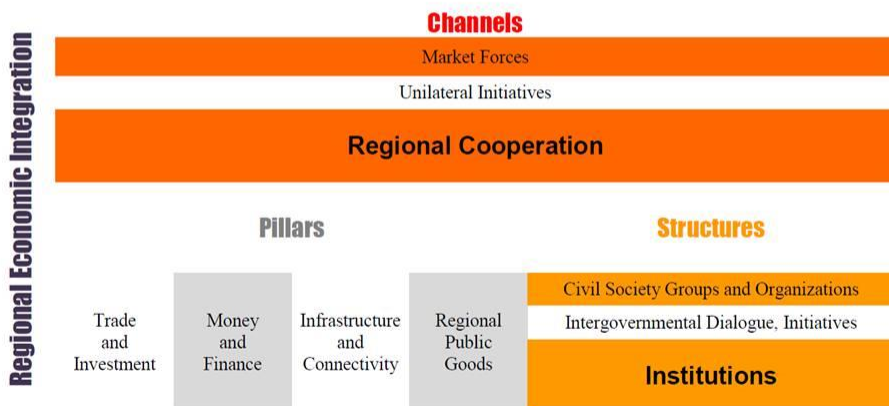


**Panel Session III**  
**Economic and Financial Cooperation and the Regional Integration**

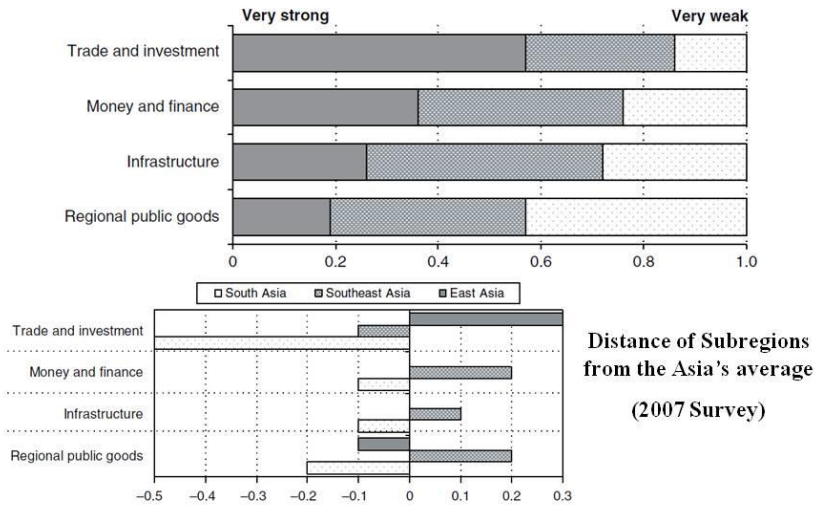
**Asia's Institutional Architecture for Economic and Financial Integration**

Capannelli, Giovanni

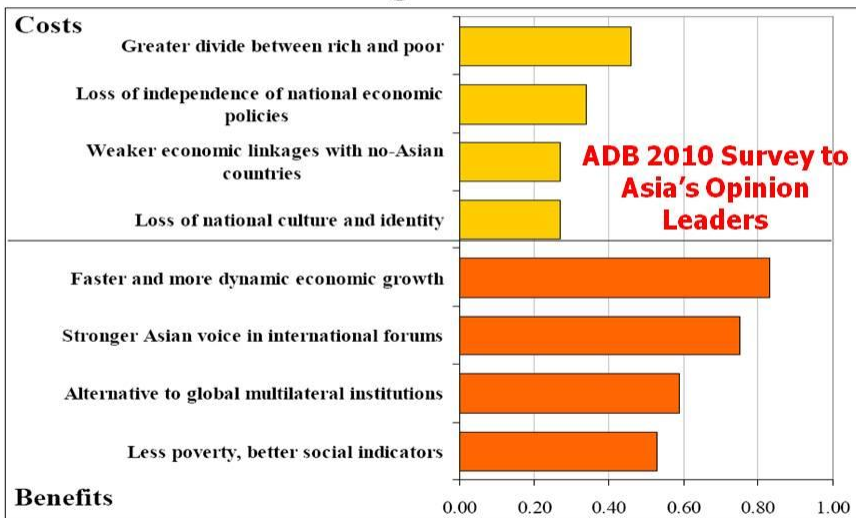
**Asia's Regional Cooperation and  
Economic Integration:  
Logic Framework**



