

# **Perspectives on Asian Regional Cooperation and Integration \***

**ADB-ITD Seminar on Asian Trade and  
Investment Integration and Implications  
for Thailand**

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\* The views expressed here are those of the author and do not necessarily reflect the views of the Asian Development Bank (ADB) or ADB's Board of Governors or the countries they represent.



## **Contents:**

- Snapshot of Asia's Economy—now; and 2020
- European benchmarks for Asian Integration: Sequencing, style, scope, and speed
- Next Steps in Asian Integration
- Conclusion



## **Asia's importance to the global economy continues to increase...**

- Asia today—60% of global population, 40% of world output, and 30% of total trade
- Fastest economic growth in the world for past five decades
- Huge gains in poverty reduction and living standards
- China and India—with over a billion people each—now major part of Asia's economic success story
- Asia's contribution to global economy to increase next few decades
- By 2020, most large Asian economies graduated to middle income status

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## **Regional economic cooperation and integration is key to Asia's future development strategy**

- Pragmatic institutions and policies key components of success
- Outward-oriented, open approach to global economy behind Asia's dramatic economic success
- To reach middle income status and beyond, regional-level initiatives increasingly complement national level policies, helping drive Asia's global engagement
- For Asia's future economic development strategy, regional cooperation and integration must be addressed systematically
- Natural for Asia to look upon Europe as global benchmark on regional integration—both for what went right and what didn't

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## Economic integration is already increasing in importance

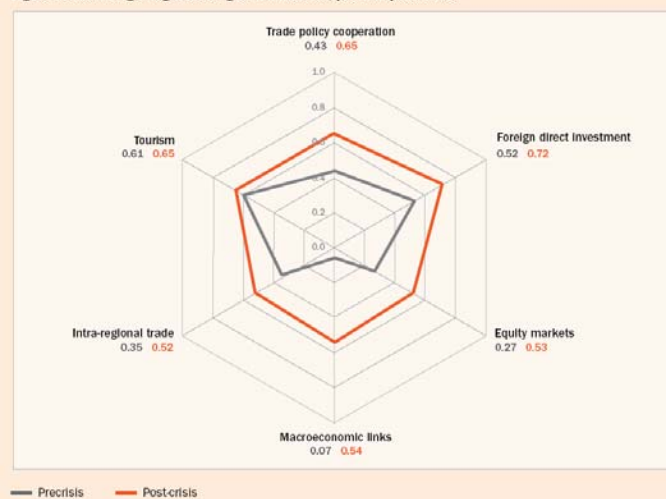
- Asian integration is rapid, broad, and with global links
- Asian Financial Crisis of 1997/98 was a watershed
- Cooperation is accelerating, but needs more focus
- Asian regionalism will be distinctive: outward-oriented, multi-speed, multi-track, and pragmatic
- Regionalism is good for Asia, good for the world

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## All indicators of integration are rising

Figure 2. Advancing Integration: regional indicators, pre- and post-crisis



### 6 Indicators

- Foreign Direct Investment
- Equity Markets Correlation
- GDP Correlation
- Intraregional Trade
- People-to-people exchange (tourism)
- Trade Policy FTA

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## Asia needs to address the four “S”s—the format for achieving regional integration

- **Sequence:** Which to integrate first—trade, money, or finance?
- **Style:** How institution-intensive should Asia’s integration be?
- **Scope:** How much to integrate—across sectors, across countries, across subregions?
- **Speed:** How fast should Asia integrate? How to manage the pace of Asian economic integration?
- What are the lessons from Europe? What should Asia emulate? What should Asia avoid?

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## Asia’s sequence will be different from Europe’s (1)

- European integration—trade integration first and monetary and financial integration afterward
  - necessitated by high trade intensity within Europe and widespread capital controls until late-1980s
- Today, trade barriers globally and within Asia—especially East Asia—are far less than when Europe started
- Capital controls are also much less, and will continue to be liberalized over the coming years

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## **Asia's sequence will be different from Europe's (2)**

- Freer capital flows means financial integration will proceed in tandem with trade, not afterward as in Europe
- Also, given general lack of appetite as well as compelling preconditions, Asia may have to proceed slower on monetary integration than Europe

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## **Style less institution-intensive than Europe**

- Political support/commitment for Asia integration less than Europe
- Cultural, social, and political diversity makes it difficult to "sell" supranational institutions that override national sovereignty
- Buying political support in Asia for economic integration through publicly-funded expenditure programs (as was done in Europe) is fraught with difficulties
- Asia likely to benefit more from an "open method" of cooperation and coordination instead of European "community method"

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## **Asia may also follow a bottom up, subregional approach to integration**

