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**Economic Integration in East Asia:  
The Path of Law**

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# ECONOMIC INTEGRATION IN EAST ASIA: THE PATH OF LAW

ZHANG ZHIYONG\*

## ABSTRACT:

The impressive economic performance of East Asian economies and the achievement of economic integration in East Asia before the financial crisis of 1997-98 were more attributable to the governments' strategic actions and market forces, than the law. The weakness of domestic legal systems and the lack of regional legal mechanisms caused trouble to the East Asian economies in 1997-98. Since the aftermath of the crisis, while strengthening governance and supervision at the domestic level, the East Asian economies have made significant progress in areas such as trade, investment and monetary cooperation at the regional level. ASEAN, being the driving force of regional integration, is gradually shifting from being an organization based on political dialogue to one with an international legal personality, capable of being involved in binding commitments. However, the complex situation of East Asia demands that a specific mechanism be designed for deeper economic integration. No matter what kind of approach is adopted, there is no doubt that it is the rule of law which will ultimately safeguard East Asian economic integration.

## I. INTRODUCTION

The financial crisis of 1997-98 fundamentally changed the East Asian economies' perspectives on regional economic integration.<sup>1</sup> In the Joint Statement on East Asia Cooperation dated 28 November 1999 done at Manila, the Heads of State/Government of Association of Southeast Asian Nations ("ASEAN")+3 underscored their commitment to strengthen cooperation in various levels and in various areas.<sup>2</sup> Till now, significant progress has been made in areas such as trade, investment and monetary cooperation. For example, the ASEAN-China Free Trade Area ("ACFTA"), which was realized on 1 January 2010, is the world's largest Free Trade Area in terms of population and is expected to accelerate integration in East Asia.<sup>3</sup>

Traditionally, market forces and strategic action by governments have been identified by scholars as the main factors in the furthering of economic dynamism and

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<sup>1</sup> This study defines East Asia as ASEAN plus China, Japan and Korea, that is ASEAN+3. Economic integration includes all mechanisms or arrangements of economic cooperation and integration such as FTAs, comprehensive economic agreements, and economic community, *etc.*

<sup>2</sup> ASEAN, Media Release, "Joint Statement on East Asia Cooperation" (28 November 1999), online: ASEAN <<http://www.aseansec.org/5469.htm>>.

<sup>3</sup> In terms of GDP, the ACFTA is only smaller than the European Union and North American Free Trade Area. See Zhang Jin, "Experts: ASEAN free-trade agreement is a win-win deal" *China Daily* (4 January 2010).

regional cooperation in East Asia. However, what role has the law played in East Asian economic integration?

To some extent, the domestic legal systems of some East Asian economies impeded the pace of regional economic integration. For example, while a sound and transparent legal system is the foundation for the free flow of goods, services, investments, capital and skilled labor, the legal systems of some East Asian economies are unable to provide effective oversight of corporate and financial sector governance.<sup>4</sup>

The main instrument used by East Asian economies for regional cooperation has been international agreements, such as free trade agreements (“FTA”) and bilateral investment treaties (“BIT”). However, cooperation in East Asia has been characterized by consensual decisions, with weak regional institutions.

Fortunately, East Asian economies have realized the important function of law and have made efforts to strengthen their rule of law both domestically and internationally. For example, Japan, Korea and China have enhanced the capabilities of their judicial systems in the commercial arena.<sup>5</sup> With its Charter<sup>6</sup>, ASEAN has begun to shift from a purely deliberative, process-oriented arrangement towards a more rules-based, regulatory, and results-oriented organization.<sup>7</sup>

This paper, aiming to examine the legal framework of economic integration in East Asia and discussing the problems therein, is divided into three parts: The first part reviews the concise history of economic integration in East Asia before the financial crisis of 1997-1998; the second part describes the progress made in this region since the financial crisis; the third part discusses the challenges surrounding future deeper integration.

## II. STORY BEFORE 1997

The “East Asian miracle” was used to describe the impressive economic performance of some East Asian economies over a period of about 30 years in the last century. Market forces and strategic action by the governments have been identified by economic or/and political economy academics as the main factors for East Asian economic dynamism and regional cooperation. Some academics think the East Asian economic performance was due to the economies’ appreciation of market forces, and subsequent formulation and implementation of market-conforming economic policies. Market force is viewed as the most powerful vehicle for fostering regional economic cooperation. Other academics think that the essence of the East Asian economic miracle lies in the export-led industrialization strategy of the economies. According to this view, the East Asian economic miracle is rather unique to East Asia, and it could never have been possible without strategic intervention of the state. These academics also argue that the primary actors involved in regional economic cooperation are not firms, but governments. Thus,

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<sup>4</sup> Shahid Yusuf, *Innovative East Asia: The Future of Growth* (Washington D.C.: The World Bank, 2003) at 88 [Yusuf].

