

Discussion Paper



TOWARDS BROADER REGIONAL COOPERATION IN ASIA

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TOWARDS BROADER REGIONAL COOPERATION IN ASIA

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ABBREVIATIONS AND ACRONYMS

ACD	Asian Cooperation Dialogue
ACU	Asian Currency Unit
ADB	Asian Development Bank
AEC	Asia Economic Community
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
BFA	Boao Forum for Asia
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral, Technical and Economic Cooperation
BTA	Bilateral Trade Agreement
CER	Closer Economic Relations
CEC	Committee on Economic Cooperation
CEPEA	Comprehensive Economic Partnership in East Asia
CGE	Computable General Equilibrium
CLMV	Cambodia, Lao PDR, Myanmar and Viet Nam
CMI	Chiang Mai Initiative
COMESA	Common Market for Eastern and Southern Africa
EAC	East Asian Community
EAS	East Asian Summit
ECTF	Energy Cooperation Task Force
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FTAA	Free Trade Area of the Americas
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GTAP	Global Trade Analysis Project
IMF	International Monetary Fund
IT	Information Technologies
JACIK	Japan, ASEAN, China, India and Republic of Korea
Lao PDR	Lao People's Democratic Republic PDR
MERCOSUR	Mercado Comun del Sur
MFN	Most-favoured-nation
NAFTA	North American Free Trade Area
NALs	New Asian Leaders
NEAT	Network of East Asian Think-tanks
OPEC	Organization of Petroleum Exporting Countries
PPP	Purchasing Power Parity
R&D	Research and Development
RIS	Research and Information System for Developing Countries
RTA	Regional Trade Arrangement
SAARC	South Asian Association for Regional Cooperation
SACU	South African Customs Union
SADC	South African Development Community
SAFTA	SAARC Free Trade Area
SAPTA	SAARC Preferential Trade Area
SARS	Severe Acute Respiratory Syndrome
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
US	United States

INTRODUCTION

Regional economic integration was adopted as a strategy for development in many regions of the world in the 1990s following the formation of the single market in the European Union (EU) and the creation of the North American Free Trade Area (NAFTA). As a result, more than half of world trade is now conducted between members of regional trading arrangements on a preferential basis and not on a most-favoured-nation (MFN) basis and regional integration has become an important factor in shaping global patterns of production and investment.

Asian countries were slow to respond to the worldwide trend of regionalism, continuing to place their faith in multilateralism until nearly the turn of the Millennium. More recently, Asian countries have come to recognize the potential of regional economic integration and have started taking steps to benefit from it. In addition to moves towards integration within the frameworks of subregional bodies such as the Association of Southeast Asian Nations (ASEAN), the South Asian Association for Regional Cooperation (SAARC) and the Bay of Bengal Initiative for Multi-Sectoral, Technical and Economic Cooperation (BIM-STEAC), a number of broader initiatives are underway to push the agenda of regional economic integration further. For example, ASEAN brings together major Asian countries including China, India, Japan and Republic of Korea as summit-level dialogue partners which meet at the annual ASEAN summits. A complex web of free trade agreements (FTAs) linking these countries with ASEAN or with individual ASEAN members is in the process of being formed and a virtual Asian or East Asian economic community is emerging as a result.

In this regard, the launch of the East Asian Summit (EAS) in December 2005 in Kuala Lumpur, Malaysia, as an annual forum bringing together ASEAN and all its dialogue partners was an important initiative. Participants at the EAS comprise the 10 members of ASEAN, its four dialogue partners namely China, India, Japan and Republic of Korea, as well as Australia and New Zealand. In due course, the EAS is likely to lead to the formation of an East Asian Community (EAC) comprising these countries.

Against this backdrop and drawing upon work done as a part of the ongoing research programme at RIS, this paper briefly summarizes the relevance of broader regional economic integration in Asia, highlighting the gains from such integration and outlining an approach for broader or pan-Asian economic integration. The paper concludes with a discussion of the priorities for discussion at future EAS meetings.

STIMULUS FOR REGIONAL ECONOMIC COOPERATION IN ASIA

Successful experiences with regional economic integration in the industrialized countries which began in the mid-1980s in Europe and North America have prompted Asian countries to adopt economic integration strategies. Regional trade agreements (RTAs) such as the EU and NAFTA have pursued more profound integration covering preferential FTAs, complemented by strong rules of origin, and mobility of capital and, in some instances, labour across the region. The level of economic integration has progressively deepened and the coverage of RTAs has expanded over time as illustrated by the EU which has evolved into an economic and political union while expanding membership to 27 countries. Thirteen of its members have entered into a monetary union with a common currency. NAFTA is hoping to expand southwards into a Free Trade Area of the Americas (FTAA). As more than 50 percent of world trade began to be conducted on a preferential basis, other regions have been prompted to form their own RTAs such as Mercado Comun del Sur (MERCOSUR) and the Andean Pact in South America and the Common Market for Eastern and Southern Africa (COMESA), the Southern African Development Community (SADC) and the Southern African Customs Union (SACU) in sub-Saharan Africa. Currently some 350 RTAs or bilateral trading arrangements (BTAs) in the world (including 84 in Asia-Pacific) are at different stages of implementation. Major Asian countries such as India, Japan and Republic of Korea, among others, which had remained faithful adherents of multilateralism, have also begun to rethink the role of regional economic integration in trade policy. Japan conducted a review of its trade policy towards the end of the 1990s and decided to assign an important role to regionalism. To some extent, the slow progress of multilateral trade negotiations and the inability of the multilateral trading system to live up to the expectations of Asian countries or to discipline the trend of regionalism have also contributed to the increased importance attached to regionalism by Asian countries.

