

RIS A Think-Tank of Developing Countries

RIS is a New Delhi-based autonomous policy think-tank supported by the Government of India and devoted to trade and development issues. Its work programme focuses on policy research and capacity building on multilateral trade and financial negotiations, regional economic cooperation in Asia, South-South cooperation, new technologies and development, and strategic policy responses of developing countries to globalization, among other issues. The work of RIS is published in the form of research reports, books, discussion papers, policy briefs and journals.

RIS has networked effectively with other prominent policy think-tanks, government agencies, industry bodies and international organizations in Asia and other parts of the world for collaborative research and joint activities. It has a consultative status with UNCTAD, and has been accredited to the Summit Meetings of NAM and WTO Ministerial Conferences. It has conducted policy research and other activities in collaboration with other agencies, including UN-ESCAP, UNCTAD, UNU, Group of 77, SAARC Secretariat, Asian Development Bank (ADB), the World Bank, and the South Centre.

For more information about RIS and its work programme, please visit its website: www.ris.org.in.

— Policy research to shape the international development agenda



RIS
Research and Information System
for Developing Countries

Core IV-B, Fourth Floor
India Habitat Centre
Lodhi Road
New Delhi-110 003, India.
Ph. 91-11-2468 2177-80
Fax: 91-11-2468 2173-74-75
Email: dgoffice@ris.org.in
Website: <http://www.ris.org.in>
Website: <http://www.newasiaforum.org>

RIS Discussion Papers

Regional Cooperation and Integration Prospects in Asia

Rajat Nag

RIS-DP # 131



RIS
Research and Information System
for Developing Countries

Regional Cooperation and Integration Prospects in Asia

Rajat Nag

RIS-DP # 131

December 2007



RIS
**Research and Information System
for Developing Countries**

Core IV-B, Fourth Floor, India Habitat Centre
Lodhi Road, New Delhi – 110 003 (India)
Tel: +91-11-2468 2177/2180; Fax: +91-11-2468 2173/74
Email: dgoffice@ris.org.in

RIS Discussion Papers intend to disseminate preliminary findings of the research carried out within the framework of institute's work programme. The feedback and comments may be directed to the author(s). RIS Discussion Papers are available at www.ris.org.in

Regional Cooperation and Integration Prospects in Asia

Rajat Nag*

Abstract: There is indeed a strong opportunity for South Asian countries to benefit from intensifying regional ties. As a regional policy dialogue becomes stronger and barriers are gradually eliminated, or at least substantially reduced, economic integration will intensify in the next decade or two. This is partly due to the very low level of integration it starts from. For instance, intraregional trade in South Asia accounts for only 5.5 per cent of total trade, as opposed to East Asia's almost 60 per cent. As the region continues to build its economic infrastructure and new cross-border projects are implemented, these will not only intensify trade in goods and services, but also facilitate the movement of people. Easing existing cross-border impediments to trade and labour movements, will likely be the strongest economic driver over the coming decade. But the key to any experiment in cooperation and economic integration is political will.

I intend to talk about regional cooperation and integration prospects in Asia, and how I expect the process unfolding in the coming years – especially in South Asia. It is my view, and that of ADB, that economic cooperation and integration will be a key pillar—possibly *the* key pillar—of the region's future development.

* Managing Director-General, Asian Development Bank, Manila.

Email: rnag@adb.org

This discussion paper is based on the text of a talk delivered by Mr. Rajat Nag at RIS, New Delhi on 5 December 2007.

The dramatic shift toward greater market-driven development strategies – particularly in India and China – has become a major driver for dynamic growth in Asia, and indeed globally. It is estimated that 40 per cent of incremental annual world GDP now emanates from India and China alone. This growth has led to a rapid expansion in intraregional trade and cross-border investment, and created opportunities for greater cooperation in areas like easing restrictions on capital flows and developing regional bond markets.

Asia's governments have embraced economic cooperation through various informal dialogues and formal ministerial and summit processes. The RIS High-Level Conference on Asian Economic Integration here just 3 weeks ago attests to India's commitment to the process. The road may be long but the benefits of closer cooperation will be tremendous. Increased productivity and competitiveness, less poverty, fewer income gaps among countries, improved risk sharing and greater connectivity within the region and with the world are just a few of the benefits that South Asia can anticipate by promoting regional cooperation and integration. And, as the EU experience shows, cooperative leadership is key to building a regional agenda in international forums. All this is indeed appealing to build a stronger South Asia.