<sup>5</sup> *Ibid.*

<sup>6</sup> *Charter of the Association of Southeast Asian Nations*, 20 November 2007, online: ASEAN <<http://www.aseansec.org/publications/ASEAN-Charter.pdf>> (entered into force 15 December 2008) [ASEAN Charter].

<sup>7</sup> *Institutions for Regional Integration: Toward an Asian Economic Community* (Manila: Asian Development Bank (ADB), 2010) at 116 [ADB].

regional cooperation or integration is not market-driven, but determined by the nature of the legal and institutional frameworks formed through coordination among nation-states.<sup>8</sup>

However, the East Asian miracle did not seem to be everlasting. Just several years before the financial crisis of 1997-98, Paul Krugman pointed out that “Asian growth, like that of the former Soviet Union in its high growth era, seems to be driven by extraordinary growth in inputs like labor and capital rather than gains in efficiency”.<sup>9</sup> In fact, both market failure and government failure were accountable for the financial crisis of 1997-98. The rule of law was also overlooked at both domestic and regional levels.

### A. Domestic Arena

The legal system is at the nub of many corporate and financial issues.<sup>10</sup> In the East Asian context, however, the system of checks and balances was weak and prudential supervision was not established during the process of economic development. The experience of Korea illustrates the problem. The large conglomerates (also known as ‘*chaebol*’) that dominated the economy were very heavily leveraged, mostly through long-term borrowing from local banks. The banking system also suffered from serious problems. For many years, the banks’ lending decisions had been heavily influenced by the policy choices of government officials rather than by commercial considerations of risk and return. Bank prudential controls and their regulatory enforcement were lax, particularly in the areas of provisioning, concentration of lending risks, and liquidity management. The result was an accumulation of questionable loans on bank balance sheets.<sup>11</sup>

The lessons of Thailand provided another example. One of the key domestic factors that led to the crisis of 1997 in Thailand is the lax prudential rules and financial oversight, which led to a sharp deterioration in the quality of the banks’ loan portfolios. As the crisis unfolded, political uncertainties and doubts over the authorities’ commitment and ability to implement the necessary adjustment and reforms exacerbated pressures on currencies and stock markets. Reluctance to tighten monetary conditions and to close insolvent financial institutions clearly added to the turbulence in financial markets.<sup>12</sup>

The crisis of 1997-98 demonstrates that although relatively weak legal systems did not impede rapid growth in the past because domestic economies were relatively isolated from market forces, if the government is to cede its role to the workings of the market, market participants must be able to rely on an appropriate legal framework and on the impersonal enforcement of the law.<sup>13</sup>

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<sup>8</sup> Chung-in Moon, “Political Economy of East Asian Development and Pacific Economic Cooperation” (1999) 12:2 *Pac. Rev.* 199 at 201-203 [Moon].

<sup>9</sup> Paul Krugman, “The Myth of Asia’s Miracle” (1994) 73 *Foreign Affairs* 62 at 70.

<sup>10</sup> Yusuf, *supra* note 4 at 83.

<sup>11</sup> Independent Evaluation Office, *The IMF and the Recent Capital Account Crises: Indonesia, Korea, Brazil*, Evaluation Report (Washington D.C.: International Monetary Fund, 2003) at 17, online: IMF <<http://www.imf.org/external/np/ieo/2003/cac/pdf/all.pdf>> [Evaluation Report].

<sup>12</sup> Stanley Fischer, “The Asian Crisis: A View from the IMF” (Speech delivered at the Midwinter Conference of the Bankers’ Association for Foreign Trade, 22 January 1998), online: <<http://www.imf.org/external/np/speeches/1998/012298.htm>>.

<sup>13</sup> Yusuf, *supra* note 4 at 83.

## B. Regional Level

At the regional level, economic integration in East Asia began before the crisis of 1997-98. For decades, Japan played a leading role in the establishment of the so-called ‘flying geese’ production network in East Asia.<sup>14</sup> In many cases, industrial products were assembled in one East Asian country from parts and components produced in others. This production-based economic interdependence explains the rapid increase in intra-regional and intra-industry trade in East Asia over the past 25 years. The economies of East Asia have become increasingly integrated through trade and investment flows since the mid-1980s.<sup>15</sup>

The ‘flying geese’ pattern suggests that economic integration in East Asia is the result of market forces, not that of legal mechanisms. Although some FTAs and BITs were concluded between some East Asian economies<sup>16</sup>, no significant legal mechanism was developed for deeper cooperation or integration before 1997. In fact, FTAs were not initially part of East Asia’s dynamic growth story and their impact on trade and investment growth have so far been limited.<sup>17</sup>

Of course, apart from the bilateral agreements, East Asia does have regional arrangements such as ASEAN and the Asia-Pacific Economic Cooperation (“APEC”). However, ASEAN and APEC are not institutions specially designed for East Asian integration, and their mechanisms have been characterized by consensual decision-making, weak institutionalisation and weak legalization.

