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Macroeconomic Policy and Development Division (MPDD)

Economic and Social Commission for Asia and the Pacific

United Nations Building, Rajadamnern Nok Avenue, Bangkok 10200, Thailand

Email: escap-mpdd@un.org

Director

Dr. Nagesh Kumar

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Dr. Aynul Hasan

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Financial Crisis and Regional Economic Cooperation in Asia-Pacific: Towards an Asian Economic Community?¹

by Nagesh Kumar*

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Abstract

Asia-Pacific region has emerged as the growth pole of the world economy over the past decade. However, in the aftermath of global financial crisis, sustaining the dynamism of Asia-Pacific economies would require a rebalancing in favour of greater domestic consumption and exploiting the potential of regional economic integration. This paper argues that broader regional economic integration in Asia within the Comprehensive Economic Partnership of East Asia (CEPEA) framework, proposed for the ASEAN+6 countries, could be an engine of growth for not only the participating countries but also has the potential to enhance the welfare of the rest of the world by unleashing the synergies of Asian countries for trade creation besides making the region emerge as the third pole of the world economy along side NAFTA and the EU. Furthermore, monetary and financial cooperation in the region has further possibilities of generating additional aggregate demand for sustaining their dynamism by efficiently intermediating between region's excess savings and unmet investment needs. By forming credible schemes of regional economic integration, Asia will be able to seek its due place in the global economic governance and contribute to building a more democratic and multipolar world economy. Asian economic integration by increasing the interdependence of countries in the region will also ensure peace and stability.

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* Nagesh Kumar is Chief Economist, United Nations Economic and Social Commission for Asia and the Pacific (UN-ESCAP), Bangkok, Thailand; email: nkumar@un.org; nageshkum@gmail.com

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Introduction

Regional economic integration has been adopted as a strategy for development in different regions of the world over the 1990s following the formation of single market by the European Union and of NAFTA by the North American countries. With the growing popularity of the regional economic integration worldwide, more than half of world trade is now conducted between members of regional trading arrangements (viz., on preferential basis) and not on most favored nation (MFN) basis. Asia-Pacific region has been rather slow to respond to the global trend of regionalism and in exploiting the potential of regional economic integration. For historical and geopolitical reasons, Asia-Pacific region has been better connected to the western world than with itself. Quite unexpectedly, the financial crises acting as external shocks, help in promoting the regional economic integration by highlighting the regional interdependence and vulnerability. The Asian Financial Crisis of 1997, for instance, had led to ASEAN advancing the schedule of implementation of ASEAN Free Trade Agreement and also adopt the Chiang Mai Initiative with three dialogue partners (ASEAN+3) in monetary cooperation. The global financial and economic crisis of 2008/09 has demonstrated the resilience of Asian economies such as China and India that continued growing robustly in the face of sharp contraction in the advanced economies in the west and east alike. It is now clear that growth rate of demand for the goods and services of Asia-Pacific region in western countries may not recover to pre-crisis levels as they try to restrain the debt fuelled consumption to unwind the global imbalances (ESCAP 2010). Therefore, Asia-Pacific countries will have to find new sources of aggregate demand to sustain their dynamism through expanding domestic consumption or regional demand. Hence, regional economic integration is likely to occupy a much more important place in the regional policy agenda in the coming years than before. Furthermore, this paper argues that the current phase of regional economic cooperation and integration is likely to be broader and more comprehensive in terms of coverage as countries in the region discover regional sources of demand and supply of resources. The deeper regional economic integration will enable the region to play its due role in the global economic governance and will make it an anchor of peace and shared prosperity in the world economy.

