

*The views expressed in this presentation are the views of the author and do not necessarily reflect the views or policies of the Asian Development Bank (ADB), or its Board of Governors, or the governments they represent. ADB does not guarantee the accuracy of the data included in this presentation and accepts no responsibility for any consequences of their use. Terminology used may not necessarily be consistent with ADB official terms.*

# **Regional Economic Cooperation and Integration in Asia: Opportunities and Challenges**

**Masahiro Kawai**

**Dean**

**Asian Development Bank Institute**

“New Ventures in Regional Cooperation:  
Learning Program for CAREC Participating Countries”

Organized by the Asian Development Bank

Manila, 29-30 March 2007



# Outline

- I. Key Issues**
- II. Regional Economic Integration in Asia**
- III. Spread of Regional/Subregional Cooperation in Asia**
- IV. ADB's RCI Strategy**
- V. Regional Cooperation Agenda**
- VI. Challenges Ahead**



# I. Key Issues

- Over the last twenty years the global landscapes have changed significantly—further globalization, regionalism elsewhere, market-driven economic integration in Asia, rise of China and India.
- Many Asian economies are increasingly integrated with the global economy and their neighbors.
- Reflecting such changes, the Asian economies have embarked on regional and subregional economic cooperation of various types.
- What is the current state of regional cooperation in Asia? How is CAREC doing?
- How is ADB helping regional cooperation?
- What are the challenges ahead?



# II. Regional Economic Integration in Asia

## 1. Emerging Trends

- Economic openness, IT revolution, improved physical connectivity, multinational corporations' global business activities, the spread of vertically integrated production networks, and the rapid growth of large emerging market economies like China and India, have brought Asian economies ever closer together.
- Success of regionalism in Europe and progress of regionalism in the Americas together with the process of globalization.
- Free trade agreements (FTAs) are proliferating in Asia: 183 bilateral and regional FTAs in Asia, with 40 notified to the WTO.



# Growth of FTAs in East Asia

Free Trade Agreements*	2000		2006**	
	WTO Notified	Not Notified	WTO Notified	Not Notified
<b>Total Agreements</b>	<b>23</b>	<b>20</b>	<b>40</b>	<b>143</b>
<b>Bilateral agreements</b>	18	20	32	119
Within Asian sub-regions	8	8	15	29
East Asia	1	0	7	16
South Asia	1	1	1	6
Central Asia	4	7	5	7
Pacific	2	0	2	0
Across Asian sub-regions	0	0	2	18
With non-Asian countries	10	12	15	72
<b>Plurilateral agreements</b> (involving at least one Asian country)	5	0	8	24

\*Include FTAs under implementation, under negotiation, and proposed FTAs in Asia

\*\* As of September 2006

Source: ADB FTA Database

# II. Regional Economic Integration in Asia

## 2. Market-driven Integration

- Since 1980, FDI inflows into Asia (including Japan) rose from 7% of world total FDI inflows in 1980 to 18% in 2005.
- Asian FDI outflows increased from 5% to 14% of world outflows, and much of this was intra-East Asian—from Japan & NIEs to China and ASEAN, and from ASEAN to ASEAN and to China
- Total Asian trade grew faster than world trade and the intra-regional trade share increased from 35% in 1980 to 55% in 2005 (vs. 46% in NAFTA region and comparable to EU before the 1992 Maastricht Treaty)

## **II. Regional Economic Integration in Asia**

### **3. Production Networks and Supply Chains**

- The rise of production networks underlies East Asia's industrial growth, export and integration
- Multinational corporations' strategy to locate different sub-processes in different Asian countries according to comparative advantage and to re-integrate them
- Asian NIEs was the first to be part of such networks, followed by ASEAN, and now China is rapidly participating in the networks. India is now following.
- As a result, much of the region's trade is between MNCs in parts, components, semi-finished and finished goods.