In its initial phase, ASEAN was mostly a consensus-based politico-security community which paid little attention to economic issues. Although ASEAN adopted a preferential trading arrangement at its Bali summit in 1976, this had little impact on regional trade because of its narrow commodity coverage and half-hearted implementation. The launch of the ASEAN Free Trade Area in 1992 represented an evolution of ASEAN from a forum aimed mainly at promoting peace and stability in the region to one aimed at deepening the economic partnerships within the region.<sup>18</sup> However, ASEAN cooperation has been loose and informal, relying on political persuasion rather than legal enforcement and basing itself on *musyawarah* (consultation) and *mufakat* (consensus).<sup>19</sup>

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<sup>14</sup> Shahid Yusuf, M. Anjum Altaf & Kaoru Nabeshima, eds., *Global Change and East Asian Policy Initiatives* (Washington D.C.: The World Bank, 2004) at 103.

<sup>15</sup> Siow Yue Chia, “Trade and Investment Policies and Regional Economic Integration in East Asia”, ADBI Working Paper Series, No. 210, April 2010, online: ADBI <<http://www.adbi.org/files/2010.04.05.wp210.trade.investment.policies.east.asia.pdf>>.

<sup>16</sup> For example, before 1997, China concluded a BIT with Indonesia, Japan, Lao DPR, Malaysia, Philippines, Thailand and Viet Nam.

<sup>17</sup> Masahiro Kawai & Ganeshan Wignaraja, “Free Trade Agreements in East Asia: A Way Toward Trade Liberalization?” (2010) ADB Briefs, No.1, June 2010, online: ADB <<http://www.adb.org/documents/briefs/ADB-Briefs-2010-1-Free-Trade-Agreements.pdf>> [Kawai & Wignaraja].

<sup>18</sup> Paul J. Davidson, *ASEAN: The Evolving Legal Framework for Economic Cooperation* (Singapore: Times Academic Press, 2002) at 74.

<sup>19</sup> Ali Alatas, “The ASEAN Charter: Towards its Ratification and Implementation” in Pavin Chachavalongpun, ed., *The Road to Ratification and Implementation of the ASEAN Charter* (Singapore: ISEAS Publishing, 2009) 15 at 15-16 [Ali Alatas].

Although most ASEAN countries, China, Japan and Korea are members of APEC, APEC is not a place solely for East Asian economies.<sup>20</sup> APEC is a unique forum, operating on the basis of open dialogue and respect for the views of all participants. In APEC, all economies have an equal say and decision-making is reached by consensus. There are no binding commitments; compliance is achieved through discussion and mutual support in the form of economic and technical cooperation.<sup>21</sup>

Several reasons can explain the abovementioned cooperation-based approach adopted by East Asian economies at that time.

First, some East Asian countries are post-colonial societies that attach special value to their national sovereignty. It is then the calculus of state interests that dictates the pattern of regional economic conflict and cooperation. If and when cooperation yields gain, countries will actively engage in regional economic cooperation and integration. If the salience of gain does not exist, it might be quite difficult to expect cooperative behaviour.<sup>22</sup>

Second, East Asian economies have integrated more with the rest of the world than among themselves. Some economies took the advantage of the multilateral trade system for economic expansion. Before the 1990s, the Japanese government did not think it was necessary to acquire a market share through economic integration agreements.<sup>23</sup> Similarly, China did not pay much attention to regional arrangements before it became a member of the World Trade Organisation (“WTO”).

Third, the ASEAN way has not resulted in it being ineffective. Its method has been integral to the cultivation of the requisite confidence and trust needed to build the support required for deeper cooperation and integration. It has successfully reconciled the value that its constituent countries and their residents attach to national sovereignty, with the need for common rules and regulatory standards—and governance thereof—to support integrating markets.<sup>24</sup>

However, what has worked well in the past may work less well in the future.

The contagious effect of the 1997-98 crisis shows that the economic interdependence in East Asia calls for regional self-protection and a cooperation mechanism. Taking finance as an example, East Asia as a whole was actually running on a saving surplus prior to the crisis. However, the saving surplus of the region was invested mostly in USD denominated assets and the countries running deficits had to rely on

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<sup>20</sup> The idea of APEC was first publicly broached by former Prime Minister of Australia, Mr. Bob Hawke, during a speech in Seoul, Korea in January 1989. APEC has now 21 Member Economies: Australia; Brunei Darussalam; Canada; Chile; People's Republic of China; Hong Kong, China; Indonesia; Japan; Republic of Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; The Republic of the Philippines; The Russian Federation; Singapore; Chinese Taipei; Thailand; United States of America; Viet Nam. Till now, Cambodia, Lao DPR and Myanmar are not Member Economies of APEC yet. More information is available online: Asia-Pacific Economic Cooperation <<http://www.apec.org>>.