Impetus for Regional Economic Cooperation in Asia

The East Asian Crisis of 1997 highlighted the economic interdependence of the affected countries and thus underlined the importance of regional economic cooperation. The ASEAN countries expedited the programme of implementation of ASEAN Free Trade Area (AFTA) from 2008 to 2002 and moved on to further deepen the economic integration. The crisis also led to Chiang-Mai Initiative for monetary cooperation which involves ASEAN+3 (Japan, China, and South Korea) countries. A more important stimulus for regionalism seems to have come from the emergence of Asia as the centre of final demand. With the emergence of large populous economies viz. China and India as powerful growth poles of the world economy, Asia is quickly becoming the centre of gravity of the world economy. For many products from mobile phones to motor cars to jet planes, the biggest markets of the world are

now in Asia rather than in the west. As a result more than 55 per cent of Asia's trade is now intra-regional thus making regional economic integration as an increasingly viable development strategy. Global investment banks such as Goldman Sachs are projecting China and India to emerge as the two largest economies in the world by 2050, a forecast that may be realized sooner in the post-crisis scenario with the uncertain and fragile recovery of advanced economies.¹ The booming intra-regional trade is suggestive of the complementarity or synergies that have developed between economic structures of the Asian economies. Regional economic integration could help in their exploitation for mutual benefit. Although regional production networks have begun to be developed across Asia to exploit the synergies through vertical specialization, regional economic integration could help in expanding such opportunities and exploiting the potential of such rationalization or restructuring more fully. The slow progress of the multilateral trade negotiations and its inability to live up to the expectations of Asian countries has also contributed to the importance attached to regionalism by them.

Finally, as observed earlier, in the aftermath of global financial crisis, the Asia-Pacific countries may be forced to look inwards and seek to exploit the potential of regional economic integration as a return to business as usual is rendered increasingly difficult by the compulsions of restraining debt fuelled consumption in the western countries as a part of unwinding global imbalances (ESCAP 2010, 2011).

Emerging Patterns of Regional Economic Integration in Asia and the case for broader Arrangement

Asian developing countries have made a number of attempts at regional economic cooperation in the 1970s promoted by the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP). These include the Bangkok Agreement established in 1975 which covered reciprocal tariff concessions between five member States, namely Bangladesh, India, Lao People's Democratic Republic (PDR), Republic of Korea and Sri Lanka. In 2000, China also joined the Bangkok Agreement. The Asian Clearing Union with seven members in the region (Bangladesh, India, Iran, Myanmar, Nepal, Pakistan and Sri Lanka) came into being in 1974. The expectations for these early initiatives have not been fully met for various reasons. For instance, the Bangkok Agreement (now known as Asia-Pacific Trade Agreement, APTA) has suffered from its limited membership and product coverage given its positive list approach to liberalization, shallow preference margins and lack of coverage of non-tariff barriers. The bulk of preferential trade under the Agreement comprises China-India trade which does not enjoy any other preferential arrangement.

Although set up in 1967, Association of Southeast Asian Nations (ASEAN) had limited cooperation in economic areas until the ASEAN Free Trade Agreement (AFTA) was signed in 1992. Similarly, South Asian Association for Regional Cooperation (SAARC) came into being in 1985 but did not adopt a programme of economic cooperation until 1991 when the Committee on Economic Cooperation (CEC) was formed. It created a SAARC Preferential Trading Agreement (SAPTA) in 1995 and in 2004 eventually agreed to create a SAARC Free Trade Area (SAFTA) to be implemented over 10 years from 2006. At the Summit held in Bhutan in 2010, it adopted a SAARC Agreement on Trade in Services (SATIS) and established the SAARC Development Fund. Besides SAARC agreements,

¹ See Wilson and Purushothaman (2003).

bilateral preferential trading arrangements between India and Nepal, India and Bhutan, and between India and Sri Lanka have also contributed to economic integration in the South Asian subregion. Another notable initiative in Asia is the Bay of Bengal Initiative for Multisectoral Techno Economic Cooperation (BIMSTEC) involving five South Asian (Bangladesh, Bhutan, India, Nepal, and Sri Lanka) and two South-East Asian (Myanmar and Thailand) nations, bridging the two subregions. BIMSTEC adopted a Framework Agreement for an FTA to be implemented within 10 years at its first summit held in Bangkok in July 2004. Initiatives in other sub-regions of the Asia-Pacific region include the Economic Cooperation Organization (ECO) initially formed with Turkey, Iran and Pakistan as members in 1985 but later expanding its membership to cover Afghanistan and six Central Asian countries viz. Azerbaijan, Kazakhstan, Kyrgyzstan, Turkmenistan, Uzbekistan, Tajikistan. ECO has established the ECO Trade Agreement (ECOTA) in 2003. Pacific Islands Forum (PIF) was set up as the South Pacific Forum in 1971 and has 16 member states including Australia and New Zealand and 14 independent Pacific Island states. Twelve members of PIF have also signed the Pacific Island Countries Trade Agreement (PICTA) in 2006 created within the framework of Pacific Agreement for Closer Economic Relations (PACER) signed in 2001.

