

Deepening Asian Integration: Issues and Challenges*

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A Four-Part Presentation:

- A Snapshot of Asian Economy: now and into 2020 (slides 1 and 2)
- European benchmarks for Asian Integration: Sequencing, style, scope, and speed (slides 3-7)
- Next Steps in Asian Integration (slides 8-13)
- Conclusion (slide 14)

Asia's importance in the global economy is most likely to rise in the next few decades

- Asia now accounts for about 60% of the world's population, 40% of the global output, and 30% of world trade.
- With the possible exception of the 1997-98 crisis years, Asia has been the fastest growing region in the world economy for many decades.
- Impressive achievements in poverty reduction and improvements in socio-economic conditions in the last few decades.
- China and India – two countries with over a billion people each – have also joined the Asian economic success story.
- Most projections indicate that Asia's importance in the global economy is going to increase in the next few decades.
- Current assessment is that by 2020 most large Asian economies would have graduated to middle income status.

Regional economic cooperation and integration would be a key pillar of Asia's future development strategy

- Pragmatic national economic institutions and policies will continue to play a key role in navigating the Asia's economic success story.
- Asia will also continue to be open to the global economy – a strategy that underpinned Asia's dramatic economic success over the decades.
- But, as Asia navigates its way to the middle income status and beyond, regional-level initiatives will increasingly complement national level policies as well as Asia's global engagement.
- Charting the course of this important pillar of Asia's future economic development strategy - regional cooperation and integration - therefore, needs to be addressed in a systematic way.
- It is only natural for Asia to look upon Europe for charting the course of its regional integration efforts/agenda -- both to draw the right lessons and to avoid mistakes.
- Europe – a global benchmark on regional integration.

Asia needs to address four sets of issues and challenges in its future efforts at regional integration--the four "S"s, so to say

- **Sequencing:** How should Asia sequence its integration efforts in the areas of trade, monetary, and financial integration?
- **Style:** What is the appropriate style for Asian economic integration? Specifically, how institution-intensive should Asia's integration initiatives be?
- **Scope:** What would be the scope of Asian economic integration in terms of countries and subregions covered?
- **Speed:** How fast should Asia pursue regional integration in its various dimensions/tracks, or what is the appropriate speed for Asian economic integration?
- What lessons Europe hold for Asia in each of these four "S"s? How much should Asia emulate Europe? Are there things that Europe did that Asia should avoid?

Asia should perhaps sequence its integration initiatives differently than Europe

- Sequencing of European integration – trade integration first, monetary integration next, and financial integration subsequently.
- Such sequencing was partly necessitated by the widespread trade barriers as well as the almost universal application of capital controls during most of the European integration process.
- In comparison, today trade barriers both globally and within Asia, especially East Asia, are much less than when Europe started its integration initiatives.
- Capital controls are also not as universal today and, if anything, the move to freer capital flows is likely to accelerate in the coming years.

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Asia should perhaps sequence its integration initiatives differently than Europe

- Freer capital flows would not give Asia the luxury of delaying financial integration (until the completion of trade integration) as Europe did.
- Overall, unlike Europe, Asia may have to focus on financial integration even as it completes the remaining agenda on trade integration.
- Also, given general lack of appetite as well as compelling preconditions for monetary integration, Asia may have to proceed slower on monetary integration than Europe.

In style, Asian integration may have to be less institution-intensive than Europe

- The political support/commitment for integration in Asia appears to be less than in Europe.
- The highly diverse cultural, social and political contexts across Asia makes it difficult to “sell” the notion of a joint framework or supranational institutions that relinquishes national economic sovereignty.
- The efficacy of buying political support for economic integration through publicly funded expenditure programs (as done in Europe) in Asia is fraught with difficulties.
- Thus, compared to Europe, Asian integration is likely to be less institution-intensive.
- Asia would, therefore, benefit more from “open method” of cooperation and coordination than the European “community method”.