<sup>21</sup> APEC at a Glance, online: APEC <[http://publications.apec.org/publication-detail.php?pub\\_id=1077](http://publications.apec.org/publication-detail.php?pub_id=1077)>.

<sup>22</sup> Moon, *supra* note 8 at 203.

<sup>23</sup> Naoko Munakatu, “Evolution of Japan’s Policy Toward Economic Integration” cited in Lu Jianren, “Japan’s Regional Cooperation Policy”(2006) 1 *Contemporary Asia Pac. Stud.* 13 at 14 (Chinese edition).

<sup>24</sup> ADB, *supra* note 7 at 11.

foreign bank borrowings, which were mostly of short-term maturity. Some had argued that at that time if the financial resources within the region had been better utilized to provide liquidity support and longer-term development finance to countries in the region in need of such provisions, then the crisis could possibly have been avoided.<sup>25</sup>

Since there was no regional mechanism available when the crisis happened, East Asian economies had to resort to help from the International Monetary Fund (“IMF”). However, the bargaining power of the East Asian economies was very weak and they had to accept the IMF conditionality which was in fact a reflection of the so-called “Washington Consensus”, arrived at among IMF, the World Bank, US Treasury and the Federal Reserve. IMF’s surveillance before the crisis and its rescue program during the crisis were criticized. For example, the evaluation report by the Independent Evaluation Office admitted that in Indonesia, the IMF had underestimated the severity of the vulnerabilities in the banking sector and the potential macroeconomic risks posed by them.<sup>26</sup> And in Korea, IMF’s surveillance failed to adequately identify the risks posed by the uneven pace of capital account liberalization and the extent of banking sector weaknesses.<sup>27</sup>

### III. PROGRESS AFTER 1997

The East Asian economies woke up after the financial crisis of 1997-98 and accelerated the pace of instituting economic integration mechanisms in the region. Significant progress has been made in areas such as finance and trade since the aftermath of the crisis. The following are examples.

#### A. The Chiang Mai Initiative (“CMI”) and its Multilateralization

As it was the financial crisis that brought the region together, it is not surprising that the region’s first substantive cooperation agreement is in the area of finance, particularly the CMI, economic surveillance and bond market development (*e.g.* Asian Bond Market Initiative, together with the Asian Bond Funds).<sup>28</sup> Let us take the CMI and its multilateralization as an example.

Reached in May 2000, the CMI is the first significant regional financial arrangement to enable countries to cope with disruptive capital flows and maintain exchange rate stability.<sup>29</sup> The CMI called for:<sup>30</sup>

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<sup>25</sup> Chalongphob Sussangkarn, “The Chiang Mai Initiative Multilateralization: Origin, Development and Outlook”, ADBI Working Paper Series, No. 230, July 2010 at 2, online: ADBI <<http://www.adbi.org/files/2010.07.13.wp230.chiang.mai.initiative.multilateralisation.pdf>> [Chalongphob Sussangkarn],

<sup>26</sup> Evaluation Report, *supra* note 11 at 1.

<sup>27</sup> *Ibid.* at 2.

<sup>28</sup> Chalongphob Sussangkarn, *supra* note 25 at 4.

<sup>29</sup> UNESCAP, “Regional Financial Cooperation in East Asia: The Chiang Mai Initiative and Beyond”, online: UNESCAP <<http://www.unescap.org/dpad/publication/bulletin%202002/ch8.pdf>> [UNESCAP].

<sup>30</sup> Pradumna B. Rana, “Monetary and Financial Cooperation in East Asia—The Chiang Mai Initiative and Beyond” (Paper presented at the 2001 KIEP/NEAEF Conference on “Strengthening Economic Cooperation in Northeast Asia” in Honolulu, Hawaii, 16-17 August 2001), online: <[http://www.adb.org/Documents/ERD/Working\\_Papers/wp006.pdf](http://www.adb.org/Documents/ERD/Working_Papers/wp006.pdf)>.



- (1) An expanded ASEAN Swap Arrangement that would include all ASEAN countries and a network of bilateral swap and repurchase agreement facilities among ASEAN countries, China, Japan and Korea;
- (2) Use of the ASEAN+3 framework to promote the exchange of consistent and timely data and information on capital flows;
- (3) Establishment of a regional financing arrangement to supplement existing international facilities;
- (4) Establishment of an appropriate mechanism (*e.g.* an early warning system) that could enhance the ability to provide sufficient and timely financial stability in the East Asian region.