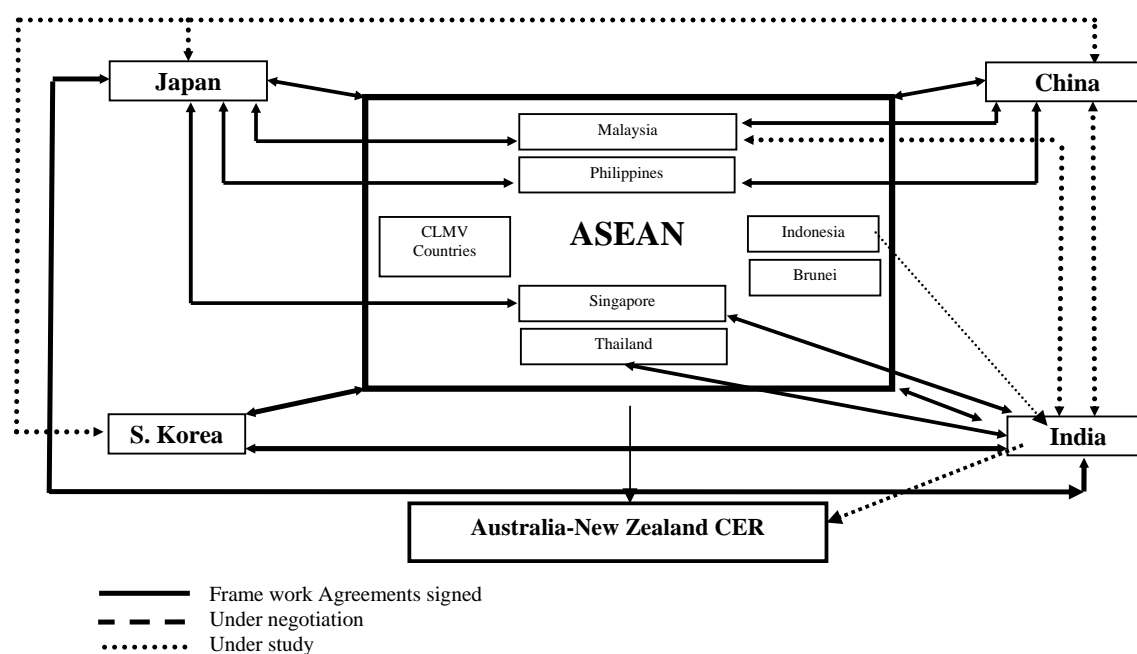
In the context of broader cooperation that brings countries from different sub-regions together, ASEAN's initiatives are exemplary. In the wake of the East Asian crisis of 1997-98 ASEAN countries expedited the programme of implementation of AFTA from 2008 to 2002 and moved on to deepen economic integration further to an ASEAN Economic Community by 2020, a goal that was later expedited to 2015. The crisis also led to the launch of several regional initiatives such as the Chiang Mai Initiative (CMI) in the area of monetary cooperation which involves ASEAN together with China, Japan and Republic of Korea – the ASEAN+3 countries. In addition, ASEAN's policy of engaging key Asian countries as dialogue partners has provided much needed cohesion in the Asian region as is clear from the numerous schemes for regional and bilateral free trade arrangements that are at different levels of implementation. China, India, Japan, Republic of Korea, Australia and New Zealand have all negotiated FTAs (the so-called '+1 FTAs') with ASEAN and are also engaging each other. It is also leading to more inclusive broader groupings. An important initiative was the launch of the East Asia Summit (EAS) in December 2005 in Kuala Lumpur, Malaysia, as an annual forum participated by ASEAN and all its dialogue partners. Bringing together 16 of the largest and fastest growing economies in an annual Summit level dialogue, EAS was widely expected to pave the way for broader regional arrangement in Asia that could be the third pole of the world economy.