## **II. Regional Economic Integration in Asia**

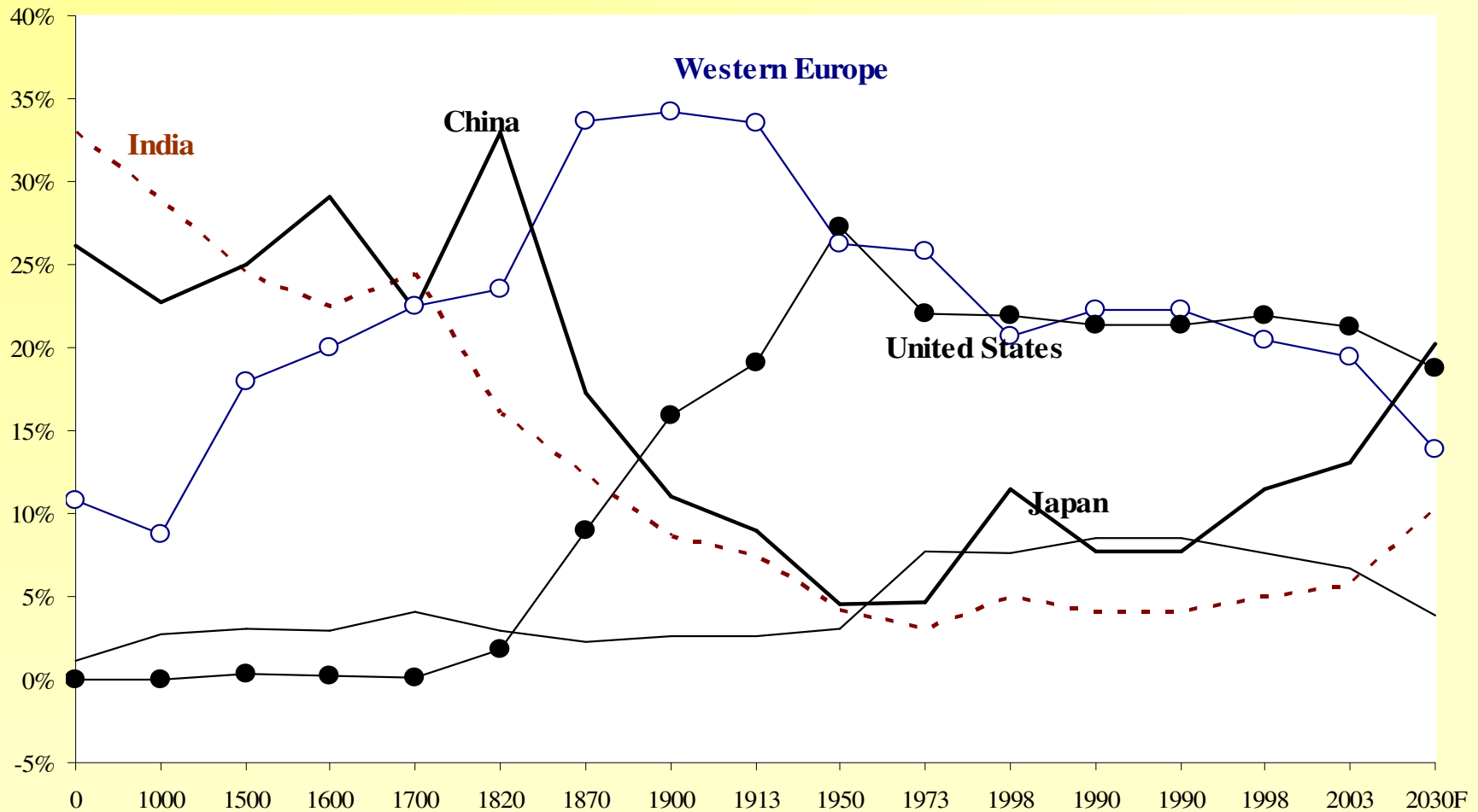
### **4. Emergence of China and India**

- China dominates many low- to mid-tech manufacturing industries (e.g. garments, electronics assembly, automobiles and parts) with a large domestic market
- India has English speaking literate graduates, dynamic SMEs, competitive services (IT, telecom, finance, back-office processing) and some manufacturing (e.g. pharmaceuticals) with a large domestic market
- China is both competitive and complementary with ASEAN, while India is complementary to ASEAN.
- India and other South Asia have yet to integrate
- Central Asia will benefit from its linkage with China and India.