A more important stimulus for regionalism seems to have come from the emergence of Asia as a source of final demand. China and India with their large populations have become powerful drivers of world economic growth, enabling Japan, the second largest economy in the world, to recover from a decade-long recession. Asia is quickly becoming the centre of gravity of the world economy and China and India are projected to become the two largest economies in the world. For many products, from jet planes to motor cars to mobile telephones, the biggest markets are in Asia. More than 55 percent of Asia's trade is now intraregional thus making regional economic integration an increasingly viable trade strategy.

Furthermore, regional economic integration could also help Asia exploit the profound synergies that have developed between the economic structures of Asian economies. For instance, the growing scarcity of labour in Japan and Republic of Korea is complemented by labour abundance in South-East and South Asian countries. Similarly, some Asian economies are focused predominantly on manufacturing and hardware capabilities while others have complementary capabilities in software and services. Already regional production networks have begun to be developed across Asia to take advantage of these synergies through vertical specialization. Regional economic integration could help in exploiting the potential for such rationalization or restructuring more fully and in expediting its development for the benefit of all.

Finally, regional economic integration will assist Asia in restoring economic, political and cultural links that had existed for centuries before being disrupted during the colonial period. The Asian region has a distinct Asian identity shaped by history and cultural exchanges and there were substantial flows of goods and services as well as labour and capital among these countries over several centuries. In ancient times, the famed Silk Routes were among several channels for such exchanges and Marco Polo's tales are just one of many such descriptions. Along with trade there was a vibrant exchange of ideas. Chinese scholars visited India and vice versa. Ideological influences spread across the nations, binding them in ties of religion. Hinduism and with it the art of governance of Chanakya found its way across much of Indonesia, Malaysia and Thailand. The sweep of Buddhism is well known. Religion has been a strong unifying factor, for with religious beliefs comes a way of life and as religious influence spread so did cultural ties. Pagan, Borobudur and Angkor Wat are but a small testimony to the vast trading and cultural network that Asia had in ancient times (Shankar 2004).¹ During the nineteenth century, the colonial powers provided the framework for extensive and liberal trade within Asia in goods and services as well as massive movements of labour and capital. Assisted by Japan's rise, trade was brisk. Even during the first half of the twentieth century, the intraregional trade ratio was over 50 percent. These trade and investment flows were, however, disrupted by political and military factors during the colonial period and in post-war Asia.

¹ For a discussion of cultural linkages as well as diversities, see Sen (2007).

TRENDS IN REGIONAL ECONOMIC COOPERATION IN ASIA

Asian developing countries 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. It is generally agreed, however, that these early experiences have not been very successful. The expectations for these initiatives have not been met for various reasons. For instance, the Bangkok Agreement has suffered from its limited membership and product coverage, shallow preference margins and lack of coverage of non-tariff barriers.

Although set up in 1967, ASEAN had limited cooperation in economic areas until the ASEAN Free Trade Area (AFTA) was established in 1992. Similarly, SAARC came into being in 1985 but did not adopt a programme of economic cooperation until 1991 with the formation of the Committee on Economic Cooperation (CEC). 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. Besides regional economic integration, BTAs between India and Nepal and between India and Sri Lanka have also speeded-up economic integration in the South Asian subregion. Another notable initiative in Asia is 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.

The East Asian crisis of 1997-98 highlighted the importance of regional economic cooperation and provided a much needed stimulus for regional economic integration. ASEAN countries expedited the programme of implementation of AFTA from 2008 to 2002 and moved on to deepen economic integration further. The crisis also led to the launch of several regional initiatives such as the Chiang Mai Initiative (CMI) 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 and Republic of Korea are all engaged in negotiations of FTAs with ASEAN and also with each other.

To sum up, initiatives towards regional economic integration include the following:

- Subregional attempts such as those by ASEAN, SAARC and BIMSTEC to form FTAs and further deepen economic integration;
- FTAs or comprehensive partnership arrangements between ASEAN and its dialogue partners, namely China, India, Japan and Republic of Korea; and also between ASEAN and Closer Economic Relations (CER) (Australia-New Zealand)

- 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 and India-China (under study).