## Assessment of intra-Asian Economic Relations by Pillars



## Benefits of Integration Outweigh its Costs



## Recent Trend of Asia’s Economic Integration

- **Distinctive characteristics: open, multi-speed, multi-track, pragmatic, bottom-up**

### 1. Trade and Investment

- Production Networks and “Factory Asia”

### 2. Money and Finance

- Portfolio investment flows, Stock price correlation, Variation coefficients of interest rates

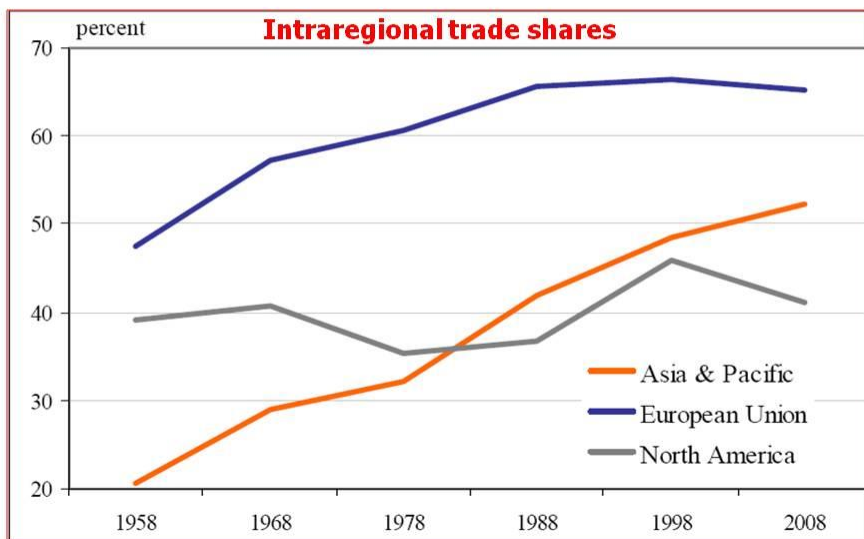
### 3. Infrastructure

- Physical connectivity; Software and standards’ harmonization

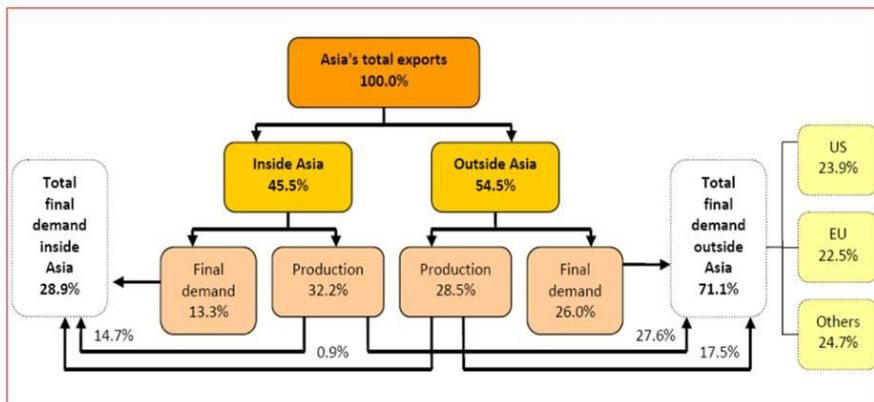
### 4. Regional Public Goods

- Environment, Disaster Management, Health, Energy, Crimes