## Share of Major Economies in the World (Percentage, Measured in 1990 International Dollars)



Source: Angus Maddison, *The World Economy: A Millennial Perspective* (2001); and "The West and the Rest in the World Economy: 1500-2030" (2005)



# **III. Spread of Regional/Subregional Cooperation in Asia**

## **1. Association of Southeast Asian Nations (ASEAN)**

- Established in August 1967
- Members: Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam
- ASEAN Community to be created by 2015 : Security Community; Economic Community; Socio-cultural Community.
- Economic cooperation: AFTA; customs; dispute settlements; finance; food, agriculture and forestry; ICT; industry; intellectual property; investment; minerals and energy; services; SMEs; tourism; and transport



# III. Spread of Regional/Subregional Cooperation in Asia

## 2. ASEAN+3

- Begun in December 1997 and institutionalized in November 1999
- Members: ASEAN-10 plus China, Korea and Japan
- Political and security cooperation
- Economic, trade and financial cooperation: economic; monetary and financial; social and human resources; scientific and technical; cultural and information; development
- Ministerial meetings: economic; foreign; finance; tourism; health; and labor
- An important feature is monetary and financial cooperation, including ERPD, CMI & ABMI



# **III. Spread of Regional/Subregional Cooperation in Asia**

## **3. East Asia Summit Group**

- Established in December 2005
- Members: ASEAN+3 plus India, Australia, and New Zealand
- Covering trade, investment, energy, and other economic cooperation
- ASEAN on its way toward ASEAN Economic Community to be created by 2015
- ASEAN as the “driving force” and ASEAN+3 as the “vehicle” for realization of EAEC; and East Asia Summit as an integral part of the overall evolving regional architecture



# **III. Spread of Regional/Subregional Cooperation in Asia**

## **4. South Asian Association for Regional Cooperation (SAARC)**

- Established in December 1985
- Members: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka
- Areas of cooperation: agriculture and rural development; health and population activities; women, youth and children; environment and forestry; science and technology and meteorology; human resources development; and transport.
- Recent focus has been on ICT, biotechnology, intellectual property rights, tourism, and energy.
- Economic cooperation includes: trade (FTAs, facilitation), manufactures and services



# **III. Spread of Regional/Subregional Cooperation in Asia**

## **5. Greater Mekong Subregion (GMS) Program**

- Established in 1992 (ADB as Secretariat)
- Members: Cambodia, Lao PDR, Myanmar, China (Yunnan Province & Guangxi Zhuang Autonomous Region), Thailand, and Vietnam
- Strategic focus (enhanced connectivity, increased competitiveness, and a greater sense of community):
  - strengthen infrastructure linkages through a multisectoral approach
  - facilitate cross-border trade and investment
  - enhance private sector participation in development and improve its competitiveness
  - develop human resources and skill competencies
  - protect the environment and promote sustainable use of the subregion's shared natural resources



# III. Spread of Regional/Subregional Cooperation in Asia

## 6. Central Asia Regional Economic Cooperation (CAREC)

- Established in 1997 (ADB as Secretariat)
- Members: Afghanistan, Azerbaijan, Kazakhstan, Kyrgyz Republic, Mongolia, China (Xinjiang Uygur Autonomous Region), Tajikistan and Uzbekistan
- Multi-stakeholder cooperation: ADB, EBRD, IMF, IsDB, UNDP, WB
- Four “action” pillars (development through cooperation):
  - knowledge/capacity building
  - regional infrastructure network (transport corridors, interconnection of energy markets)
  - trade, investment, and business development
  - regional public goods (disaster management, avian flu)



# ADB Developing Member Countries

Least Developed Countries	Small States	Other Developing Member Countries	
Afghanistan	Cook Islands	Armenia	Singapore**
Bangladesh	Fiji Islands	Azerbaijan	Sri Lanka
Bhutan	Marshall Islands	Brunei	Taipei,China**
Cambodia	Micronesia	PRC	Tajikistan
Kiribati *	Nauru	Hong Kong, China**	Thailand
Lao PDR	Palau	India	Turkmenistan
Maldives *	Papua New Guinea	Indonesia	Uzbekistan
Myanmar	Tonga	Kazakhstan	Viet Nam
Nepal		Malaysia	
Samoa *		Mongolia	
Solomon Islands *		Pakistan	
Timor-Leste *		Philippines	
Tuvalu *		Korea**	
Vanuatu *		Kyrgyz Republic	

