/publications/chapters_preview/345/3iie3381.pdf

“The EU’s Relations with China”, <http://ec.europa.eu>.

“Visit to Tokyo, Kyoto and Osaka,” NATO PA Secretariat report 145ESCTER 07.

Abe, Shinzo, “Japan and NATO: Toward Further Collaboration”, Speech to the North Atlantic Council, January 2007, <http://www.nato.int/docu/speech/2007/s070112b.html>

Aggarwal, Vinod et al., “The Evolution of APEC and ASEM: Implications of the New East Asian Bilateralism”, *European Journal of East Asian Studies*, Vol. 4, No. 2 (2005), 233-262.

Bennet, John T., “DoD Report Notes Shift to Asymmetric Chinese Strategy,” *Defense News*, 4 June 2007.

Bersick, Sebastian, “The EU’s Approach to East Asia: Strategic and Systemic Implications for New EU States”, Paper presented to Seimas of the Republic of Lithuania, 22 March 2006.

Christensen, Thomas, “Fostering stability or creating a Monster: The rise of China and US Policy toward East Asia”, *International Security*, Vol. 31, No. 1 (Summer 2006), 81-126.

Eckhardt, Jappe, “Dynamics of East Asian Regionalism, what implications for the EU?” *Policy Brief*, European Institute for Asian Studies, 05/01 (January 2005).

Giles, Chris, “Wrong lessons from Asia’s crisis”, *Financial Times*, 2 July 2007.

Gilson, Julie, "New Interregionalism? The EU and East Asia", *European Integration*, Vol.27, No. 3, 307-326.

Green, Michael J., "U.S.-Japanese Relations after Koizumi: Convergence or Cooling?" *The Washington Quarterly* (Autumn 2006).

Hill, Christopher R., "Assistant Secretary for East Asian and Pacific Affairs Statement Before the House Foreign Affairs Committee", US Department of State, Washington, D.C., 28 February 2007, <http://www.state.gov/p/eap/regional/c15455.htm>

Kagan, Robert and William Kristol, "Toward a Neo-Reaganite Foreign Policy," *Foreign Affairs*, July/August 1996.

Kagan, Robert, "The Illusion of Managing China", *The Washington Post*, 15 May 2005.

Linn, Johannes F. and David Tiomkin, "The New Impetus towards Economic Integration between Europe and Asia", *Asia Europe Journal*, Vol. 4, No. 1 (April 2006), 31-41.

Lobe, Jim, "US debates new links to Indonesian military," *Asia Times on Line*, 19 January 2005.

Moffet, Sebastian and Jason Leow, "Signs of thaw between Japan, China?" *The Wall Street Journal*, 10 April 2007.

Natno, Dick K., "East Asian Regional Architecture: New Economic and Security Arrangements and US Policy", CRS Report for Congress, 18 September 2006.

Niquet, Valerie, "Les grands enjeux strategiques en Asia", *Defense National*, No. 62, January 2006.

Nye, Joseph, *Power in the Global Information Age* (Routledge: London, 2004).

Peimani, Hooman, "Trans-Asia Rail Network A Potential Benefit to Central Asian and Caucasian States", *Analyst*, Central Asia-Caucasus Institute, the Johns Hopkins University, 15 November 2006, http://www.cacianalyst.org/view_article.php?articleid=4563

Przystup, James J. and Phillip Saunders, "Visions of Order: Japan and China in U.S. Strategy", *Strategic Forum*, No. 220, June 2006.

Rachman, Gideon, "The Hard evidence that China's soft power policy is working", *Financial Times*, 20 February 2007.

Reiterer, Michael, "Interregionalism as a new Diplomatic Tool: The EU and East Asia," *European Foreign Affairs Review*, No. 2, 2006.

Segal, Gerald et al., "Getting Serious About Asia-Europe Security Cooperation", *Survival* (Spring 1997), 138-155.

Smith, Heather and Garth Day, Brian Thomas, Luke Yeaman, "The Changing Patterns of East Asia's Growth", http://www.treasury.gov.au/documents/958/PDF/05_changing_pattern.pdf

Söderbaum, Fredrik et al., "The EU as a Global Actor and the Dynamic of Interregionalism: a Comparative Analysis", *European Integration*, Vol. 27, No. 3, 365-380.

Synnott, Hilary, "The Second Asia-Europe Summit and the QSEM Process," *Asian Affairs*, Vol. 30, No. 1, 3-10.

Taniguchi, Makoto, "Towards the establishment of East Asian Economic Zone - How can Japan, China and Korea Co-operate to Attain this Aim?" Working Paper, June 2003.

The World Bank, <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GNI.pdf>

Walker, Marcus and Andrew Batson, "China's GDP soon to top Germany's in power shift", *Wall Street Journal*, 16 July 2007.

Walker, Marcus and Joellen Perry, "German official wants G-7 talks on the yen", *Wall Street Journal*, 2 February 2007.

Xiang, Lanxin, "Washington's Misguided China Policy", *Survival*, Vol. 43, No. 3 (Autumn 2001).

Zebregs, Harm, "Interregional Trade in Emerging Asia", Policy Discussion Paper, PDP/04/1, International Monetary Fund.