- Diverse economic development in Asia much more than in Europe at start of its regional integration process
- Appetite for regional integration in Asia varies widely across subregions as well as among countries within subregions
- Regional integration most advanced in East Asia—much less in subregions such as South Asia or Central Asia
- Even in East Asia, trade integration is far along while monetary and financial integration is just beginning
- Most practical for Asian integration—a multi-track, multi-speed approach firmly anchored on subregional integration
- Over time, subregional integration could form the building blocks for pan-Asian integration

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## **Speed of integration will thus vary across subregions—and by integration track**

- In East Asia, while trade integration is likely to accelerate, monetary and financial integration will likely proceed much more modestly
- Even within East Asia, ASEAN integration would perhaps proceed faster on almost all tracks
- Monetary and financial integration in East Asia will likely hinge on how Japan, the PRC, and Rep. of Korea push the agenda
- Outside East Asia, regional integration is likely to proceed at a much slower pace, with South Asian countries focusing mainly on improving cross-border connectivity and enhancing the still low degree of trade integration
- Overall, Asia is likely to witness a multi-speed and multi-track integration process built on subregional initiatives

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## On trade, ASEAN could be the driving force for Asian integration

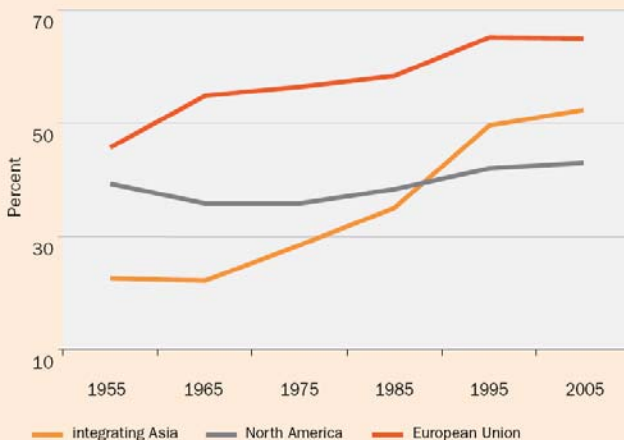
- Anchored on AFTA and the AEC, ASEAN could form the hub for Asian trade integration
- Already plays important role via FTA arrangements with a number of countries—for example, Japan, Republic of Korea, PRC, and India
- Future trade integration in Asia is likely to evolve around the multiple agreements under ASEAN, ASEAN+3, and East Asia Summit processes
- Core lies with ASEAN as “driving force” of Asian integration, with ASEAN+3 as “main vehicle” for eventual Asian economic community. EAS remains “integral part of the overall evolving regional architecture”
- Immediate challenge, of course, is to design and implement various FTAs with the aim to ultimately achieve regional trade integration without building a “Fortress Asia”
- How wide should Asian trade integration go? APEC? Others? Debate currently open-ended

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## Asia's trade integration is comparable to Europe, North America

Figure 1. Increasing intraregional trade



Intraregional trade is increasing fast  
Higher than Europe's at its early stages

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## **Integrating financial markets is another key challenge (1)**

- Asia's financial systems/markets have not kept pace with impressive economic growth and poverty reduction—the gap needs to be closed to reach middle income status
- Robust financial markets, especially capital markets, require significant national-level reforms and restructuring—a process begun since the 1997-98 crisis
- With several small individual economies, however, regional-level initiatives to build integrated financial markets would also be increasingly important
- Going forward, there is a need to consolidate regional financial market initiatives under the various regional forums—ASEAN, ASEAN+3, EMEAP, and APEC

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## **Integrating financial markets is another key challenge (2)**

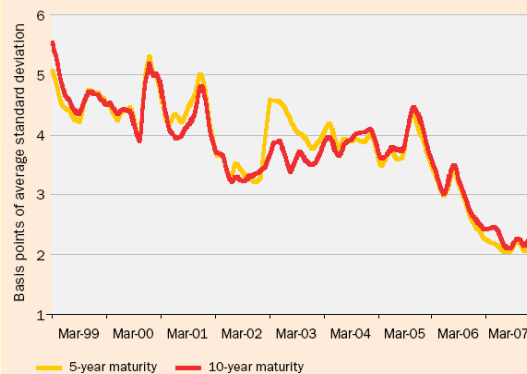
- ASEAN+3 could lead financial integration initiatives
- Australia and New Zealand—as developed countries with small but robust financial markets—and India with its experience in financial market development, could play important complementary roles
- A strong Asian regional financial market could help structure a better balanced global financial system, which relies heavily on US and European markets for intermediating global savings and investments
- How to build an integrated Asian financial market with minimum supranational institutions and maximum national freedom in policy making remains a significant challenge

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## Financial integration is less advanced, but under way: Price indicators

**Figure 6. Converging bond yields**  
(standard deviation of cross-market bond-yield spread differentials)



Notes: Average standard deviation (61-day) of government bond yield spreads of 10 Asian currencies (for which data are available) over the dollar. The currencies are the yuan, Hong Kong dollar, rupiah, yen, won, ringgit, peso, Singapore dollar, New Taiwan dollar, and baht. Source: Data from Bloomberg. Available at <http://www.bloomberg.com>.