The CMI evolved into the CMI's multilateralization over the course of ASEAN+3 finance ministers' meeting held in 2008 and 2009, as the respective member countries agreed to transform their bilateral swap agreements into a self-managed reserve pooling arrangement governed by a single contract.<sup>31</sup> The objectives of the Chiang Mai Initiative Multilateralization ("CMIM") were to address the short-term liquidity problem in the region and to supplement the existing international financial arrangements. The total size of the CMIM is USD 120 billion with the contribution proportion between ASEAN and the Plus Three countries being 20:80. The maximum amount that each country can borrow is based on its contribution multiplied by its respective borrowing multiplier. On the decision-making mechanism of the CMIM, the fundamental issues (*i.e.* review, readmission, membership, terms of lending) are decided through consensus of the members of ASEAN+3, while the lending issues (*i.e.* lending, renewal, default) are decided through majority.<sup>32</sup> Finance ministers of the ASEAN+3 are also committed to establishing by early 2011, in Singapore, the ASEAN+3 Macroeconomic Surveillance Office, an independent regional surveillance unit to support the successful implementation of CMIM.<sup>33</sup>

The establishment of the CMIM shows that a regional cooperation mechanism with a strengthened decision-making procedure and surveillance arrangement is emerging.

## **B. Comprehensive Economic Cooperation between ASEAN+3**

The crisis of 1997-98 made it clear that East Asia needed to address the common challenges faced in the areas of trade and investment in order to sustain growth and stability. Since the end of the 20<sup>th</sup> century, the number of FTAs in the region had increased more than tenfold. By May 2010, East Asia had emerged at the forefront of the global FTA activity, with 45 FTAs in effect and another 84 in various stages of preparation.<sup>34</sup>

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<sup>31</sup> Domenico Lombardi, "Financial Regionalism: A Review of the Issues", The Brookings Institution Issues Paper, November 2010 at 7, online: <[http://www.brookings.edu/~media/Files/rc/papers/2010/11\\_global\\_economy\\_lombardi/11\\_global\\_economy\\_lombardi.pdf](http://www.brookings.edu/~media/Files/rc/papers/2010/11_global_economy_lombardi/11_global_economy_lombardi.pdf)> [Domenico Lombardi].

<sup>32</sup> ASEAN, Attachment to a Media Release, "The Joint Media Statement of the 12<sup>th</sup> ASEAN Plus Three Finance Ministers' Meeting" (3 May 2009), online: ASEAN <<http://www.aseansec.org/22536-attachment.pdf>>.

<sup>33</sup> ASEAN, Media Release, "Joint Media Statement of the 14<sup>th</sup> ASEAN Finance Ministers' Meeting (AFMM)" (8 April 2010), online: ASEAN <<http://www.aseansec.org/24491.htm>>.

<sup>34</sup> Kawai & Wignaraja, *supra* note 17.

The comprehensive economic cooperation agreements between the ASEAN+3 countries deserve more attention because they are arrangements of the East Asian economies. The year 2002 witnessed the formation of the framework agreement on the comprehensive economic cooperation between ASEAN and China. The framework agreement provided the legal basis for the birth of the ACFTA on 1 January 2010. Since then, ASEAN has signed framework agreements for comprehensive economic cooperation with Japan and Korea respectively in 2003 and 2005. Additionally, the ASEAN-Japan Comprehensive Economic Partnership was signed in 2008.

The objectives of these agreements, as stated in the framework agreement between ASEAN and China, are: to strengthen and enhance economic, trade and investment cooperation between the Parties; to progressively liberalize and promote trade in goods and services as well as create a transparent, liberal and facilitative investment regime; to explore new areas and develop appropriate measures for closer economic cooperation between the Parties; and to facilitate more effective economic integration of the newer ASEAN member states and bridge the development gap among the Parties.<sup>35</sup>

These comprehensive economic agreements cover not only trade in goods, but also trade in services and investments. The rules (such as the ‘most favoured nation’ treatment and ‘national’ treatment) set out in these agreements aim to promote investment flow and create a liberal, facilitative, transparent and competitive regime in East Asia.<sup>36</sup> The dispute settlement mechanism shows that the East Asian countries are not averse to rules-based institutions.<sup>37</sup>

Until now, the comprehensive economic cooperation agreement between ASEAN+3 actually involves ASEAN entering into three separate agreements with China, Japan and Korea respectively. An FTA among China, Japan and Korea<sup>38</sup> and an East Asia Free Trade Area that puts the ASEAN+3 countries together are under consideration.<sup>39</sup>

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<sup>35</sup> *Framework Agreement on Comprehensive Economic Cooperation between ASEAN and the People's Republic of China*, ASEAN and People's Republic of China, 4 November 2002, online: ASEAN <<http://www.asean.org/13196.htm>>, art. 1.

<sup>36</sup> *Agreement on Investment of the Framework Agreement on Comprehensive Economic Cooperation between the People's Republic of China and the Association of Southeast Asian Nations*, ASEAN and the People's Republic of China, 15 August 2009, online: China Trade in Services <<http://tradeinservices.mofcom.gov.cn/en/b/2009-08-15/76350.shtml>>, art. 2 [*Agreement on Investment*].