\* Also Small States \*\* Non-borrowing regional members



# IV. ADB's RCI Strategy

## 1. Regional Cooperation & Integration Strategy

- The ADB charter mandates ADB to play an active role in regional “cooperation” in Asia.
- ADB “Regional Cooperation Policy” in 1994:
  - Limited to regional “cooperation” and not including regional “integration”;
  - Supportive (reactive), rather than promoting (proactive), role for ADB in regional cooperation; and
  - No additional resources to support regional cooperation.
- Changing world economic realities have highlighted the importance of regional “integration” and ADB is required to address RCI in a coherent manner.
- ADB’s “Regional Cooperation and Integration Strategy” endorsed by the Board in July 2006.



# IV. ADB's RCI Strategy

## 2. Logic of RCI strategy

- Market-driven economic “integration” requires “cooperation” to manage the externality/spillover problems — such as cross-border impacts of economic policies and shocks, contagion of financial crises, communicable diseases, and environmental damages.
- Regional “cooperation”—for cross-border physical connectivity, trade/FDI opening and facilitation, monetary and financial cooperation, and provision of regional public goods—can in turn accelerate regional “integration.”
- Through its RCI strategy, ADB can provide coherent support to unlock Asia's vast economic potentials, and significantly contribute to economic growth, development and poverty reduction.