## Growing Trade Integration

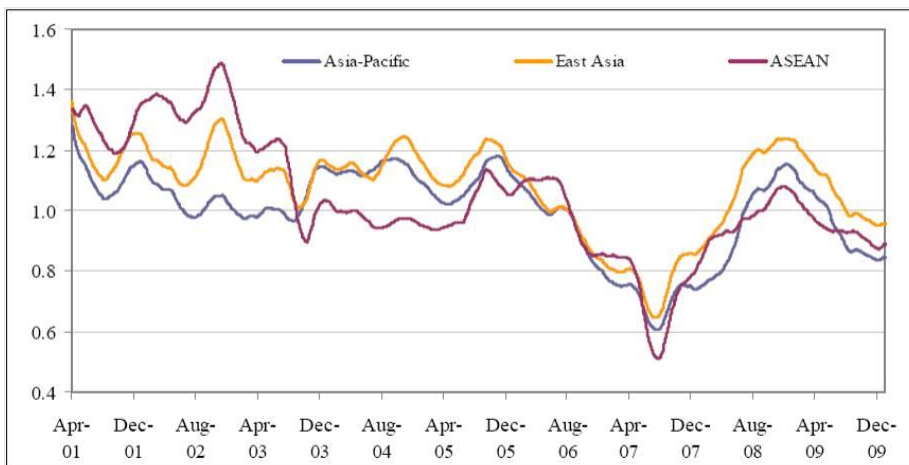


## Final Demand of Asian Exports



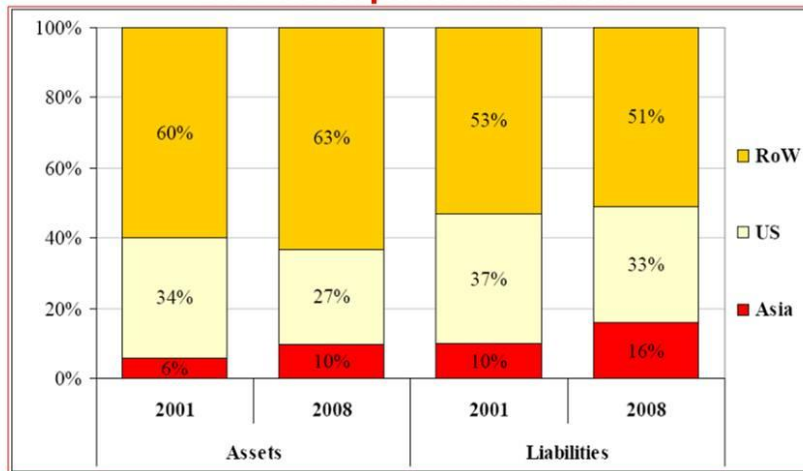
Note: Asia includes 14 countries for which data is available: Hong Kong, China; Japan; People's Republic of China; Republic of Korea; and Taipei, China (Northeast Asia); Indonesia; Malaysia; Philippines; Singapore; Thailand; Viet Nam (Southeast Asia); Bangladesh; India; Pakistan (South Asia). Source: ADB staff estimates from Global Trade Analysis Project (GTAP) version 7. Data refers to the world economy in 2007.

## Variation Coefficient of cross-market 10-year bond yield spread



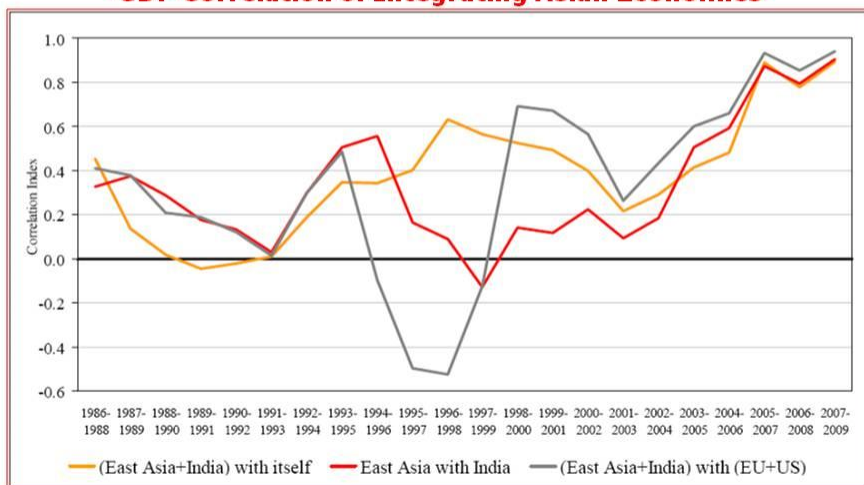
## Financial Integration: Low but Increasing