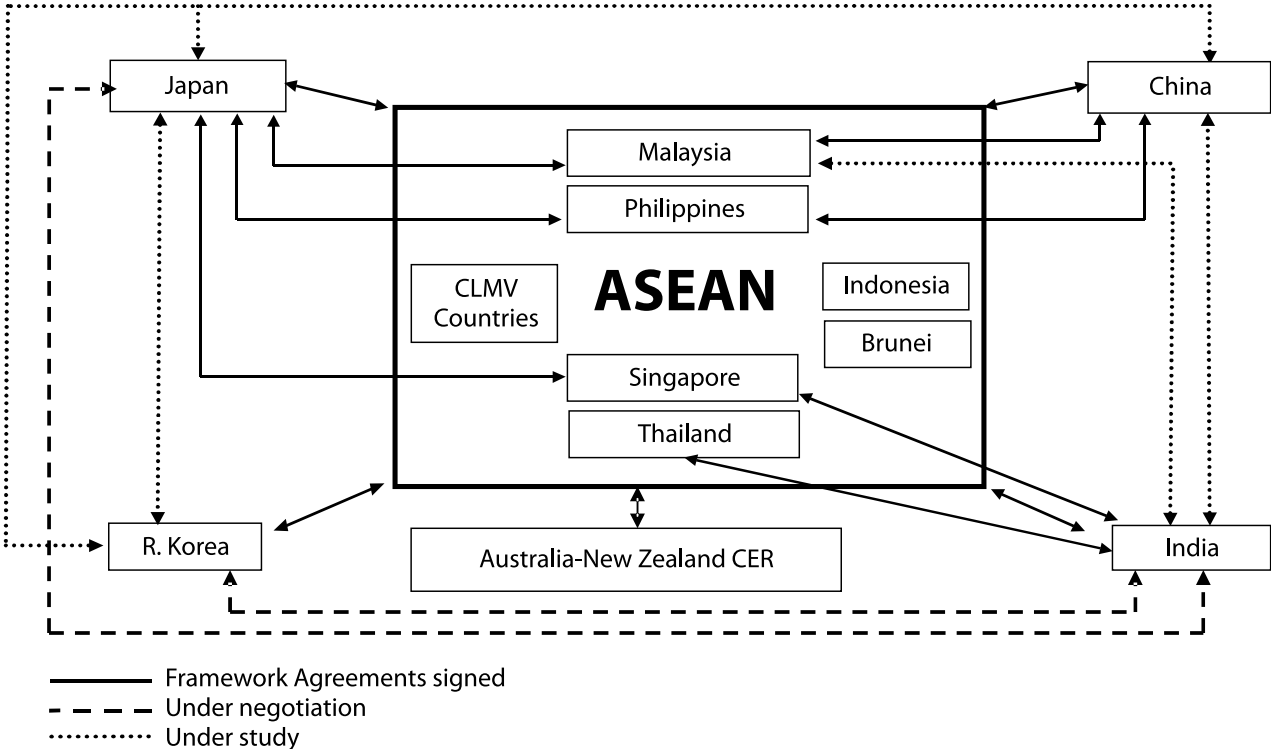
A diagram of these arrangements, as presented in figure 1, suggests that a virtual Asian grouping may be emerging from the complex web of trading arrangements linking ASEAN countries with their dialogue partners in different stages of evolution. However, it can be argued that subregional and bilateral attempts at regional cooperation, while desirable, are unlikely to exploit the full potential of regional economic integration in Asia and, hence, are suboptimal. This is because the extent of complementarities at subregional levels is limited because of similar factor endowments and economic structures within a neighbourhood. This is clear from the fact that trade between ASEAN or SAARC countries and East Asian countries is much larger than the trade within each subregion. It is for this reason that the success achieved so far from subregional or bilateral attempts at cooperation has been meagre. At the broader Asian level, the differences in levels of economic development and capabilities are quite wide thus providing for more extensive and mutually beneficial linkages. The range of economic structures within the region provides its own indigenous capacity for dynamic industrial restructuring on the basis of 'flying geese' patterns. Hence, Asia needs an overarching, region-wide scheme of economic integration to exploit the full potential for efficiency-seeking industrial restructuring and the synergies that exist in the region. Among other factors, the twin scourges of regional natural disasters, such as the Severe Acute Respiratory Syndrome (SARS) epidemic or the December 2004 tsunami, together with the threat posed by terrorism have also promoted East Asian regionalism (Teo 2005a).

There is now growing recognition in Asia of the importance of regional economic integration for generating growth impulses from within (Yamazawa 1998, 2001a, and 2001b; Alatas 2001; and Shinawatra 2001). There have been initiatives for functional regional cooperation, such as Thailand's launch of the Asian Cooperation Dialogue (ACD) in 2002 at Cha-Am, Thailand. The ACD is the inter-governmental dialogue and cooperation in Asia, focusing on promoting regional cohesion among regional organizations such as ASEAN, SAARC or the Gulf Cooperation Council (GCC). The latest 6th ACD Ministerial Meeting was convened on 5–6 June, 2007 in Seoul, Republic of Korea, addressing the promotion of IT cooperation in Asia. Similarly, the Boao Forum for Asia (BFA) was initiated by China in 2001 at Boao, in Hainan province of China, as a pan-Asian economic forum where the leaders from Asia and the globe gather to foster Asian economic integration. The recent BFA Annual Conference 2007 was held on April 21, 2007 and attended by a total of 1,410 government leaders, top business executives, scholars and media representatives. India hosted a meeting of Asian energy ministers in early-2005 in New Delhi to advance cooperation in this area.² Further attempt on regional cooperation in energy was emphasized during the first East Asian Summit (EAS) Energy Ministers' Meeting in Singapore in August, 2007. Furthermore, pooling capabilities and resources in information technologies (IT) for addressing the common needs of the region was considered at the Asian IT Ministers meeting in Hyderabad, India in early-2004.³

² See the report in the *New Asia Monitor*, January 2005.

³ See the report in the *New Asia Monitor*, March 2004.

Figure 1: An Emerging East Asian Community



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

The Prime Minister of India, Dr. Manmohan Singh, has been making a case for an Asian Economic Community (AEC) combining 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 innovations, thereby building a community that would release enormous creative energies.

In that context, the launch of the EAS in December 2005 in Kuala Lumpur is an important initiative and there appears to be widespread recognition in Asia of the relevance of broader regional economic integration. Moreover, the second EAS convened in January 2007 in Cebu, Philippines came out with the Cebu Declaration on East Asian Energy Security, emphasizing the energy development of biofuels.