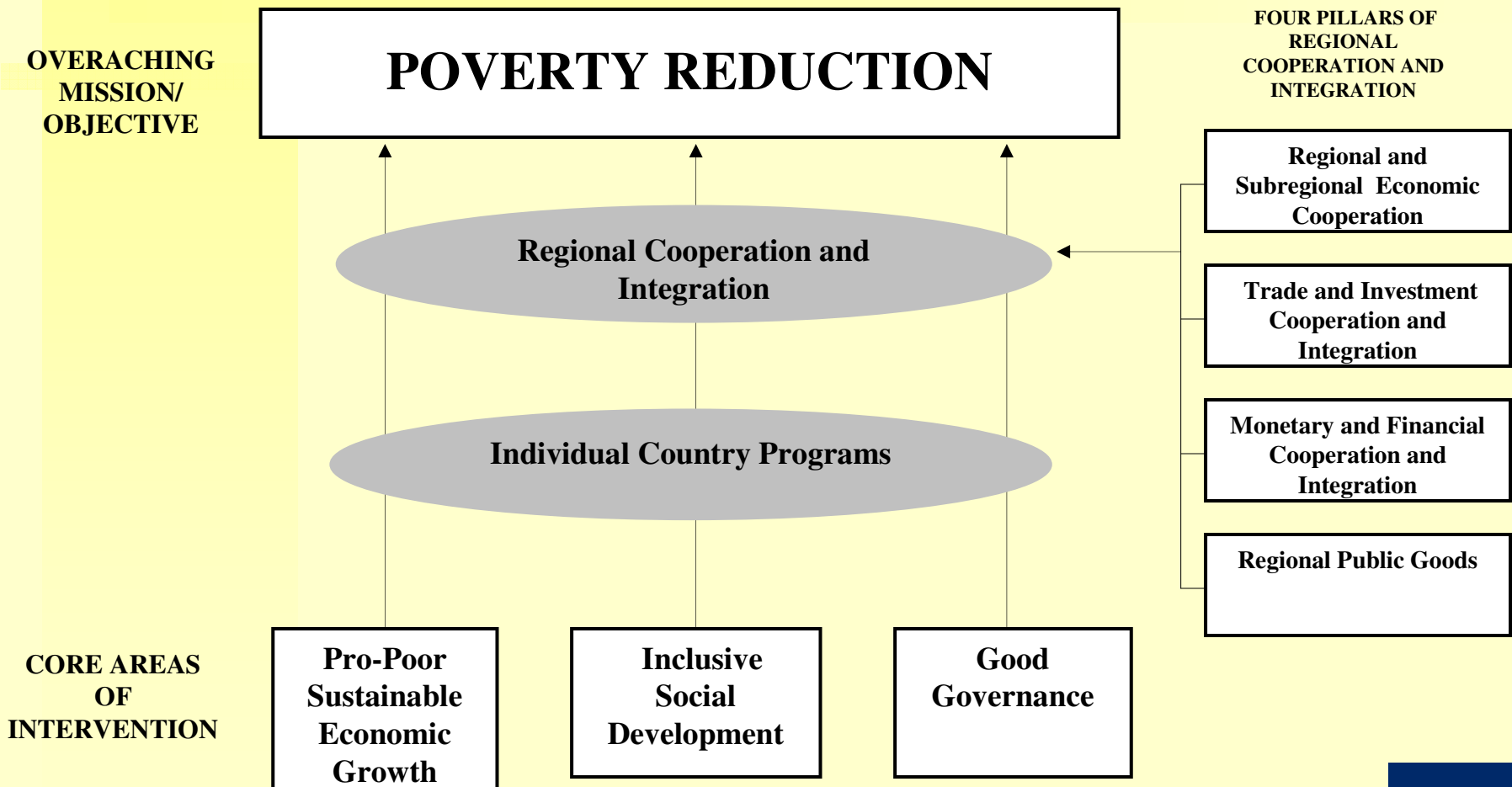


# IV. ADB's RCI Strategy

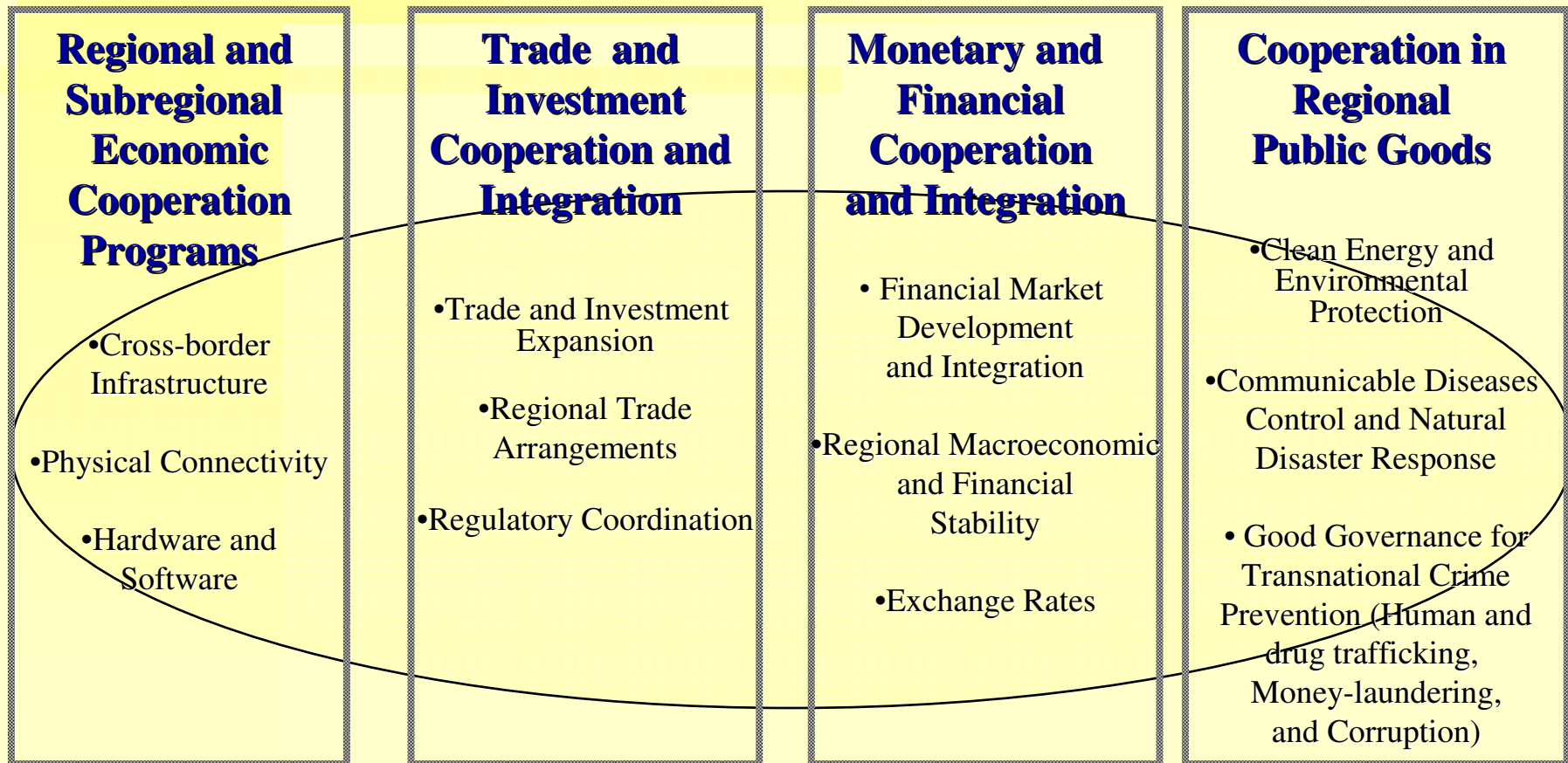
## 3. RCI and Poverty Reduction

- RCI is a powerful instrument or platform through which the three core areas of intervention—pro-poor growth, inclusive social development and good governance—can contribute to ADB's overarching objective of poverty reduction.
- RCI, if appropriately designed and managed, helps:
  - ✦ strengthen cross-border connectivity;
  - ✦ expand trade and investment;
  - ✦ mobilize regional savings for regional investment;
  - ✦ reduce economic and financial vulnerability to shocks;
  - ✦ provide regional public goods; and
  - ✦ improve the overall governance standards across the region.
- RCI offers a “win-win” outcome for the region's economies, rich and poor.

# ADB's Mission and the Role of Regional Cooperation and Integration



# Four Pillars of RCI



# IV. ADB's RCI Strategy

## 4-1. Component Strategy in Pillar 1

### First Pillar:

#### **Regional and Subregional Economic Cooperation Program**

- Cross-border Infrastructure
- Physical Connectivity
- Hardware and Software

- Cross-border infrastructure is the core of RCI—transport, energy, power, telecommunication, water
- Physical connectivity key to trade, investment and people's movement
- The software component requires knowledge mobilization—for regulatory and institutional coordination—and ADB's "honest broker" role



# IV. ADB's RCI Strategy

## 4-2. Component Strategy in Pillar 2

### Second Pillar:

#### **Trade and Investment Cooperation & Integration**

- Trade and Investment Expansion
- Regional Trade Arrangements
- Regulatory Coordination

- Facilitation and promotion of trade and FDI
- Management of FTA proliferation across to ensure WTO consistency and to avoid “Asian noodle bowl”
- Scope of cooperative agreements expanding among different sub-regions
- Harmonization of rules, regulations and procedures as the next step