A Pragmatic Approach toward Integration

This is not to say that a comprehensive pan-Asian “vision” or grand plan as was done in Europe is needed, or even desirable. Rather, I believe we should rely on a *pragmatic step-by-step, bottom-up process* that builds trust among what are the most diverse countries anywhere in the world. I also believe that Asia's “*multi-speed*” and “*multi-track*” approach to cooperation, whereby a few countries start working together on selected common issues, is quite appropriate in this context.

Countries and subregions within Asia are already at quite different stages of regional integration and economic development.

Southeast Asia—via ASEAN—has been at it the longest, and has thus made the most progress. ASEAN+3 has enhanced the momentum. Together, the region's economic authorities continue to work on initiatives to deepen integration—not only in infrastructure development, trade, and investment, but they have also begun the process toward monetary and financial cooperation. And within East Asia itself, the Greater Mekong Subregion focuses primarily on enhancing connectivity, improving competitiveness, and building a sense of community.

As you know, the South Asian Association for Regional Cooperation, or SAARC, has focused mainly in agriculture, rural development, and health. More recently, SAARC is delving into broader integration issues such as cross-border infrastructure and services, free trade agreements, financial and monetary cooperation, and regional public goods. The Central Asia Regional Cooperation Program, or CAREC, organized in 1997, promotes shared infrastructure projects and is working on improving the region's policy environment in priority areas—including transport, energy, trade policy, and trade facilitation.

In all of these efforts, what is important is to build the concept of “ownership” and regional identity across borders. This will be just as true as regionalism expands among subregions as common denominators break through decades, even centuries, of distrust.

It is also important to ensure that the integration framework is responsive to business needs. After all, it is the private sector and business networking across the region that is driving government-led cooperation initiatives in infrastructure, trade, investment, finance, and regional public goods.

So what are the main elements that make up a workable framework for broader Asian cooperation and regional economic integration over the medium term?

Clearly, physical connectivity should form the bedrock of regional cooperation initiatives in our region. The trends to date are encouraging. Intra-Asian internet connectivity, for example, is growing at twice the pace of the trans-Pacific internet. This offers enormous potential for the region to become more integrated through e-commerce – and creates a natural opportunity for India in the service sector. Similarly, intra-regional passenger traffic across Asia has almost doubled to 1 trillion passenger-kilometers a year over the last 20 years. The Asia Highway project has been revived, and the trans-Asian Railway has some new momentum. In East Asia, the number of air routes has doubled during that period as well.

On trade, a framework to unify free trade agreements could help link together fragmented markets for goods, services, and capital. It would be natural to look at ASEAN as a regional hub for an eventual ASEAN+3-wide FTA, or even an ASEAN+6 (or East Asian) FTA. Intra-regional trade now accounts for close to 60 per cent of total trade in East Asia. With China and India's continued economic expansion, this is likely to increase further, as production centers throughout the region seek raw materials and intermediate goods from more accessible markets within the region itself.

Some Thoughts on South Asian Economic Cooperation and Integration

Turning specifically to South Asia, significant reforms have been made in trade, investment, industrial, and fiscal policies, along with financial liberalization. In recent years, the growth rates of South Asian economies have improved, poverty ratios have declined, and trade flows as a proportion of GDP have increased. Today, in terms of its trade flows, South Asia is much more open than at any time in the past. However, much remains to be done.

The East Asian experience can offer some important lessons for South Asian regional cooperation. One such lesson

is to give primacy to economic issues and not allow political differences to stand in the way. Within ASEAN and ASEAN+3, for example, there have been periods of significant political differences between Malaysia and Singapore, Thailand and Myanmar, China and Japan—to name a few. However, these have not been allowed by the political leadership to stall the process of economic cooperation.

It does appear that South Asia is moving in this direction as well. I am reminded of Prime Minister Manmohan Singh's statement at the Federation of Indian Chambers of Commerce and Industry—just prior to last January's East Asia Summit—when he said – quote:

I dream of a day, while retaining our respective national identities, one can have breakfast in Amritsar, lunch in Lahore, and dinner in Kabul. That is how my forefathers lived. That is how I want our grandchildren to live.

Wise words indeed. Given the significant benefits that will accrue to the people of South Asia, it is my sincere hope that the region's leaders will put their political differences aside and push forward the regional economic cooperation agenda.