<sup>37</sup> According to art. 13 of *Agreement on Investment*, *ibid.*, the *Agreement on Dispute Settlement Mechanism of the Framework Agreement on Comprehensive Economic Co-operation Between the Association of Southeast Asian Nations and the People's Republic of China*, ASEAN and the People's Republic of China, 4 November 2002, shall apply to disputes between or among the contracting parties. And investment disputes between a contracting party and investor can be settled under the 1965 *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 575 U.N.T.S. 159, 4 I.L.M. 532 (1965) (entered into force 14 October 1966), which established the International Center for Settlement of Investment Disputes (ICSID), and the *ICSID Rules of Procedure for Arbitration Proceedings*.

<sup>38</sup> Ministry of Commerce of the People's Republic of China, Media Statement, “Joint Statement of the Joint Study Committee for an FTA among China, Japan and Korea” (6 May 2010), online: Ministry of Commerce <[http://fta.mofcom.gov.cn/china\\_japan\\_korea/lhsm\\_en.pdf](http://fta.mofcom.gov.cn/china_japan_korea/lhsm_en.pdf)>.

<sup>39</sup> ASEAN, “ASEAN Plus Three Cooperation”, online: ASEAN <<http://www.aseansec.org/16580.htm>>.

### C. The Change of ASEAN

The ASEAN Member States have sought to establish an ASEAN Community comprising of three pillars since 2003.<sup>40</sup> The ASEAN Charter, which entered into force on 15 December 2008, serves as a firm foundation to achieving the ASEAN Community by providing ASEAN with a legal personality and an institutional framework.<sup>41</sup>

Although consultation and consensus are still the basic principles for decision-making in ASEAN,<sup>42</sup> the ASEAN Summit may decide how a specific decision can be made if consensus cannot be reached.<sup>43</sup> In case of a serious breach of the Charter or non-compliance, the matter shall be referred to the ASEAN Summit for decision.<sup>44</sup> Here, consensus is not mentioned, thus providing the opportunity to make a decision in another way.<sup>45</sup>

The Secretary General is empowered to facilitate and monitor progress in the implementation of ASEAN agreements and decisions, and submit an annual report on the work of ASEAN to the ASEAN Summit.<sup>46</sup>

The dispute settlement mechanism provided in the ASEAN Charter is one of the important provisions too. ASEAN has, of course, long committed itself to having recourse only to peaceful means of resolving disputes. There is already a dispute settlement mechanism for ASEAN economic agreements. The Charter envisions dispute settlement mechanisms for all other agreements.<sup>47</sup> It states that where it is not otherwise specially provided, appropriate dispute settlement mechanisms, including arbitration, shall be established for disputes which concern the interpretation or application of the Charter and other ASEAN instruments.<sup>48</sup> The Secretary General shall monitor the compliance with the findings, recommendations or decisions resulting from an ASEAN dispute settlement mechanism, and submit a report to the ASEAN Summit.<sup>49</sup>

In sum, ASEAN is gradually shifting from being an organization based on political dialogue to one with an international legal personality, capable of being involved in binding commitments. A more rules-based and more formally institutionalized ASEAN

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<sup>40</sup> At the 9<sup>th</sup> ASEAN Summit in 2003, the ASEAN Leaders resolved that an ASEAN Community shall be established. At the 12<sup>th</sup> ASEAN Summit in January 2007, the Leaders affirmed that their strong commitment to accelerate the establishment of an ASEAN Community by 2015 and signed the *Cebu Declaration on the Acceleration of Establishment of an ASEAN Community by 2015*, 13 January 2007, online: ASEAN <<http://www.aseansec.org/19260.htm>>. The ASEAN Community is comprised of three pillars, namely the ASEAN Political-Security Community, ASEAN Economic Community and ASEAN Socio-Cultural Community.

<sup>41</sup> *ASEAN Charter*, *supra* note 6.

<sup>42</sup> See *ibid.*, art. 20, para. 1.

<sup>43</sup> See *ibid.*, art. 20, para. 2.

<sup>44</sup> See *ibid.*, art. 20, para. 4.

<sup>45</sup> Ali Alatas, *supra* note 19 at 20.

<sup>46</sup> See *ASEAN Charter*, *supra* note 6, art. 11, para. 2.

<sup>47</sup> Developed from Rodolfo C. Severino, "The ASEAN Charter" in Pavin Chachavalpongpun, ed., *The Road to Ratification and Implementation of the ASEAN Charter* (Singapore: ISEAS Publishing, 2009) 24 at 29.

<sup>48</sup> See *ASEAN Charter*, *supra* note 6, art. 25.

<sup>49</sup> See *ibid.*, art. 27, para. 1.

will be helpful to it fulfilling its function as the driving force of regional integration within the ASEAN+3 countries.<sup>50</sup>

#### IV. CHALLENGES AHEAD

Deeper economic integration in East Asia is inevitable. Although significant progress has been made in the region, there are still many challenges ahead.