# IV. ADB's RCI Strategy

## 4-3. Component Strategy in Pillar 3

### Third Pillar:

#### **Monetary and Financial Cooperation & Integration**

- Financial Market Development and Integration
- Regional Macroeconomic and Financial Stability
- Exchange Rates

- Development of sound and deep financial markets and regional macroeconomic and financial stability key to global financial stability
- Development of local bond markets
- Intra-regional exchange rate stability
- Support for ASEAN, ASEAN+3, (potentially SAARC and CAREC), APEC, ASEM





# IV. ADB's RCI Strategy

## 4-4. Component Strategy in Pillar 4

### Fourth Pillar:

#### **Regional Public Goods**

- Clean Energy and Environmental Protection
- Communicable Diseases Control and Natural Disaster Response
- Good Governance for Transnational Crime Prevention (trafficking, money-laundering, and corruption)

- Clean energy and energy efficiency (Clean Development Mechanism, Carbon Market Initiative) and environmental protection
- Prevention and containment of communicable diseases (avian flu, SARS, HIV/AIDS) and management of natural disasters (tsunami and earthquakes)
- Good governance for transnational crime prevention



## IV. ADB's RCI Strategy

### 5. Multi-track, Multi-speed Approach

- ADB supports and promotes RCI in a way that complements, and allows management of, globalization efforts—“open regionalism”
- RCI is likely to intensify in a number of regions and subregions and in a number of aspects in Asia.
- Asia includes highly diverse regions, subregions and countries and client needs for RCI are different.
- Hence, the ADB approach to RCI will be a multi-track, multi-speed (or variable geometry) approach.
  - ✦ Different regions and sub-regions would embrace RCI at different paces.
  - ✦ Even within a region or a subregion, the pace of progress would be different on different aspects of RCI and across countries.