APPROACHES TO BROADER ASIAN ECONOMIC INTEGRATION

It is clear from the previous section that the ongoing attempts in Asia towards regional cooperation at subregional and bilateral levels are unlikely to enable the region to exploit the full potential of regional economic integration. The multiple attempts at subregional and bilateral levels that are underway in the region do suggest, however, that there is now a growing recognition in the region of the importance of deep economic integration at the pan-Asian level and of the opportunity costs of not doing so. There is the realization that the stimulus for future growth in the region has increasingly to come from within, given the trend in the formation of regional trading blocs in the rest of the world as well as the emergence of Asia as a centre of final demand. Substantial complementarities exist between Asian economies that remain to be exploited for their mutual benefit. For instance, while there are economies in the region that have surplus capital resources, there are also economies with inadequate domestic savings for rapid development. The region is similarly characterized by complementarities in the demand and supply of other resources such as technology and skilled manpower. Regional cooperation, by generating intra-regional demand, could supplement external demand and reduce the vulnerability of the region owing to over-dependence on other regions. Regional cooperation could also help in exploiting the existing capacities of the region fully. The output lost as a result of the underutilization of capacity in the Japanese and Korean construction and engineering industries could be of the order of 10-15 percent of the gross domestic product (GDP) of the region or about a trillion dollars a year (Agarwala 2002). If more intensive cooperation resulted in the matching of underutilized capacity in some countries of the region with unmet demand in others, it could go a long way towards placing Asia on a higher-growth trajectory, so helping it to re-emerge as the centre of gravity of the world economy that it was until 1800 (Madison 2001).

The Asian region combines some of the fastest growing economies in the world. Together they form a huge market that is expanding faster than any other region and could form a vibrant regional grouping that would be roughly the size of the EU in terms of GDP; have a larger magnitude of trade than NAFTA; and with international reserves greater than those of the EU and NAFTA countries put together. The formation of a broader Asian grouping will also help the region to play a more effective role in shaping the emerging world trading and financial systems to be more responsive to its needs. A broader regional grouping will also formalize the high level of functional integration that has already taken place in Asia, especially between ASEAN and its dialogue partners.

An Approach to Integration

The approach towards broader regional economic integration has to take into consideration the process of cohesion in Asia brought about by ASEAN. As argued earlier, ASEAN has helped to bring together four major economies of Asia – China, India, Japan and Republic of Korea. These countries meet annually at ASEAN Summits, either individually in ASEAN+1 Summits or together in the ASEAN+3 Summits. It has been observed that the ASEAN+1 approach has become more attractive compared with ASEAN+3 as is

clear from the FTAs being developed by China, India, Japan and Republic of Korea with ASEAN (Bonapace 2005). Bilateral FTAs between the dialogue partners themselves are also under study. The grouping of ASEAN and its four dialogue partners, all of whom are engaged in creating FTAs with each other, as shown in Figure 1 above, can be referred to as JACIK (derived from the initials of Japan, ASEAN, China, India and Republic of Korea). Through this complex web of FTAs, a virtual JACIK or an East Asian FTA is emerging. Bilateral or subregional FTAs do not allow for the full exploitation of the potential of regional economic integration that exists in view of the substantial complementarities arising from diversity in factor endowments and levels of development. Hence, a vision for Asian economic integration can be formulated by combining the multiple FTAs between JACIK countries into an overarching East Asian RTA (Wei 2004; Yao 2005; Bonapace 2005 and Kumar, Kesavapany and Yao 2008) that will facilitate the optimal utilization of Asia's resources and synergies for the benefit of all countries. 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).

An East Asian RTA combining the JACIK economies could become the core of an EAC which could be expanded later to include other Asian countries into an AEC. This approach is supported by a number of Asian leaders including former Singapore Prime Minister Lee Kuan Yew⁴ and, as mentioned earlier, the Indian Prime Minister. President Arroyo of the Philippines has observed that "the emerging ASEAN+3+India ... will be a formidable regional grouping that can negotiate then with the EU, the Americas, Africa and such regional groupings"⁵

As the EAS brings together all the JACIK countries as well as Australia and New Zealand, which are party to the CER agreement, 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 countries participating in the EAS.

Combining sixteen of the largest and fastest-growing economies of Asia-Pacific with significant complementarities, an EAS trade bloc is a potential third pole of the world economy. The grouping has a population of 3 billion people or a half the world's population (see table 1). In terms of purchasing power parity (PPP), the EAS grouping will have a combined gross national income exceeding US\$ 18 trillion accounting for one third of the global income is much larger than either NAFTA or the EU. EAS's exports will equal US\$ 2.6 trillion compared with US\$ 1.5 trillion from NAFTA. The combined official reserves of the EAS economies, at US\$ 1.6 trillion in 2005, are much larger than those of the United States of America and the EU combined. In fact, the latest estimates suggest that the foreign exchange holdings of EAS countries exceed US\$ 3 trillion in 2007. Clearly, the region would have sufficiently large market and financial resources to support and sustain expedited development.

⁴ See, for instance, Mr. Lee Kuan Yew's address at the Foreign Correspondents Association of Singapore as reported in *The Straits Times*, 22 December 2004.

⁵ See speech delivered at the ASEAN Business Summit, Vientiane, Lao PDR, 28 November 2004.

Table 1: Proposed East Asian or JACIK Community in relation to the EU and NAFTA in 2005 (US\$ billions)

Indicator	EU	NAFTA	JACIK(14)	EAS(16)
Gross national income (PPP) (percent of world total) (2004)	10960 (19.47)	13679 (24.30)	18079 (32.12)	18759 (33.33)
GDP (percent of world total) (2004)	12213 (29.58)	13366 (32.37)	8707 (21.09)	9443 (22.87)
Exports (percent of world total)	3 682 (35.42)	1 461 (14.05)	2412 (23.20)	2538 (24.42)
International reserves	182	122	1 602	1 637
Population (millions) (percent of world total)	381 (6.12)	425 (6.83)	3 065 (49.27)	3 089 (49.65)

Source: RIS based on World Bank, *World Development Indicators 2006* (CD-ROM); International Monetary Fund (IMF), *Direction of Trade Statistics 2006* (Washington: IMF); and International Monetary Fund (IMF), *International Financial Statistics 2006* (Washington: IMF).