To sum up, major initiatives towards regional economic integration led by ASEAN include the following:

- Subregional attempts such as those by ASEAN to form FTA and further deepen economic integration to the ASEAN Community;
- FTAs or comprehensive partnership arrangements between ASEAN and its dialogue partners, namely China, India, Japan and Republic of Korea; and also between ASEAN and CER (Australia-New Zealand)—or the +1 FTAs;
- FTAs or comprehensive arrangements between individual ASEAN countries and ASEAN dialogue partners, for example Japan-Singapore, India-Singapore and India-Thailand; and
- FTAs or comprehensive arrangements between the dialogue partners themselves, such as India-Japan, India-Republic of Korea already signed and Japan-China-Republic of Korea (JCK), and India-China (under study).

From this complex web of free trade arrangements linking the ASEAN and its dialogue partner countries, a virtual Asian or East Asian economic community is emerging (Figure 1).² It has been argued however that the sub-regional or bilateral attempts at regional co-operation such as these while desirable are unlikely to exploit the full potential of the regional economic integration in Asia and hence are sub-optima.³ This is because the extent of complementarities are limited at the sub-regional levels because of similar factor endowments and economic structures within an immediate neighbourhood as is clear from low proportions of intra-subregional trade such as within ASEAN or SAARC. At the broader Asian level, on the other hand, the diversities in the levels of economic development and capabilities are quite wide thus providing for more extensive and mutually beneficial linkages. Recent quantitative analysis at ESCAP shows that complementarities between sub-regions are greater than within the sub-regions.⁴ Secondly, the bilateral arrangements do not provide a seamless market because of different scopes and coverage and rules applicable to different FTAs producing an Asian noodle bowl syndrome and increasing transaction costs for businesses.

Figure 1. An Emerging Virtual Asian Community



Note: The CLMV countries are Cambodia, Lao PDR, Myanmar and Viet Nam.

Source: the author

As one observer has pointed out, without some form of overall regional framework within which to work, capital, human and natural resources may all be deployed at less than their optimal values (Rowley 2004). Hence, a case has been made of a broader regional arrangement coalescing various bilateral FTAs between Japan, ASEAN, China, India and South Korea (JACIK) countries that will facilitate the optimal utilization of Asia's resources

² See for more details, Kumar (2005).

³ See *ibid.*

⁴ See ESCAP (2011) for evidence.

and synergies for the benefit of all countries (Kumar 2004; Kumar, Kesavapany and Yao 2008). The Prime Minister of India, Dr. Manmohan Singh, has made a case for an Asian Economic Community (AEC) combining, to begin with, ASEAN countries, China, India, Japan and Republic of Korea as an 'arc of advantage' across which there would be a large-scale movement of people, capital, ideas and creativity, thereby creating a community that would release enormous creative energies. Recognizing the need for deepening regional economic integration in the aftermath of the financial crisis, other leaders of the region have also articulated their own visions of broader pan-Asian economic communities at the Fourth East Asia Summit held in Hua Hin in October 2009, where the Philippines made a case for 'Asian economic cooperation including through the possible establishment of an economic community of Asia'. Japan made a case 'to reinvigorate the discussion towards building, in the long run, an East Asian community based on the principle of openness, transparency and inclusiveness and functional cooperation' and Australia proposed to build an 'Asia Pacific community in which ASEAN will be at its core'.⁵ The leaders' perceptions about the relevance of broader integration are widely shared as revealed by a survey conducted by the World Economic Forum and Taylor Nelson Sofres revealed that over 37 percent of New Asian Leaders (NALs) view an extended Asia, comprising ASEAN, China, India, Japan and Republic of Korea, as the most desirable model of economic integration, with only 26.8 percent preferring Asean+3 (WEF 2003).⁶

As EAS brings together all the JACIK countries as well as Australia and New Zealand, a start can be made on broader regional integration in the EAS forum. The Second EAS held in Cebu, Philippines, on 15 January 2007 endorsed the preparation of the track-II feasibility study of a Comprehensive Economic Partnership of East Asia (CEPEA) involving ASEAN+6 countries. The Fourth East Asia Summit held in Hua Hin, Thailand in October 2009 adopted the final report of the CEPEA Study Group set up as a follow up of the Cebu Session in 2007. The CEPEA Study Group finds a fruitful case for deeper regional integration in EAS region involving three pillars of liberalization, facilitation and cooperation implemented in parallel (CEPEA Study Group 2009). The leaders agreed to a consideration by the senior officials, the CEPEA proposal along with an East Asia FTA (EAFTA) combining ASEAN+3 countries in parallel.