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

- Economic diversity in terms of stages of economic development in Asia is much more than in Europe when it initiated regional integration.
- The appetite for regional integration vary vastly across subregions in Asia as well as among countries within subregions.
- Regional integration has advanced the most in East Asia, while the degree of regional integration is much less in other subregions such as South Asia, or Central Asia.
- Even in East Asia, trade integration has progressed the most, while integration in the monetary and financial spheres is just about beginning.
- The most practical way of promoting Asian integration would therefore be through a multi-track, multi-speed approach firmly anchored on subregional integration.
- Over time, subregional integration could form the building blocks for a pan-Asian integration

The speed of integration will thus vary across the subregions and on the different integration tracks

- In East Asia, while trade integration is likely to accelerate in the coming years, monetary and financial integration will perhaps proceed at a much more modest pace.
- Even within East Asia, integration would perhaps proceed faster on almost all tracks among the ASEAN countries than others.
- Monetary and financial integration in East Asia would perhaps hinge a lot on how Japan, China and 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.

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

- Anchored on AFTA and the AEC, ASEAN could form the hub for Asian trade integration.
- ASEAN is already playing an important role in regional trade integration through a series of FTA arrangements with a number of countries -- Japan, Korea, China and India, for example.
- Future trade integration in Asia is likely to evolve around the multiple agreements under the ASEAN, ASEAN+1, and ASEAN+3 and the East Asia Summit (EAS or ASEAN+6) processes.
- There is a growing political consensus that the core of Asian integration lies in ASEAN as the “driving force”, with the ASEAN+3 as the “main vehicle” for the eventual Asian economic community, and the EAS as “an integral part of the overall evolving regional architecture”.
- The key immediate challenge, of course, is to design and implement the various FTAs to achieve the ultimate objective of regional trade integration without at the same time not building a “fortress Asia” – making the best out of the second best.
- Should Asian trade integration be APEC-wide? There are arguments on both sides of this question.

Building integrated financial markets – another key challenge for Asia

- In the past, Asia's financial sectors/markets have not kept pace with the region's impressive achievements in economic growth and poverty reduction– a gap that needs to be closed as the region graduates to middle income status and beyond
- Building robust financial markets, especially capital markets, would require significant national-level reforms and restructuring –a process that has begun since the 1997-98 crisis.
- But given the small size of several individual economies, regional-level initiatives at building integrated financial markets would also be increasingly important.
- Going forward, there is a need to consolidate the regional financial markets initiatives under the various regional forums -- ASEAN, ASEAN+3, EMEAP, and APEC.

Building integrated financial markets – another key challenge for Asia

- The ASEAN+3 could take the lead in carrying forward the region's financial integration initiatives.
- While Australia and New Zealand—as developed countries with small but robust financial markets and India which has significant experience in financial market development could play important complementary roles.
- A strong regional financial market in Asia would give the world economy a much more balanced global financial system which now relies heavily on the American and European markets for intermediating global savings and investments.
- The challenge is one of building an integrated Asian financial market with minimum supranational institutions and maximum national freedom in policy making.

Monetary integration in Asia likely to take longer than either trade or financial integration

- Rising intra-regional trade as well as deepening macroeconomic interdependence in East Asia make a case for intra-regional exchange rate stability.
- Yet, progress in monetary integration is likely to be much more gradual than trade and financial integration, partly due to the absence of an anchor currency (unlike German mark in Europe).
- Moreover, since monetary integration tends to be institution-intensive in that it requires delegation of policy autonomy to a regional arrangement, mustering political support would be much more difficult.
- Given these constraints, one option may be for a small group of countries, say, among the ASEAN or the Plus three countries to anchor their exchange rate policies on some version of a (common) basket currency system.

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- Once these countries gain enough experience in running such an exchange rate system, and if the system becomes appealing to other countries in the region, more countries could join such a system, thus paving the way for a region-wide basket currency regime.
- Building on the Chiang Mai Initiative, an augmented regional reserve pooling system and better regional economic surveillance would further support such an initiative at bringing about intra-regional exchange rate stability.
- Even these modest initiatives at monetary integration would thus require significant institution building at the regional level.

In Conclusion

- European integration experience provides a useful benchmark for Asian economic integration.
- Yet, Asia may 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 may have to be somewhat different from Europe: “Asia is not Europe, and 2007 is not 1957”.
- A multi-track, multi-speed approach firmly grounded on subregional initiatives seems to be appropriate for deepening Asian integration.
- While the ASEAN could be the driving force for Asian trade (and investment) integration, ASEAN+3 could take the lead in deepening regional financial integration.
- Asian monetary integration is likely to be a much more gradual process than either trade or financial integration.