Therefore, EAS has the potential to create a regional grouping that could be comparable in size with NAFTA and the EU and hence form a third pole of the world economy. Besides the potential welfare gains accruing from economic integration, by taking advantage of the synergies such a grouping would help Asia play its due role in global economic governance, which would be commensurate with its increasing economic weight (see Kumar et al. 2008).

GAINS FROM ECONOMIC INTEGRATION IN EAS FRAMEWORK

The studies conducted by RIS have found considerable evidence of complementarities between EAS countries in their production and trade structures (Sinha-Roy et al. 2004, Kumar et al. 2008). Formation of an RTA may help in the exploitation of these complementarities for mutual advantage. Furthermore, trade policy liberalization needs to be accompanied by additional measures such as freer capital mobility, harmonization of customs procedures and product standards and mechanisms to ensure an equitable distribution of gains.

By now, a number of studies conducted independently of each other have reported the substantial potential of regional cooperation in increasing the welfare gains for the region (as summarized in Table 2). The RIS studies conducted using a computable general equilibrium (CGE) model have shown that trade liberalization within the framework of a RTA in JACIK could produce efficiency gains worth US\$ 147 billion. However, when an RTA is combined with investment liberalization and mobility of skilled manpower, the gains from integration add up to US\$ 210 billion, representing more than 3 percent of the combined GDP of JACIK economies. Moreover, all the JACIK countries benefit from integration. Interestingly, the welfare of the rest of the world also improves by US\$ 109 billion in scenario III suggesting that Asian economic integration will be Pareto optimal, i.e. benefiting all. A more recent exercise at RIS with a more up to date database and with the scope of the integration extended to EAS has also corroborated these findings. Furthermore, the exercise finds that the welfare gains are proportionately higher for relatively poorer countries than for the richer countries, thus presenting a potential for economic convergence. These findings have been corroborated by Asian Development Bank (ADB) and ADB Institute studies as summarized in Table 2.

Table 2: Welfare Gains from Economic Integration in East Asia

Study	Scope of Economic Integration	Estimated welfare gains for the scenario of deepest integration	Remarks
RIS [Mohanty et al 2003]:	JACIK	US\$ 210 billion	Every country benefits; potential for rest of the world also gaining
ADB [Brooks et al 2005]:	Developing Asia	much larger gains than multilateral trade liberalization	Smaller countries can share the dynamism of China and India
ADBI [Kawai & Wignarajah 2007]:	ASEAN+6 [EAS members]	US \$ 284 billion	Every country benefits
RIS [Mohanty & Pohit 2007]:	ASEAN+6 [EAS members]	US\$ 178 billion	Welfare gains vary between 1.5% of GDP (Singapore) to 4.7% (Indonesia); much higher gains for poorer countries as a % of GDP

Source: RIS based on respective studies

Using the Global Trade Analysis Project database (GTAP 6) with the World Bank's LINKAGE model, the 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 nearly US\$ 284 billion from regional economic integration in EAS or ASEAN+6 framework.

Furthermore, creation of regional institutional infrastructure to mobilize even a small proportion of the region's considerable savings of about US\$ 3 trillion for investment in regional public goods, such as transport infrastructure, gas and oil pipelines, satellites and broadband cables has the potential to generate additional output and welfare gains.⁶ These gains could amount to hundreds of billions of dollars in view of the substantial underutilized capacity in Japan, Republic of Korea and other Asian countries in the engineering and construction industries.

EAS versus East Asian Economic Integration based on ASEAN+3

There is some debate on whether ASEAN+3 is a better forum for developing a broader scheme of economic integration in Asia than EAS. However, research has shown that EAS has greater potential welfare gains for all participants than ASEAN+3. The CGE simulations reported earlier were repeated for ASEAN+3. The simulation results as summarized in table 3 clearly demonstrate that welfare gains in the EAS are much higher than in an ASEAN+3 framework in each of the three studies that compared the two alternative frameworks. A possible explanation for this considerable difference in welfare gains could lie in the greater economic diversity of EAS owing to the inclusion of additional countries such as Australia, India and New Zealand with complementary strengths. For instance, India's software- and services-dominated economy complements well with the hardware- and manufacturing-driven economies of other East Asian countries and its inclusion appears to be welfare-enhancing for all partners in EAS, a 'win-win' situation for Asia.

⁶ See RIS (2007a) for a discussion of the potential of such cooperation.

Table 3: Comparative Welfare Gains from Economic Integration in EAS and ASEAN+3

Study	Welfare gains arising from broader integration in US\$ bn	
	ASEAN+3	EAS (ASEAN+6)
RIS [Mohanty et al 2003]	162	210*
ADB [Kawai-Wignarajah 2007]	233	284
RIS [Mohanty-Pohit 2007]	92	178

*in JACIK framework.