South Asia might also consider the open regional approach as followed in East Asia. South Asia is a latecomer to the concept of regional cooperation, and the inward-looking mind-sets of earlier years are still visible in some of its approaches to regionalism. It would be a positive move, for example, if the large negative lists, limited number of products for tariff concessions, restrictive rules of origin, exclusion of services, exclusion of issues such as para-tariffs and non-tariff barriers in the South Asia Free Trade Agreement (SAFTA) could change in favor of greater openness. East Asian economies have shown that bilateral and regional trade arrangements do not act as stumbling blocs for promoting multilateral trading negotiations. South Asia

should not view the process of bilateral FTAs within the region as inimical to the regional cooperation process.

It is important to examine the depth and coverage of existing FTAs in South Asia, and their implications for private sector interests. Economic integration begins as a natural process of business expansion. The private sector has played a major role in the globalization process through the integration of production networks across countries. This, in turn, has provided considerable impetus to regional economic integration. The South Asia Subregional Economic Cooperation (SASEC) Program, spearheaded by ADB, seeks to reduce non-trade barriers and promote private sector cooperation. And the South Asia Business Forum was established to enhance business cooperation and address the most significant non-tariff and non-trade barriers for the private sector.

Some suggest that India should now take the lead in revitalizing SAARC. It may very well be in India's interest to build greater credibility and stature as a driver of open regionalism in South Asia. India has the advantage not only of size, but also of geography, bordering all South Asian economies.

One subregion in particular, India's underdeveloped Northeast Region, borders Bangladesh, Bhutan, China, Nepal, and Myanmar. The draft "Vision 2020" for the region, prepared by the National Institute of Public Policy, in part reads very similar to the East Asia's Greater Mekong Subregion program, which has been in full swing—and with great success—for 15 years. There may be some very useful lessons learned that can be shared between the two subregions as Vision 2020 gathers steam.

India's "Look East Policy" began in 1992, with building relations with ASEAN as one of its pillars. India became a

sectoral dialogue partner with ASEAN the same year, and a full dialogue partner in 1995. Today, it is a member of the ASEAN Regional Forum and the East Asia Summit Process, and it just held the 6th ASEAN-India Summit in Singapore. While a proposed ASEAN-India Free Trade Area is viewed as an important building block for an eventual Asian regional FTA, an early step—the ASEAN-India Trade in Goods Agreement—is expected to be concluded by March next year. ASEAN-India trade has now reached \$30 billion, with a target of \$50 billion by 2010.

Like ASEAN+3, but at an informal level, a South Asian Finance Ministers' process has been established. ADB has worked closely with SAARC on this process and its meetings have been held on the sidelines of ADB Annual Meetings—similar to the ASEAN+3 Finance Ministers meetings. This process could be formalized under the SAARC framework and further strengthened. A South Asian Commerce Ministers' forum might also be established to foster greater trade integration and ensure the follow up of decision taken in SAARC summits. India might decide to take the lead in giving unilateral trade concessions and removing para-tariffs and non-tariff barriers. Trade facilitation, including customs facilitation, could also be targeted. Once achieved, countries will have the necessary confidence to move ahead on freer movement of services, capital, and skilled labor.

As the atmosphere of mutual confidence and trust is built, the region may then be ready for financial and monetary cooperation involving regional institutions. It may consider establishing a subregional liquidity arrangement to guard against any future liquidity crisis, with India and its expanding foreign exchange reserves taking the lead. In this regard, a formal finance ministers' process, similar to ASEAN+3 Financial Ministers Process, might be established. This could then become a starting point for interaction between South Asia

and East Asia that could eventually end up moving toward an Asian Economic Community. I admit this is a long-term view. But it is something to keep in mind as we begin our discussions later.

Looking ahead, there is indeed a strong opportunity for South Asian countries to benefit from intensifying regional ties. As a regional policy dialogue becomes stronger and barriers are gradually eliminated, or at least substantially reduced, economic integration will intensify in the next decade or two. This is partly due to the very low level of integration it starts from. For instance, intraregional trade in South Asia accounts for only 5.5 per cent of total trade, as opposed to East Asia's almost 60 per cent. As the region continues to build its economic infrastructure and new cross-border projects are implemented, these will not only intensify trade in goods and services, but also facilitate the movement of people. Easing existing cross-border impediments to trade and labour movements, will likely be the strongest economic driver over the coming decade. But the key to any experiment in cooperation and economic integration is political will.