Improving efficiency of Asian financial markets since the crisis

Close links to global markets

Recycling of Asian savings into Asian investment

Development of global financial centers in Asia

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## Monetary integration to take longest (1)

- Rising trade within Asia and deepening macroeconomic interdependence within East Asia make intraregional exchange rate stability necessary
- Yet, progress in monetary integration is likely to be much more gradual than trade and financial integration—lack of anchor currency (unlike German mark in Europe)
- Moreover, as monetary integration tends to be institution-intensive—it requires policy autonomy—mustering political support is much more difficult
- Given these constraints, one option is for a small group of countries, say, among ASEAN or ASEAN+3, to anchor their exchange rate policies on some version of a common basket of currencies

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## Monetary integration to take longest (2)

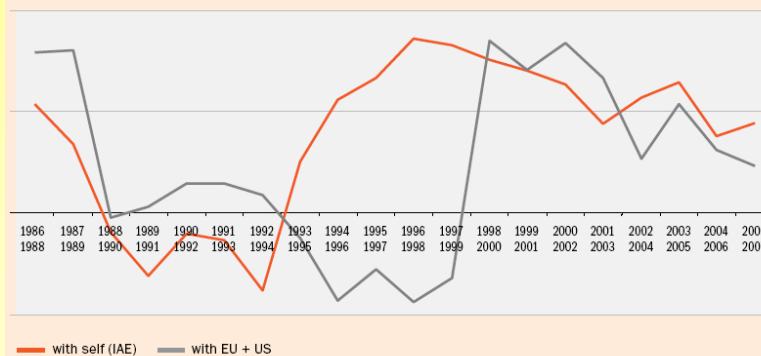
- With sufficient experience in running such an exchange rate system, and if the system appeals to others, more countries could join, paving the way for a region-wide basket currency regime
- Building upon the Chiang Mai Initiative, an augmented regional reserve pooling system and better regional economic surveillance would augment the drive for intraregional exchange rate stability
- Even modest initiatives at monetary integration would require significant institution building at the regional level

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## Macroeconomic interdependence deepening

**Figure 7. Increasing intra-regional links: output correlation**  
(detrended quarterly GDP growth correlation of the IAEs with itself and with the EU + US)

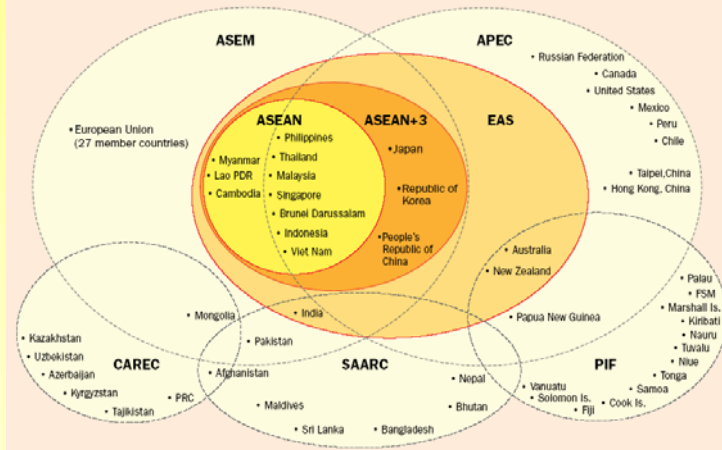


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## Regional and transregional forums

Figure 10. Economic architecture: regional and transregional forums



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## A Partnership for shared prosperity

- **Asian economies in the long-run are likely to have**
  - a single market
  - deep, liquid and integrated financial markets
  - effective macroeconomic policy coordination
  - workers moving much more freely than today
  - collective efforts to address social issues
  - stronger voice in global policy forums
  - more regional institutions

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## In Conclusion

- Asian economic integration is an idea whose time has come
- Europe's experience a useful benchmark for Asia
- Yet Asia will have to "calibrate" the European model to suit its own historical context, socio-economic, and political conditions
- The sequencing, style, scope, and speed of Asian integration will be somewhat different from Europe
- A multi-track, multi-speed approach firmly grounded on subregional initiatives most appropriate
- While ASEAN could continue to be the driving force for Asian trade (and investment) integration, ASEAN+3 could take the lead in deepening regional financial integration