Source: RIS based on respective studies

The dynamism and other strengths of Australia, India and New Zealand will also benefit the EAS group. India, with a US\$ 1000 billion economy growing at 9 percent per annum and a 300 million strong middle class, is emerging as the second largest economy in the world. With foreign exchange reserves of over US\$ 260 billion, one of the best-performing stock markets in Asia⁷, low rates of inflation, a market-determined exchange rate, abundant human capital and entrepreneurial resources, rapidly growing industries and services and a prudently managed financial system⁸, India is attracting attention for its strong macroeconomic fundamentals. India has recently been ranked among the top two investment destinations in the world by AT Kearney in terms of their foreign direct investment (FDI) confidence index (AT Kearney 2005). India is seen as having the potential to show the fastest growth over the next 30 and 50 years (Wilson and Purushothaman 2003). Another study by IMF finds India poised to sustain growth rates of around 7 percent over the next 30-40 years with very few downside risks (Rodrik and Subramanian 2004) The growing openness of the Indian economy means that this growth is spilling over to other economies as well and, according to IMF, India is contributing nearly 10 percent to global growth and 20 percent to growth in Asia (IMF September 2005). With China and India as two major dynamos propelling regional growth, the Asian dream will be realized faster (Kesavapany 2005). India's burgeoning demand for infrastructure investments, projected at over US\$ 500 billion, can provide a huge market for East Asian investors and underutilized construction and engineering capacities. India can help neutralize any loss of demand in Asia resulting from attempts by the United States to curb its mounting trade deficit. Malaysian companies, among others, have already won substantial projects in road construction in open bidding. The booming middle class in the country is increasingly becoming a source of final consumption demand as income levels rise. India has also emerged as a major source for high-spending tourists for a number of countries in East Asia.

Rapid integration with East Asia as part of the "Look East" policy followed by India after 1991 has made the region India's largest trade partner, ahead of the EU and the United States. India is increasingly being integrated into East Asian production chains especially in more critical knowledge-based segments such as research and development (R&D) and product design. Indeed, East Asian companies have begun

⁷ India's capital markets are highly developed with a world-class electronic settlement system and rapidly improving corporate governance. Over 6,000 companies are listed on India's stock exchanges, second only to the New York Stock Exchange (NYSE).

⁸ The ratio of non-performing assets to GDP is just 3 percent compared with China's 41 percent, Japan's 11 percent and Thailand's 9 percent.

to exploit India's strengths in R&D, software and design by locating their global R&D centres in India. For instance, Samsung's R&D Centre in India recently announced successful development of a hybrid mobile telephone that can be operated using different network technologies. China's Huawei Technologies, like many others, employs hundreds of engineers doing chip design or embedded software development in Bangalore. Hyundai uses its Indian operations as a sourcing base for compact cars. Toyota is sourcing gearboxes from its Indian plant for South-East Asian markets. Furthermore, these production networks not only include those belonging to Japanese or Korean companies but also those being developed by Indian enterprises. For instance, Daewoo Trucks has become linked with the production chain of Tata Motors following its acquisition by the latter. Several Indian companies have also begun to take advantage of cheaper manufacturing costs for hardware in China and other East Asian countries by rationalizing their production. The trend is likely to be more firmly entrenched as the emerging FTAs between India and East Asian countries come into effect. India is already negotiating an FTA with ASEAN (in addition to those with individual countries such as Singapore and Thailand), Republic of Korea and Japan and is studying an FTA with China. Hence, it is very much part of the growing web of FTAs linking the East Asian countries. There are also complementarities in the demographic trends of other East Asian countries and India. Just as those countries are about to enter into a phase of demographic burden, implying a lower share of the working-age population, and higher median age of workers, India is entering a demographic gift phase, with a higher share of the working-age population. Through IT, an India integrated into Asia could help address East Asia's demographic challenges (Asher and Sen 2008). With its excellent trading and transport links and emerging preferential trading arrangements with South Asian countries, the GCC and other West Asian countries, India could act as a bridge for East Asia to markets in South, West and Central Asian countries. Lastly, it can be argued that a group based on the EAS countries will be more balanced than one based solely on ASEAN+3.

The potential of growing economic integration between East Asia and India is catching peoples' imagination. A survey conducted by the World Economic Forum and Taylor Nelson Sofres 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, revealed that over 37 percent of 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+3.⁹ Former Singapore Prime Minister and Minister Mentor Lee Kuan Yew has argued that "India should join in, as there is nothing to be lost. It will expand the market, force more specialization, division of labour, and India has something to contribute in economic, political, diplomatic as well as the security field. So I believe it is to the advantage of the ASEAN countries that any such EAC should include India".¹⁰

⁹ The World Economic Forum, Press Release, 18 June, 2003

¹⁰ See address to the Foreign Correspondents Association of Singapore as reported in *The Straits Times*, 22 December 2004.

PRIORITY AREAS FOR COOPERATION IN THE EAS FRAMEWORK

The discussion above has shown that an RTA based on the EAS or a Comprehensive Economic Partnership in East Asia (CEPEA) would enhance welfare significantly not only for participating countries but also for the rest of the world. There are a number of other areas where regional cooperation could be fruitful such as in monetary and financial matters, energy security and science and technology, among others. Some of these areas have already been identified for cooperation within the EAS framework, as follows.

Comprehensive Economic Partnership of East Asia (CEPEA)

EAS at its second session agreed to launch a track-II feasibility study on a CEPEA covering all EAS countries. The EAS comprehensive economic cooperation arrangement could set a target for the phased liberalization of regional trade and investment regimes by 2020.

Like any scheme of trade liberalization, whether multilateral, regional or bilateral, CEPEA can adversely affect certain sections of industry in different countries. However, the decision-making is to be based on a broad assessment of positive overall net benefits. Therefore, CEPEA negotiations need to be preceded by a detailed analysis of complementarities of the possible partners, potential of industrial restructuring and welfare gains as well as identification of potentially vulnerable sections, among others. Sensitive sectors that need to be protected could be put on negative lists. Provisions for safeguards for sensitive products, special and differential treatment for countries at different levels of development and dispute resolution will need to be built into the agreement. Agricultural trade liberalization should be attempted on a separate track from that of industrial goods to allow greater consideration of food security and livelihood issues. Care must be taken in designing programmes of regional economic integration to keep equity, employment generation and necessary social transformation and social safety nets for the vulnerable sections of the society at their heart so that they represents regionalism with an 'Asian' face. 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 (RIS 2006, 2007b).