ADB and Regional Cooperation and Integration

We at ADB are committed to supporting these efforts. While promoting regional cooperation is part of our Charter, we took the initiative recently to adopt a formal Regional Cooperation and Integration (RCI) Strategy that improves the quality of our lending and non-lending services, and strengthens support for trade, investment, monetary, and financial integration. The RCI Strategy is a coherent and strategically-focused approach covering four essential "pillars":

- *Physical connectivity* – the bedrock of regional and sub-regional initiatives—to enhance cross-border infrastructure and the related services that ease the movement of goods and people;

- *Cross-border trade and investment* – to link fragmented national markets for goods, services, and capital;
- *Monetary and financial cooperation* – enhancing support for regional systemic reform, opening new avenues for finance via bond market development, and promoting East Asian exchange rate stability; and
- *Regional public goods* – to improve environmental, health, and social conditions—for example, through the prevention of environmental degradation and communicable diseases, or promotion of energy security.

In June last year, President Kuroda convened an Eminent Persons Group to help define the future role of ADB against the backdrop of emerging economic trends and the evolving development challenges facing Asia and the Pacific. One of the three complementary themes of the resulting report is the shift from a primarily national focus to a regional one. The report also cites regional cooperation and integration as one of ADB's six core operational areas.

In February this year (2007), ADB established a Regional Cooperation and Integration Financing Partnership Facility, which will mobilize ADB resources and contributions from bilateral, multilateral, and individual sources specifically for RCI activities. It comprises a Regional Cooperation and Integration Fund to support technical assistance activities, and several Regional Cooperation and Integration Trust Funds—agreed upon between financing partners and ADB—that will support technical assistance, grant components of investment projects, and other RCI activities.

I understand that during the discussions in mid-November(2007) here at RIS, there was a consensus on the need for institutional intermediation in linking growing regional savings and cross-border infrastructure needs by means of building better monetary and financial cooperation within the context of the East Asian Summit process.

- DP#110-2006 *Reinventing UNCTAD: Some Proposals for the UNCTAD Mid-term Review* by Muchkund Dubey
- DP#109-2006 *Trade Facilitation Priorities in India and Commitments at WTO: An Overview of Current Trends* by Sachin Chaturvedi
- DP#108-2006 *Towards Comprehensive Economic Co-operation between India and Central Asian Republics* by Dr. Ramgopal Agarwala
- DP#107-2006 *Monetary and Financial Cooperation in Asia: Emerging Trends and Prospects* by Ramkishen S. Rajan
- DP#106-2006 *Japan and an Asian Economic Community* by Masanori Kondo
- DP#105-2005 *India-Vietnam Trade: Current Relations and Prospects* by Rajesh Mehta
- DP#104-2005 *Trade in IBSA Economic Cooperation: The Role of Transportation Linkages* by Prabir De
- DP#103-2005 *Trade and Environment in the WTO: Negotiating Options for Developing Countries* by Sanjay Kumar and Nupur Chowdhury
- DP#102-2005 *Prospects for Environmental Trade under the Regional Process in South Asia: Evidence from SAPTA and Proposals for SAFTA* by S. K. Mohanty and Sachin Chaturvedi
- DP#101-2005 *Emergence of China and India in the new Millennium: Will it facilitate Market Access for LDCs and Developing Countries?* by S. K. Mohanty and Sachin Chaturvedi
- DP#100-2005 *Towards a Broader Asian Community: Agenda for the East Asia Summit* by Nagesh Kumar
- DP#99-2005 *Biosafety Protocol, International Trade and Agricultural Biotechnology: Policy Inferences for India* by Sachin Chaturvedi and Lian Chawii
- DP#98-2005 *The WTO Negotiations on Industrial Tariffs: What is at Stake for Developing Countries?* by Yilmaz Akyüz
- DP#97-2005 *Non-tariff Barriers Affecting India's Exports* by Rajesh Mehta
- DP#96-2005 *Advancing the ASEAN-India Partnership in the New Millennium* by Ong Keng Yong
- DP#95-2005 *The Search for Regional Architecture: The Role of ASEAN as Strange Attractor* by Djisman S. Simanjuntak
- DP#94-2005 *India-Central Asia Economic Relations: A Report of RIS/CII Seminar*
- DP#93-2005 *Asian Energy Outlook to 2020: Trends, Patterns and Imperatives of Regional Cooperation* by Kokichi Ito, Li Zhidong and Ryoichi Komiyama
- DP#92-2005 *Regional Trade and Investment Architecture in Asia-Pacific: Emerging Trends and Imperatives* by Tiziana Bonapace
- DP#91-2005 *India-East Asia Integration: A Win-Win for Asia* by Mukul G. Asher and Rahul Sen
- DP#90-2005 *Strategic Relevance of Asian Economic Integration* by Eric Teo Chu Cheow
- DP#89-2005 *China's Role in the Asian Economic Unification Process* by Yao Chao Cheng
- DP#88-2005 *Strategic Approach to Strengthening the International Competitiveness in Knowledge Based Industries: Electronics Industry* by K. J. Joseph
- DP#87-2004 *Regional Cooperation for Poverty Alleviation and Food Security in South Asia* by Sachin Chaturvedi
- DP#86-2004 *Towards a Free Trade Area in South Asia: Charting A Feasible Course for Trade Liberalisation with Reference to India's Role* by Indra Nath Mukherji
- DP#85-2004 *Industrial Restructuring and Export Competitiveness of the Textiles and Clothing Sector in SAARC in the Context of MFA Phase-Out* by Ram Upendra Das
- DP#84-2004 *India's Export by Countries and Commodities: On the Estimation of a Forecasting Model Using Panel Data* by Rajesh Mehta and Parul Mathur
- DP#83-2004 *Strategic Approach to Strengthening the International Competitiveness in Knowledge Based Industries: Indian Chemical Industry* by Vijay Kumar Kaul
- DP#82-2004 *Strategic approach to Strengthening the International Competitiveness in Knowledge Based Industries: The Case of Indian Automotive Industry* by Neelam Singh
- DP#81-2004 *Strategic approach to Strengthening the International Competitiveness in Knowledge Based Industries: Non-electrical Machinery Industry* by M. Padma Suresh