### Cross-border portfolio investment

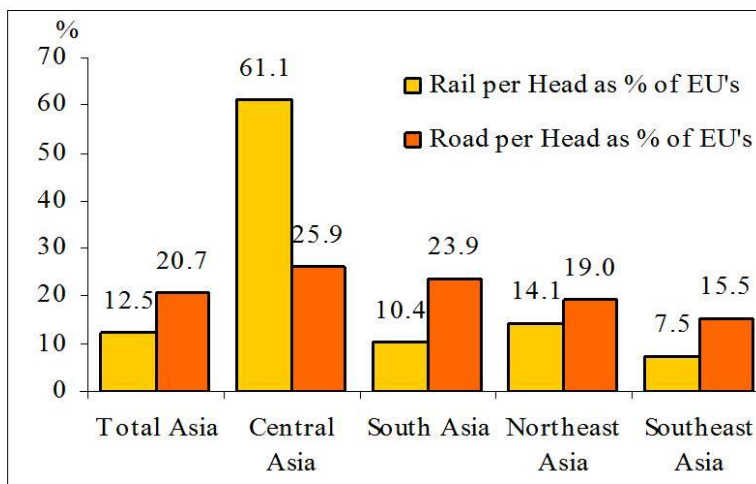


## Deepening Macroeconomic Interdependence

### GDP Correlation of Integrating Asian Economies



## Need to develop regional infrastructure



## Need for Cooperation

- **Broadening the process**  
Across sectors and Asia's subregions and sectors (twin challenges)
- **Cementing recent gains**  
Economic crises underscore the need for economic and financial stability to consolidate recent gains
- **Deepening integration**  
Competition policy; service trade liberalization; labor migration; technology and innovation policy; financial market development; exchange rate and monetary policy coordination
- **Ensuring compatibility of regional-global integration**  
Measures to cement regional integration must complement rather than jeopardize its links with the rest of the world

## Twin Challenges for Asian Integration

### Regional Economic Integration Remains Unevenly Distributed Across Sectors and Asia’s Subregions

	Production integration	Final goods integration	Services integration	Labor integration	Monetary and financial integration
East Asia	High	Moderate	Moderate	Low	Low
Central Asia	Low	Low	Low	Moderate	Low
South Asia	Low	Low	Low	Low	Low
Pacific	Low	Low	Low	Low	Low

## Rationale for Asia’s Economic Cooperation

- **Manage regional interdependence**
  - Reduce regional trade and investment barriers
  - Ensure financial stability and promote financial integration
  - Provide public goods (environment, health, security, etc.)
- **Reinforce national policy**
  - Add value to national policy making
  - Support integration against special interests
  - Increase competitiveness of domestic industries
- **Represent local interests in global institutions**
  - Champion open, stable global markets
  - Ensure support for economic development
  - Influence the agenda of global institutions (IMF, G-20, etc.)

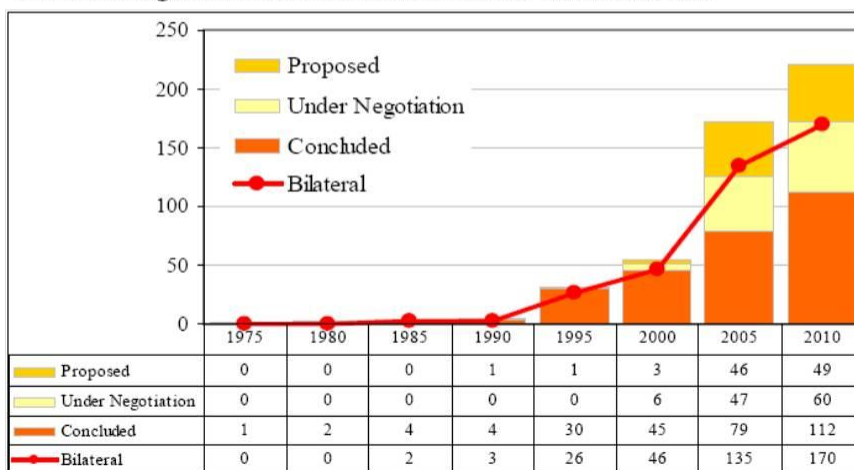


## Regionalism and Globalism

- Regionalism has an intrinsic discriminatory component: Open regionalism as the form with least discrimination against non-members
- Regional integration and cooperation can be a stepping stone towards global integration and cooperation: before becoming good global citizens it might be important to know how to serve as good regional citizens (starting from getting along together with regional neighbors)
- Historical, geographical, political, social, and cultural conditions vary across regions in the world: it is difficult to find a global ‘norm’ for regional integration and cooperation. However, regions can learn from each others especially to avoid repeating mistakes