Monetary and Financial Cooperation in Asia

The combined foreign exchange reserves of JACIK countries now add up to over US\$ 3 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 United States Treasury bonds and, therefore, do not contribute more meaningfully to Asian development. The accumulation of reserves is matched by a substantial deficit for investments in Asia with infrastructure development needs of underdeveloped parts of Asia running into trillions of dollars. India alone has a requirement of US\$ 500 billion for infrastructure development over the next five years.

The objective of financial cooperation in Asia should be to leverage the combined foreign exchange reserves of EAS countries for mutual benefit. There is a growing consensus that Asia needs a regional institution for mobilizing foreign exchange resources for its own development, in addition to using these resources to ensure stability of real effective exchange rates and to respond in an orderly manner to external shocks.¹¹ Even sceptical commentators such as Martin Wolf now acknowledge the importance of Asia having its own regional monetary and financial institutions (Wolf 2004). Studies have shown that there is growing macroeconomic interdependence between ASEAN, Japan and Republic of Korea. Such interdependence is likely to include China and India, as well as Australia and New Zealand, with ongoing reforms, liberalization and market opening (Kawai 2004, and Rajan 2006).

A number of important initiatives have been taken in the area of monetary and financial cooperation in Asia over the past decade including the CMI and the development of Asian Bond Funds. However, these initiatives need to be deepened and scaled up and broadened to cover all EAS member countries to be effective.

Asia also needs a unit of account to facilitate growing intraregional trade which now amounts to nearly 55 percent of all trade in the region. One area for cooperation would be the creation of a regional unit of account or an Asian Currency Unit (ACU) that could bring about relative stability of intraregional exchange rates. In due course, the unit could emerge as a parallel currency.

In view of Asia's sizeable resources and the need to bridge the considerable gaps between demand and supply in infrastructure financing in some countries of the region, a more ambitious attempt needs to be made towards financial cooperation, perhaps with the creation of a regional monetary and financial institution to push the process forward. As Datuk Seri Abdullah Ahmad Badawi, Prime Minister of Malaysia has suggested, 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 EAC together. Such an institution could also offer balance-of-payments support to member countries and create an ACU, initially to serve as a unit of account to facilitate growing intraregional trade and later to emerge as a parallel currency. Even a small fraction of the foreign exchange reserves of EAS countries invested in such an institution would give it a massive capital base. An Asian monetary and financial institution could also provide funding for regional public goods without putting pressure on Government budgets in member countries (Agarwala 2004). The borrowers could be regional companies, similar to the Channel Tunnel Company in the EU, with public and private sector participation. There is also substantial potential for bond market development in Asia and some steps have been taken in that regard.¹² An Asian Investment Bank for facilitating infrastructure financing and cooperation between national export-import banks in the region are other possibilities (Agarwala and De 2008, RIS 2007a, b).

The EAS held at Cebu in January 2007 identified finance as one of the areas of cooperation and has sought proposals from officials for consideration of the issue at the third Summit to be held in Singapore.

¹¹ See RIS (2007) and Agarwala and De (2008) for a proposed regional framework for financial cooperation.

¹² See the presentation by Ambassador M. Xuto at the High-level Conference on Asian Economic Integration organized by RIS in Tokyo, 18-19 November 2004.

Cooperation for Energy Security

Major countries of Asia, namely China, India, Japan and Republic of Korea among others, are highly dependent upon oil and gas imports and could benefit from mutual cooperation in this area. Regional cooperation in the area of energy could be directed towards ensuring security and sustainability of energy supplies, overseeing the efficient utilization of natural energy resources in the region and fostering rational management of energy demand with due consideration for the environment. It could also assist in establishing a policy framework and implementation modalities for setting up region-wide energy networks, such as oil or gas grids, and in coordinating, managing and monitoring the implementation of these networks. Possible targets for Asian energy cooperation could be the creation of an Asian Strategic Petroleum Reserve and an Asian Emergency Response System. The strategic reserve could act as an insurance policy to safeguard against the manipulation of oil prices and would enable Governments to provide supply liquidity in emergencies.¹³ Asian countries have some ongoing cooperation in the area as joint energy exploration or oil equity-sharing by Chinese, Indian, Japanese and Korean oil companies in projects in third countries within the region, such as in Myanmar and Viet Nam, as well as outside the region as in Sudan. The major oil importers in the region have begun to coordinate their positions in negotiations with the Organization of Petroleum Exporting Countries (OPEC) with respect to the premium that is currently charged by the Middle East countries on oil supplies to Asian countries (Ito et al. 2005). The cooperation could also extend to cover joint patrols of sea-lanes through which the bulk of the oil and gas supplies for the region pass, such as Straits of Malacca, to prevent piracy. Asian energy ministers met in January 2005 in New Delhi to advance cooperation in this area.¹⁴ There is need to create an Asian Energy Dialogue that would bring together energy enterprises and other stakeholders in the region to take the initiative on energy cooperation on a continuous basis. The EAS Summit at Cebu identified energy security as an important area of its work and issued a Cebu Declaration on Asian Energy Security. Furthermore, the first East Asian Summit (EAS) Energy Ministers' Meeting in Singapore in August, 2007 highlighted the EAS Energy Cooperation Task Force (ECTF) which addresses three areas for cooperation, (i) Energy Efficiency & Conservation; (ii) Energy Market Integration; and (iii) Bio-fuels for transport and for other purposes.