## IV. ADB's RCI Strategy

### 6. ADB as Supporting Institution for RCI

- *Money bank*: Provision of financial resources for DMCs or assisting them in mobilizing such resources
- *Knowledge bank*: Creation, consolidation and dissemination of knowledge and information on RCI
- *Capacity builder*: Assistance of DMCs and regional and/or subregional bodies in building their institutional capacity to pursue and manage RCI
- *Honest broker*: Acting as facilitator, catalyst and coordinator of RCI for the DMCs.

***These four functions are mutually supportive, enabling ADB to act as an effective regional support institution for Asia's RCI.***



# V. Regional Cooperation Agenda

## 1. Cross-border Infrastructure

- Key to reduce transport and logistics costs of trade, production networks and supply chains
- Significant potential for energy trade such as gas pipelines and electricity distribution systems
- New financing schemes required, such as local currency bond market financing, public-private partnership (PPP) and other innovative schemes
- Software knowledge on regulatory and institutional coordination vital for success
- Uneven distribution of costs and benefits across countries requires coordination of cross-border projects and the presence of an honest broker



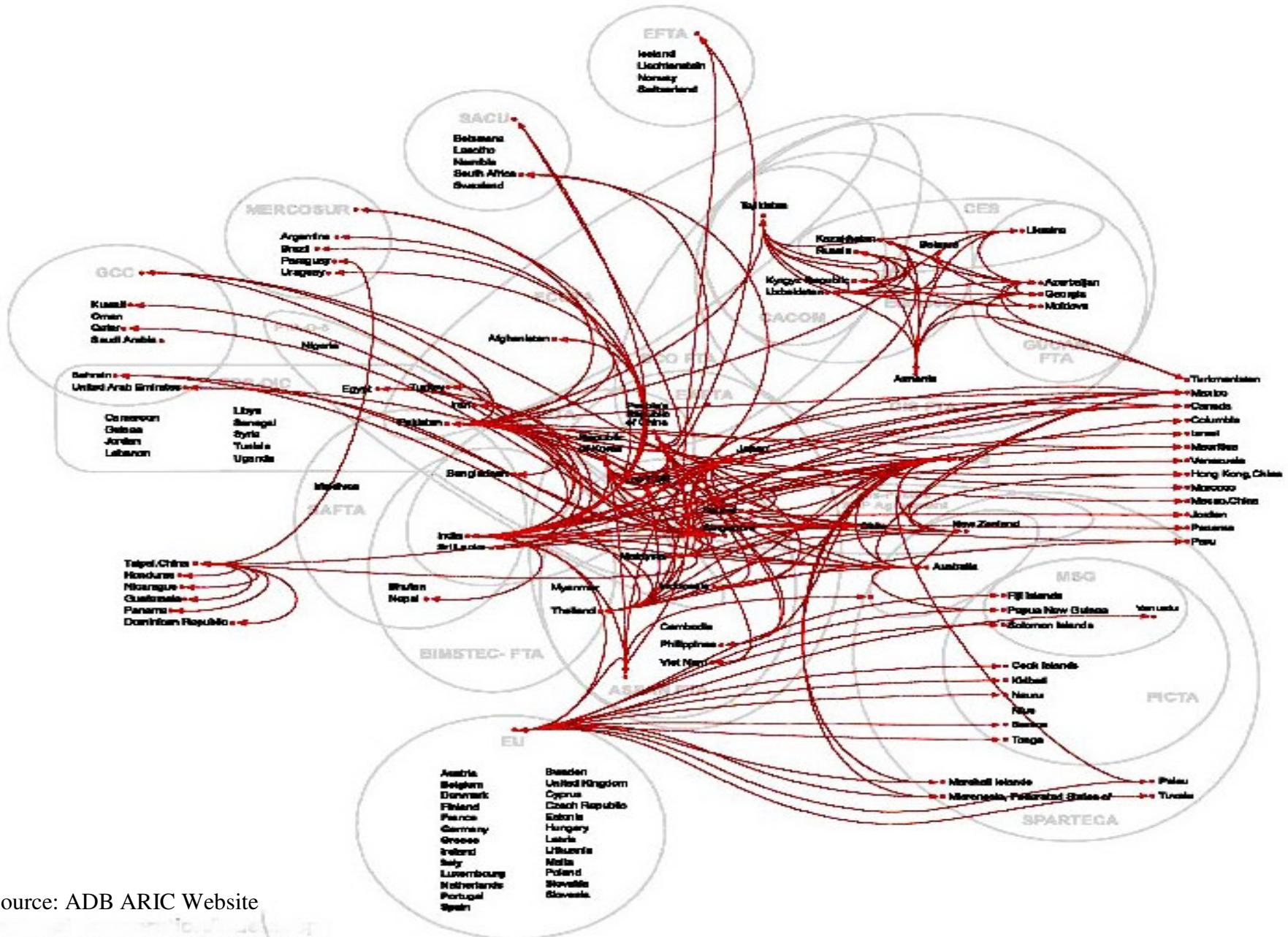
# V. Regional Cooperation Agenda

## 2. Regional Trade Arrangements

- Proliferation of bilateral and plurilateral FTAs and risk of “Asian noodle bowls” due to overlapping FTAs with different rules of origin and standards
- A need to manage FTAs so that they expand trade and investment through market forces
- The larger the number of participating countries in an FTA and the wider the coverage, the greater the benefit.
- Coordination of rules of origin and harmonization of standards is key
- Trade facilitation (customs, quarantine) can also be important to promote trade and (hence) investment



# Proliferation of the Asian “Noodle Bowls”



Source: ADB ARIC Website

# V. Regional Cooperation Agenda

## 2(b). Trade Integration: What Can ADB Do?

- Information on Asian FTAs, trade and FDI
  - ARIC: Web-based database on Asian FTAs, trade and FDI
  - Best practice information on FTAs
- Aid for trade
  - Capacity building on trade (trade policymaking, reform support, analysis, negotiation)
  - Trade-related infrastructure (national or cross-border transport, logistics, etc., for trade expansion)
  - Trade facilitation and customs modernization