##### A. To Harmonize Domestic Rules and Reform the Domestic Legal System

Economic integration in East Asia requires the economies not only to eliminate tariff barriers and border restrictions, but also to harmonize their domestic laws. This is important for the functioning of the regional market based on the principle of free flow of goods, services, investments, capital and skilled labor. For example, the region's local currency bond markets will play an important role in financing fiscal deficits and funding domestic companies when liquidity is not available from the global market. While improved policies and increased issuance have boosted primary bond markets, liquidity in secondary markets remains a concern. A recent survey of investors by Asian Bonds Online found that participants in both government and corporate bond markets agreed that increasing the diversity of the investor base and improving tax treatment were critical to improving liquidity in local currency bond markets.<sup>51</sup>

Commercial laws such as contract law also deserve harmonization. For example, United Nations Convention on Contracts for the International Sales of Goods ("CISG") is a world-accepted convention which contributes significantly to introducing certainty in commercial exchanges and decreasing transaction costs. Although CISG is currently accepted by 76 contracting parties, the contracting parties from the East Asian countries only consist of China, Korea, Japan and Singapore.<sup>52</sup>

A more open and integrated market in East Asia requires the economies to strengthen their governance and tighten their legal frameworks. In the area of financial regulation and supervision, the regulatory and supervisory agencies must be independent and accountable. In the area of corporate governance, the enforcement of corporate governance laws depends on more than the administrative capability of legal institutions. But in much of East Asia today, both courts and regulatory agencies are very weak. The challenge of building a true market economy thus includes the difficult task of strengthening the courts, the regulators, or both, relative to the executive and legislative branches of government. This strengthening must be accomplished in countries with little experience with either independent judges or independent regulators.<sup>53</sup>

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<sup>50</sup> *Kuala Lumpur Declaration on the ASEAN Plus Three Summit*, 12 December 2005, online: ASEAN <<http://www.aseansec.org/18036.htm>>.

<sup>51</sup> ADB, *supra* note 7 at 71-72.

<sup>52</sup> The *United Nations Convention on Contracts for the International Sale of Goods*, 1489 U.N.T.S. 3, 19 I.L.M. 668 (1980) enters into force for the contracting parties by ratification, accession, approval, acceptance or succession respectively. online: United Nations Commission on International Trade Law <[http://www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html)> (entered into force 1 January 1988).

<sup>53</sup> Yusuf, *supra* note 4 at 83.

## B. To Maintain a Proper Relationship with the Rest of the World

Since East Asian economies need the market of the world, East Asia's deeper integration should sustain an open, rules-based global system of trade and investment. However, while taking benefits from the global market and multilateral legal regime, the East Asian economies have to bear in mind the need to strengthen the region's defense against external shocks at the same time.

In the area of trade, of course, regional trade agreements ("RTA") between the East Asian WTO members should be consistent with the WTO rules. However, the shortcomings of the WTO rules also give rise to uncertainty in RTAs. For example, although the WTO members are required to notify the RTAs that they conclude, the time at which an RTA should be notified is neither precisely formulated nor homogeneously expressed in the WTO rules, and the legal texts of the relevant WTO provisions do not identify what information is to be provided.<sup>54</sup>

RTAs between third parties might generate trade barriers for East Asian economies too. The WTO World Trade Report 2003 points out that some analysis suggests that many RTAs do not offer strong evidence of trade creation, they often do not solve the problem of tariff peaks (high protection in sensitive sectors), and a significant part of trade within RTAs is non-preferential.<sup>55</sup>

The proliferation of RTAs in East Asia also brings about the phenomenon of overlapping RTAs, also known as the 'spaghetti bowl effect'. Overlapping raises a number of issues. For example, different rules originating from different RTAs create a maze of (sometimes conflicting) criteria for the granting of origin, which consequently raises the cost of administering such agreements.<sup>56</sup>

In the area of monetary and financial affairs, although the IMF's Articles of Agreement constitutes an international treaty, it is sometimes called 'soft law'<sup>57</sup>, which causes the multilateral monetary system to lack a solid foundation. The defects of the IMF were exposed in the financial crisis of 1997-98, forcing the East Asian economies to establish the CMI. The unconditional and immediate disbursement of some of the funds under the CMI swap arrangements postponed the need of countries in trouble to approach the IMF, avoiding conditionality. However, the countries that need assistance beyond the initial 10 per cent available under the bilateral swap arrangements are required to accept a linkage to IMF conditionality.<sup>58</sup> With the multilateralization of the CMI, there are discussions about the de-linking of the CMIM lending program from IMF conditionality or

<sup>54</sup> For a detailed analysis of this subject, see WTO, *Compendium of Issues Related to Regional Trade Agreements*, WTO Doc. TN/RL/W/8/Rev.1, online: WTO <<http://docsonline.wto.org/imrd/directdoc.asp?DDFDdocuments/t/tn/rl/W8R1.doc>>.