Combining sixteen of the largest and fastest-growing economies of Asia-Pacific with significant complementarities, the CEPEA grouping is a potential third pole of the world economy. The grouping has a population of 3.2 billion people or a half the world's population (see Table 1). In terms of purchasing power parity (PPP), the CEPEA will have a combined gross national income exceeding US\$ 20 trillion accounting for nearly 30 percent of the global income is much larger than either NAFTA or the EU. EAS's exports will equal US\$ 3.3 trillion compared with US\$ 1.6 trillion from NAFTA. The combined official reserves of the CEPEA economies, at US\$ 4 trillion in 2008 (and over \$ 5 trillion now), are much larger than those of the United States of America and the EU combined. Clearly, the region would have sufficiently large market and financial resources to support and sustain expedited development. With both China and India together in one grouping, CEPEA would have been way ahead of its western counterparts in terms of dynamism and would quickly emerge as a growth pole of the world economy.

⁵ See Chairman's Statement, Fourth East Asia Summit, Hua Hin, October 2009, available at www.asean.org.

⁶ The survey took place at the World Economic Forum's New Asian Leaders (NALs) Retreat held at Seoul in June 2003, covering all participants and invitees and other Asia-based Global Leaders for Tomorrow,

Table 1: Proposed East Asian Community in relation to the EU and NAFTA in 2008
(US\$ billions)

Indicator	EU(27)	NAFTA	CEPEA(16)
Gross national income (PPP) (per cent of world total)	15155 (21.88)	17041 (24.60)	20699 (29.89)
GDP (per cent of world total)	18328 (30.27)	16683 (27.55)	13943 (23.02)
Exports (per cent of world total)	4584 (37.05)	1603 (12.95)	3324 (26.86)
International reserves (per cent of world total)	494 (7.17)	205 (2.98)	3934 (56.98)
Population (millions) (per cent of world total)	496 (7.42)	444 (6.63)	3240 (48.39)

Note: CEPEA(16): ASEAN(10), Japan, China, India, RoK, Australia and New Zealand

Source: Author based on World Bank, *World Development Indicators Online* (accessed 20 Sept. 2010); International Monetary Fund (IMF), *Direction of Trade Statistics 2010* (CD-ROM)

Therefore, CEPEA has the potential to create a regional grouping that could be comparable in size with NAFTA and the EU but much more important in terms of its dynamism and hence constituting a third pole of the world economy. Besides the potential welfare gains accruing from economic integration exploiting the synergies, such a grouping would help Asia play its due role in global economic governance commensurate with its increasing economic weight (see Kumar et al 2008). CEPEA could be a good stepping stone for building a broader and more inclusive Asian economic community in due course.

Gains from broader economic integration

A number of recent studies have found considerable evidence of complementarities between Asian countries in their production and trade structures (Kumar, 2004, Kumar et al. 2008). Using the Global Trade Analysis Project database (GTAP 6) with the World Bank's LINKAGE model, an ADB study (Brooks, Roland-Holst and Fan Zhai, 2005) generated projections of income and trade to 2025 under different scenarios to examine the relative impact of regional integration vis-à-vis global trade liberalization. The findings suggest that regional trade and integration could offer Asia great potential for rapid and sustained growth. The ADB study also finds that much of Asia's gains from global trade liberalization could be realized by a regional initiative alone. Significantly, it finds that the combined gains from removing tariff and structural barriers to Asian trade far outweigh those from global tariff abolition. Hence, regionalism should have a very high priority for Asia. Furthermore, the ADB study suggests that regional integration would promote Asian economic convergence, raising average growth rates and benefiting poorer countries. In particular, greater regional integration would propagate commercial linkages and transfer the stimulus of Asia's rapid-growth economies, particularly China and India, to their lower income neighbours. A more recent ADBI study has also reported substantial potential welfare gains of upto US\$ 284 billion from regional economic integration in EAS or ASEAN+6 framework which are in tune with previous studies and larger than any alternatives.⁷

⁷ see Kumar (2007) for a review of simulation studies; CEPEA report.