- Research on trade and investment
  - Studies on costs and benefits of Asian FTAs/EPAs
  - Case studies on Asian “noodle bowl” effects
  - Enhancing SME trade and finance



# V. Regional Cooperation Agenda

## 3. Development of Local-Currency Bonds

- Mobilization of a large pool of Asian savings for Asian investment in infrastructure, SMEs, rural development, & environmental protection
- Establishing robust financial systems at the national level key, with strong risk management capacity of financial institutions—through effective regulatory and supervisory frameworks and competition
- At the national level, big efforts needed at building strong bond market infrastructure
- At the regional level, strong collaborative efforts needed to create an Asian credit enhancement institution, an Asian settlement and clearing system, and more harmonized credit ratings





# V. Regional Cooperation Agenda

## 4. Provision of Regional Public Goods

- Clean energy and energy efficiency
  - low-carbon growth
- Environmental protection
  - desertification, forest fires and haze, biodiversity management, water management
- Disaster management
  - early warning, rescue and rehabilitation
- Control of communicable diseases
  - HIV/AIDS, Avian flu
- Good governance and anti-corruption
  - cross-country corruption and money laundering
- Control of human trafficking
  - prevention, prosecution and reintegration



## VI. Challenges Ahead

- Globalization of Asian economies has led to natural (*de facto*) regional concentration of economic activities (trade, FDI and finance), particularly in East Asia.
- Regional and subregional cooperation initiatives are spreading in Asia—including ASEAN, ASEAN+3, SAARC, GMS and CAREC—for win-win outcomes.
- Multi-track, multi-speed approach to regional cooperation and integration makes sense given the diversity and the different stages of development of Asian countries and regions/subregions.
- For CAREC, focus on cooperation in cross-border infrastructure (transport and energy), trade (facilitation and policy), and regional public goods is natural.
- As the economies develop and begin to open their financial systems and capital accounts, needs for regional financial cooperation will rise.



# Thank you

## For more information:

**Dr. Masahiro Kawai**  
**Dean**

**Asian Development Bank Institute**

[mkawai@adbi.org](mailto:mkawai@adbi.org)

**+81 3 3593 5527**

<http://aric.adb.org>

[www.adbi.org](http://www.adbi.org)