<sup>55</sup> WTO, *World Trade Report 2003* (Geneva: World Trade Organization, 2003) at 54. This report also points out that the share of intra-regional trade has not increased significantly since the 1970s.

<sup>56</sup> For a detailed discussion of this subject, see WTO Secretariat, *Regional Trade Integration under Transformation, preliminary draft prepared for the seminar on regionalism and the WTO*, 26 April 2002, para.34-36., online: WTO <[http://www.wto.org/english/tratop\\_e/region\\_e/sem\\_april02\\_e/clemens\\_boonekamp.doc](http://www.wto.org/english/tratop_e/region_e/sem_april02_e/clemens_boonekamp.doc)>

<sup>57</sup> Joseph Gold, "Strengthening the Soft International Law of Exchange Arrangements" (1983) 77 Am. J. Int'l L. 443.

<sup>58</sup> UNESCAP, *supra* note 29.

other Fund-related ‘seal of approval’.<sup>59</sup> However, it may not be realistic for the East Asian economies to reject or abandon the IMF at present. The better way for the East Asian economies is to cooperate with the IMF.

Since most East Asian economies are both members of the IMF and WTO, attention should be paid to the relationship between these two global institutions. For example, in order to safeguard its external financial position and its ability to meet its balance payments, a member could theoretically adopt exchange control on current payment or quantitative restrictions on imports. However, the rules of the IMF and WTO generally reject these measures unless certain conditions are met.<sup>60</sup>

### C. To Strengthen the Institutions and Legalization within the Region

As regional economic integration deepens, more effective and efficient institutions are increasingly needed. Regional institutions may help to consolidate gains from integration, deepen regional integration, and widen economic integration.<sup>61</sup> In a more deeply integrated regional market, there is more need for harmonized product standards and market regulations. This, in turn, requires closer coordination and monitoring of national practices. As regional integration deepens, competition across borders also becomes more intense. This widens the scope for disputes among affected parties in different countries, which creates a need for strengthened dispute settlement mechanisms. In addition, spillovers intensify as markets grow more integrated, heightening the importance of coordinating macroeconomic and financial policies. This, in turn, requires strengthened monitoring of national policies.<sup>62</sup> The drive for stronger institutions in East Asia can also increase the region’s influence at the global level. Furthermore, an efficient decision-making mechanism is needed when urgent collective action is required.

The change in ASEAN demonstrates the intention of the East Asian economies to strengthen their institutions and legalization. In fact, the commitment of the East Asian WTO members to respecting the WTO dispute settlement mechanism and the willingness of ASEAN Member States to turn to the International Court of Justice (“ICJ”) for the resolution of territorial disputes shows that sovereignty is not an insurmountable barrier to regional institution-building and legalization-strengthening.<sup>63</sup>

However, there are still some problems which need to be solved. For example, the dispute mechanism is important for the smooth operation of the regional economic arrangements. This issue becomes more complex when an economy has entered into several RTAs and each has its own dispute settlement provisions. The decision-making and surveillance mechanisms need to be strengthened too. Taking ASEAN as an example, some think that the ASEAN Charter has failed to convince its audience and constituencies

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<sup>59</sup> Domenico Lombardi, *supra* note 31 at 9.

<sup>60</sup> For a detailed discussion of this subject, see Deborah Siegel, “Legal Aspects of the IMF/WTO Relationship: The Fund’s Articles of Agreement and the WTO Agreements” (2002) 96 Am. J. Int’l L. 561.

<sup>61</sup> ADB, *supra* note 7 at 92-93.

<sup>62</sup> *Ibid.* at 11-13.

<sup>63</sup> For example, ASEAN countries have asked the ICJ to settle the disputes between Indonesia and Malaysia over Sipadan and Ligitan in 1998 and between Malaysia and Singapore over Pulau Batu Puteh in 2003. The judgments of the two cases are available at the website of ICJ, online: ICJ <<http://www.icj-cij.org>>.

that it is, in fact, an inspiring document that would help facilitate the transformation of ASEAN into a rules-based organization.<sup>64</sup>

## V. CONCLUSION

Since East Asian economic integration is conducted within the context of globalization, the East Asian economies have to design appropriate legal mechanisms to promote integration and deal with future economic crises collectively. Although significant progress has been made since the crisis of 1997-98, there is still a long way to go. The diverse economic structure and legal systems of the East Asian economies, and the absence of a politically or economically dominant country to play the leading role in regional integration, demand that specific mechanisms be designed to fit the reality of East Asian economic integration. No matter what kind of approach is adopted, there is no doubt that it is the rule of law which will ultimately safeguard East Asian economic integration.

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<sup>64</sup> Rizal Sukma, "The ASEAN Charter: Neither Bold Nor Visionary" in Pavin Chachavalpongpan, ed., *The Road to Ratification and Implementation of the ASEAN Charter* (Singapore: ISEAS Publishing, 2009) 44 at 51.