Strengths, weaknesses, opportunities and threats of a broader Asian economic community

A SWOT analysis of the proposed Asian economic community as outlined above suggests a number of strengths and opportunities but also some weaknesses and threats. The **strengths** arise from a range of profound complementarities among the EAS members as some economies endowed with natural resource bases (e.g. Australia) while others large importers of them; some dominated by manufacturing (as China, Japan, Republic of Korea) and others dominated by services such as India and the Philippines. The group has some of the fastest growing economies of the world viz., China and India and some of the largest economies viz. Japan, China and India. There are net exporters such as China, Japan, RoK and most of the ASEAN countries but also net importers like India. Collectively, they are endowed with large human and financial resources besides natural resource endowments. As observed earlier, a number of simulation studies have been confirmed substantial welfare gains for the participating countries resulting from CEPEA to be much larger than alternatives. Furthermore all the six dialogue partners have concluded their FTAs with ASEAN and some of the dialogue partners have also concluded bilateral FTAs between themselves viz. India-Republic of Korea and India-Japan. These FTAs, together with AFTA provide a valuable foundation to build upon for a broader regional grouping in Asia-Pacific with EAS members as the core. Many Asia-Pacific countries share centuries old civilizational and cultural links and enjoyed vibrant intraregional trade in the pre-colonial times.⁸

The **opportunities** arise from the fact that Asia-Pacific countries will need to rebalance their economies in favour of greater domestic and regional consumption as the western sources of aggregate demand decline in an effort to unwind the global imbalances in the aftermath of the global financial crisis. The other opportunity arises from the public opinion in support of regionalism as evident from the statements of different leaders as well as perception surveys as observed earlier. The slow progress in the Doha Round of multilateral trade negotiations spurs the trade negotiators for working on the regional arrangements. Furthermore, a broader arrangement between CEPEA members would reduce the transaction costs for the businesses of the region caused by the noodle bowl syndrome and would facilitate efficiency-seeking industrial restructuring in the region. Furthermore, regional economic integration bringing developed and developing countries in a single arrangement could help in narrowing development gaps by facilitating building of productive capacities in poorer economies through industrial restructuring.

The **weaknesses** and **threats** arise from the perceived lack of a strong political will and leadership for driving the agenda of broader grouping. ASEAN has been the driving force for the process. But ASEAN's first priority, understandably is to complete the ASEAN Community building process. Broader integration agenda also gets slowed down for the lack of coherence between the members as a few members prefer a less inclusive EAFTA which is vehemently opposed by some others. This is despite the fact that a more inclusive arrangement has a greater viability given the range of synergies and more beneficial welfare effects. Some bilateral political sensitivities between a few countries also tend to slow down the progress. However, one may argue that a broader grouping would help to diffuse the bilateral tensions and sensitivities. Lack of regional institutions, deeper financial markets, well developed transport connectivity are other weaknesses.

⁸ See Sen (2007), Shankar (2004), and Frost (2008), among others.

On the balance, Asian economic community agenda, the favourable factors tend to overwhelm the negatives. In any case the political differences between Asian countries may not be as strong as they were between European countries before they moved towards the agenda of European economic integration. The European leaders were able to see the value that integration brought to all the members and agreed to put aside the differences and moved ahead. Hopefully the Asian leaders will also see the compulsions of deepening and broadening their economic integration especially in the post-crisis period and will begin to push the agenda.

Priority Areas for Cooperation under Asian economic community

The discussion above has shown that CEPEA would enhance welfare significantly not only for participating countries but also for the rest of the world with possibilities of trade creation. There are a number of other areas where regional cooperation could be fruitful such as in strengthening connectivity, financial architecture, energy security and science and technology, among others. A few key priorities are summarized, as follows.

A framework for balanced and equitable integration: CEPEA-An RTA with a difference?