ADB indeed has a wealth of experience in all these issues. And, as we move forward toward greater regionalism across Asia, ADB stands ready to work with all of our developing member countries to foster greater cooperation and integration in the context of increased prosperity and reduced poverty.

RIS Discussion Papers

Available at http://www.ris.org.in/risdiscussion_papers.html

- DP#130-2007 *Deepening India–Bangladesh Economic Cooperation: Challenges and Opportunities* by Prabir De and Biswa N. Bhattacharyay
- DP#129-2007 *Intellectual Property Regime, Indigenous Knowledge System and Access and Benefit Sharing: Drawing Lessons from Kani Case* by Sachin Chaturvedi
- DP#128-2007 *WTO and Trade in Electronically Delivered Software (EDS): Emerging Challenges and Policy Options - An Indian Perspective* by Sachin Chaturvedi and S. K. Mohanty
- DP#127-2007 *Economy: Recent Evolution and New Perspectives for South-South Cooperation* by Maria Lúcia L.M. Pádua Lima
- DP#126-2007 *Welfare Gains from Regional Economic Integration in Asia: ASEAN+3 or EAS* by S.K. Mohanty and Sanjib Pohit
- DP#125-2007 *Investment Provisions in Regional Trading Arrangements in Asia: Relevance, Emerging Trends, and Policy Implications* by Nagesh Kumar
- DP#124-2007 *Indian Innovation Systems and Emergence of Biopharmaceutical Sector: Issues and Prospects* by Sachin Chaturvedi
- DP#123-2007 *Regional Economic Integration, Foreign Direct Investment and Efficiency-Seeking Industrial Restructuring in Asia: The Case of India* by Nagesh Kumar
- DP# 122-2007 *Community-based Rights and IPR Regime: Revisiting the Debate* by Srividhya Ragavan and Jamie Mayer
- DP#121-2007 *India's Rising Role in Asia* by Mukul G. Asher
- DP#120-2007 *Relevance of 'Policy Space' for Development: Implications for Multilateral Trade Negotiations* by Nagesh Kumar and Kevin P. Gallagher
- DP#119-2007 *India-Sri Lanka Bilateral Free Trade Agreement: Six Years Performance and Beyond* by Saman Kelegama and Indra Nath Mukherji
- DP#118-2007 *Trade Facilitation Measures in South Asian FTAs: An Overview of Initiatives and Policy Approaches* by Sachin Chaturvedi
- DP#111-2006 *Demographic Complementarities and Outsourcing: Implications and Challenges for India* by Mukul G. Asher and Amarendu Nandy