Cooperation in Core Technologies for Addressing the Digital Divide and Nutritional and Health-Related Issues

The region's substantial capacities in hardware and software could be pooled together to address the digital divide to empower the poor to benefit from the fruits of new technologies. This would require joint development of low-cost hardware and the development of software in local languages and graphic interfaces. This would call for the pooling of the complementary strengths of North and Southeast Asia and India in hardware and software respectively. Similarly, cooperation in biotechnology could focus on the nutritional and health needs of the poor in Asia. Appropriate regional institutional mechanisms need to be created for facilitating the pooling of resources and capabilities of different member countries for undertaking these tasks. Some thinking on pooling resources for addressing the common needs of the

¹³ See Tuli (2008).

¹⁴ India hosted a meeting of Asian Energy Ministers in New Delhi in early-2005 to discuss issues of mutual concern. See *New Asia Monitor*, January 2005 for details.

region has already started and Asian IT Ministers met in Hyderabad, India, in early-2004.¹⁵ In addition, the promotion of IT cooperation and bridging of the digital divide was focused as a discussing theme for the 6th ACD Ministerial Meeting in Seoul, Republic of Korea in June 2007.

Global Governance, Peace and Security

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.

15 See *New Asia Monitor*, March 2004 for details.

CONCLUSIONS

Developments of the past few years have led to an Asian resurgence with the emergence of China and India as engines of growth, the recovery of Japan from a decade-long recession, the rise of an Asian middle class as source of final demand and the increasing resilience of Asian countries to external shocks such as rising oil prices, among others. Over the past decade, Asian countries have integrated themselves within the region as is evident from the high and growing proportion of intraregional trade and investment. Besides their growing economic interdependence, Asian countries also have shared vulnerabilities to external shocks and natural disasters as demonstrated by the 2004 tsunami.

There is great interest in Asia in building on growing functional and market-driven economic integration in the region. The emerging web of FTAs linking ASEAN and its Summit-level dialogue partners, namely China, India, Japan and Republic of Korea and possibly Australia and New Zealand, could form the basis of an inclusive EAC which could eventually grow into a broader AEC.

ASEAN has played an important role in developing a framework for broader cooperation by bringing together major Asian countries such as China, India, Japan and Republic of Korea as dialogue partners. These dialogue partners are all working on FTAs with ASEAN and are studying bilateral FTAs between themselves. Through the emerging web of FTAs, a virtual Asian economic community is evolving. There is a need to build on these subregional and bilateral attempts at integration to create a broader regional framework to facilitate the development of a seamless market for the efficient exploitation of available synergies. Studies have shown that broader regional integration in Asia has the potential for generating billions of dollars of additional output, so placing Asia on a path to higher growth. Furthermore, it has been shown that Asian economic integration will benefit the rest of the world as it implies trade creation rather than trade diversion. Hence, it is a 'win-win' strategy for Asia as well as for the world. Importantly, regional economic integration is likely to bring about convergence in levels of development and could an important instrument in the region's fight against poverty.

Various Asian leaders and statespersons have spoken of the importance of broader regional cooperation in Asia in asserting Asian identity. However, Asia lacked a forum for dialogue on such cooperation. The launch of the East Asia Summit (EAS) in Kuala Lumpur on 14 December 2005, attended by the leaders of ASEAN, Australia, China, India, Japan, New Zealand and Republic of Korea, has provided the region with the necessary forum. The second session of EAS held in Cebu in January 2007 led to an agreement to launch a feasibility study for a comprehensive economic partnership covering all EAS countries. EAS members together account for more than one fifth of global output and trade, half of the world's population and more than two - thirds of global foreign exchange reserves. The EAS could provide the basis for a major grouping that would be a third pole of the world economy, after NAFTA and the EU. Such a comprehensive partnership, after a period of development and consolidation, could be subsequently expanded to include other Asian countries to create a true AEC.

It has been shown that integration based on the EAS grouping has considerably greater potential for welfare improvement than integration limited to ASEAN+3 apart from being more inclusive and balanced. It would also enable the grouping to benefit from the dynamism and complementary resources and capabilities of economies such as India and Australia. In particular, with a US\$ 1000 billion economy growing at 9 percent annually, a large middle class and strong macroeconomic fundamentals, India is able to contribute meaningfully to East Asian integration for the benefit of all.

Other adjuncts of comprehensive economic cooperation within the EAS framework could include the creation of an Asian monetary and financial architecture to facilitate intraregional trade and exchange rate stability through pooling reserves, creation of an ACU as a unit of account and the establishment of an Asian investment bank. An Asian Energy Forum to pursue regional cooperation for energy security would be another desirable outcome.

To support these initiatives Asia needs think-tanks to brainstorm on the policy challenges for regional economic integration and to provide a roadmap for the official processes. In this regard, the Japanese proposal for an Economic Research Institute of ASEAN and East Asia (ERIA) was endorsed by the EAS at the Cebu Summit. It is expected to foster analytical capacity-building in the region through cooperation with national think-tanks in member countries. It could also coordinate existing think-tank networks such as the New Asia Forum coordinated by RIS and the Network of East Asian Think-tanks (NEAT), among others, to assist the process of policy development in a more effective manner. Finally, the EAS could take initiatives for greater people-to-people exchanges, cultural interactions and educational and media exchanges for an Asian identity or the ideas of 'Asianness' or 'One Asia' to take hold (Teo 2008).

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