The track-II CEPEA study has envisaged CEPEA to have three pillars of liberalization, facilitation and economic cooperation as a part of a single undertaking to make it a balanced framework. CEPEA should target to liberalize regional trade and investment regimes in a phased manner by 2020 with provisions for safeguards for sensitive products, special and differential treatment for countries at different levels of development and dispute resolution. Care must be taken in designing the programmes of regional economic integration in such a manner that they keep equity, employment generation and necessary social transformation and social safety nets for the vulnerable sections of the society and balanced regional development at their heart so that it represents regionalism with an 'Asian Face'. Therefore, economic cooperation with the objective of narrowing the development gaps between countries and regions has to be an integral part of the scheme of regional economic integration. The economic cooperation could cover creation of structural funds based on contributions by the member countries on the basis of capacity to pay. These funds should provide economic assistance to lagging regions within the member countries for capacity building, infrastructure development, assisting underprivileged sections of population and in adjustment with trade liberalization, improvement of connectivity and enterprise-level technological capability development. By balancing the interests of efficiency and equity, the Asian arrangement could well emerge as a role model for trade liberalization in multilateral as well as regional contexts in the whole world.

Strengthened physical connectivity and transport, energy networks

Integration of markets would not be effective unless accompanied by stronger physical connectivity and other networks such energy grids, ICT connectivity etc. and transit facilitation. Thus far, for historical, political and topographical reasons, the region has been better connected with Europe and North America than it has been with itself. Over time the region has improved its highway and railway networks, but it cannot use the infrastructure effectively without the legal and regulatory framework for vehicles, goods, and people to move across borders and transit countries. Currently, many international movements are hindered by slow and costly processes, formalities and procedures. The cost of red tape is

considerable and often wipes out the benefits of tariff reductions enacted over the past two decades. In future the region will need an integrated, multimodal transport system. For this purpose, it can, for example, build intermodal transfer points, also known as dry ports, where goods, containers or vehicles can be transhipped using the most efficient mode of transport – along with facilities for product grading, packaging, inspections and the processing of trade documentation. The areas surrounding dry ports can then emerge as growth poles, bringing new investment and employment opportunities to impoverished hinterlands while reducing the pressure on coastal areas. UN-ESCAP's work has resulted into signing of Intergovernmental Agreements on Asian Highway and Trans-Asian Railway. These networks when completed along with a regional network of dry ports, which is in progress, would assist in strengthening the physical connectivity in a substantial manner. Similarly, the region needs to strengthen the network of pipelines to transport hydrocarbons from major production centres in the region to major consumption centres, among other initiatives, to boost energy security.⁹

A more developed regional financial architecture

Combined foreign exchange reserves of CEPEA countries now add up to over US\$ 5 trillion and comprise the bulk of such reserves in the world. It has been argued that because of a lack of a regional framework for their deployment in Asia, these funds have been invested in low yielding US treasury bonds and are able to contribute to the Asian development more meaningfully. This is matched by a substantial deficit for investments in Asia with infrastructure development needs of underdeveloped parts of Asia running into USD 800 billion per year for the next decade, as per recent estimates.¹⁰ India alone has requirement of US\$ 1000 billion for infrastructure development over the five years, as per its 12th Five Year Plan.

The objective of the financial cooperation in Asia should be to leverage the combined strength of foreign exchange reserves of region's countries for their mutual benefit. There is a growing consensus that Asia needs a regional institution for mobilizing its foreign exchange resources for its own development besides for achieving stability of real effective exchange rates and for an orderly response to external shocks. Even conservative commentators like Martin Wolf now acknowledge the importance of Asia to have its own regional monetary and financial institutions.¹¹ Studies have shown that there is growing macroeconomic interdependence between Japan, Korea and ASEAN. Such interdependence is likely to include China and India, besides Australia and New Zealand with ongoing reforms, liberalization and growing intraregional trade and investments.¹²

A number of important initiatives have been taken in the area of monetary and financial cooperation in Asia over the past decade including the Chiang-Mai Initiative (CMI) and development of Asian bond markets.¹³ However, these initiatives need to be deepened and scaled up and broadened to cover all systemically important countries in the region to be effective.¹⁴ Asia also needs relative stability of exchange rates to facilitate its growing intra-regional trade which has approached nearly 55 per cent of Asia's trade. One area of

⁹ See Tuli (2008).

¹⁰ See ADB/ADB (2009).

¹¹ See Wolf (2004), among many others.

¹² See Kawai (2004); also see Saksena (2003)

¹³ See rajan (2008).

¹⁴ See ESCAP (2011: chapter 3).

cooperation is creation of a regional unit of account viz. Asian Currency Unit (ACU) that could bring about a relative stability of intra-regional exchange rates. In due course the ACU could begin to emerge as a parallel currency.

There is also a growing consensus that a more ambitious attempt needs to be made towards regional financial cooperation to provide institutional intermediation between region's growing foreign exchange reserves and its unmet infrastructure financing needs. Datuk Seri Abdullah Ahmad Badawi, Prime Minister of Malaysia has suggested that Asian countries could use "a fraction" of their massive foreign exchange reserves as capital for a fund, which would invest in basic economic infrastructure including super highways and super railways linking and binding the East Asian community. Asia has the resources to set up a regional mechanism with a large capital base which would enable it to undertake funding of infrastructure development without putting pressure on the Government budgets in the member countries.¹⁵ Integration of capital markets to enable companies to list themselves and raise capital across the borders in other countries in the region is another key priority.

As mandated by the member-states, ESCAP is elaborating on the elements of a regional financial architecture that would facilitate recycling of the region's savings to region's investment needs.

Global Governance

Regional economic integration is also likely to strengthen Asia's role in global economic governance. Although Asian countries hold two thirds of the world's foreign exchange reserves, decision-making in Bretton Woods institutions, for instance, is dominated by western countries. By forming credible schemes of regional economic integration, Asia will be able to seek its due place in global economic governance and contribute to building a more democratic and multipolar world economy. Asian economic integration, by increasing the interdependence of countries in the region, could also ensure peace and stability as Prime Minister Manmohan Singh of India has argued.

Roadmap for progressive deepening of regional economic integration towards an Asian economic community

Economic community represents a stage of deeper economic integration. The vision of forming an economic community should be achieved in a progressive manner over the next 15-20 years period with successive deepening of the integration. The stages involve completion of a free trade agreement as included in CEPEA over the 5-8 years, and to move further to build a customs union within 10 years. The next stage is to build a common market allowing free movement of factors of production, say by 2025 and finally to the economic community which involves macroeconomic policy coordination by 2030. Usually the most critical stage is FTA as it involves detailed negotiations and have to encounter various sensitivities and vested interests. Once an FTA has been agreed to and implemented, movement to other stages becomes smoother partly because business restructuring across the region to take advantage of the FTA provisions begins to create an integrated market. Hence, expediting the CEPEA implementation is the key to formation of economic community along with supportive infrastructure development and trade and transport facilitation. In that context, one way of jumpstarting the formation of a broader regional trade arrangement would

¹⁵ See ESCAP (2011). Also Agarwala and De (2008).

be for the six dialogue partners to multilateralize their ASEAN+1 FTAs for all the ASEAN+6 countries, subject to some safeguards as may be considered important by countries. Once all these FTAs have been multilateralized, it will be easier to harmonize rules and regulations including agreeing to new cumulative rules of origin, and adopt a single broader agreement that could even be opened for accession by other countries in the Asia-Pacific region.

Concluding Remarks

Broader regional economic integration in Asia within CEPEA framework could be an engine of growth for not only the participating countries but also has the potential to enhance the welfare of the rest of the world by unleashing the synergies of Asian countries for trade creation especially in the context of global financial crisis. The participating countries need to deepen their ongoing cooperation further and cooperate in shaping CEPEA towards creation of an integrated or seamless Asian market as a stepping stone of an even broader Asian economic community which could emerge as the third pole of the world economy along side NAFTA and the EU. The integration of markets needs to be complemented by strengthened physical connectivity and transport facilitation across the region. Development of the regional financial architecture to leverage region's substantial foreign exchange reserves for mutual benefit present further opportunities of generating additional aggregate demand by efficiently intermediating between region's excess savings and unmet infrastructure investment needs. By forming credible schemes of regional economic integration, Asia will be able to seek its due place in the global economic governance and contribute to building a more democratic and multipolar world economy. Asian economic integration by increasing the interdependence of countries in the region will also ensure peace and stability.

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