## Growing Asia’s FTAs

Free trade Agreements in Asia and the Pacific as of January 2010





## Regional Public Goods

<b>Environment , Climate Change</b>	<ul style="list-style-type: none"><li>• Deforestation, climate change, rising sea levels, air and water pollution, land degradation, loss of biodiversity, coastal management, aquatic resource depletion</li></ul>
<b>Disaster Risk Management</b>	<ul style="list-style-type: none"><li>• Natural calamities: tsunami, earthquake, volcanic eruptions, flooding, drought; etc.</li></ul>
<b>Health</b>	<ul style="list-style-type: none"><li>• Prevention &amp; management of communicable diseases such as HIV/AIDS, severe acute respiratory syndrome, avian influenza; etc.</li></ul>
<b>Energy</b>	<ul style="list-style-type: none"><li>• Energy sources' diversification (oil, gas, hydropower); impact mitigation of uneven resources distribution across countries</li></ul>
<b>Human and Drug Trafficking</b>	<ul style="list-style-type: none"><li>• Transnational crimes (need to reduce gaps in income and deal with connectivity issues)</li></ul>

## Regional infrastructure

### **Pan-Asian Infrastructure Forum**

- Exchanging information and conducting relevant research
- Building and managing cooperation among stakeholders
- Formulating a coordinated strategy for Asia's infrastructure development
- Identifying and prioritizing projects and infrastructure networks
- Developing a harmonized set of standards

### **Asian Infrastructure funding needs**

- Asian Infrastructure Fund
- Multilateral Development Banks
- Bilateral and National Sources
- Private Sector and PPP Initiatives

**ASEAN Infrastructure Fund (USD 700 M) started in 2010**

## New Financial Institutions for Regionalism

Chiang Mai Initiative Multilateralization (CMIM)				ASEAN Infrastructure Fund (AIF)		
Members	% Capital Contribution	Voting Power (%)	Borrowing Power (%)	Members	% Capital Contribution	Voting Power (%)
BRU	0.03	1.16	0.17	BRU	2.06	2.06
CAM	0.10	1.22	0.50	CAM	0.02	0.02
INO	3.79	4.37	9.47	INO	24.73	24.73
LAO	0.03	1.16	0.50	LAO	0.02	0.02
MAL	3.79	4.37	9.47	MAL	30.92	30.92
MYA	0.05	1.18	0.25	MYA**	0.00	0.00
PHI	3.79	4.37	9.47	PHI	3.09	3.09
SIN	3.79	4.37	9.47	SIN	3.09	3.09
THA	3.79	4.37	9.47	THA	3.09	3.09
VIE	0.84	1.85	4.17	VIE	2.06	2.06
<b>ASEAN</b>	<b>20.00</b>	<b>28.42</b>	<b>52.92</b>	<b>ASEAN</b>	<b>69.08</b>	<b>69.08</b>
PLUS3*	80.00	71.58	47.08	ADB	30.92	30.92
Total	100.00	100.00	100.00	Total	100.00	100.00

\*PLUS3=People's Republic of China, Japan, Korea.

\*\*Myanmar is not contributing to AIF.

Source: ASEAN Secretariat, Asian Development Bank, and authors' elaborations.

## Institutional Innovations

### ASEAN+3 Macroeconomic Research Office

**Features:** (i) Collective Management of Pooled Reserves; (ii) Flexible Decision Making; (iii) Small Country Bias

**Issues:** (i) Overall Size; (ii) Surveillance Capacity and Resource Availability; (iii) Conditionality–moral hazard

**Perspectives:** (i) Develop to an Asian Monetary Fund; (ii) De-link from IMF programs; (iii) Offer more instruments such as precautionary credit lines

### ASEAN Infrastructure Fund

- Example of South-South Cooperation;
- Contributions based on economic interest, not on size or equality
- Flexible decision making: Qualified majority for fundamental issues (67% voting power and stakeholders); simple majority for operational issues (50% voting power and no. stakeholders)

## Asia’s Institutional Landscape

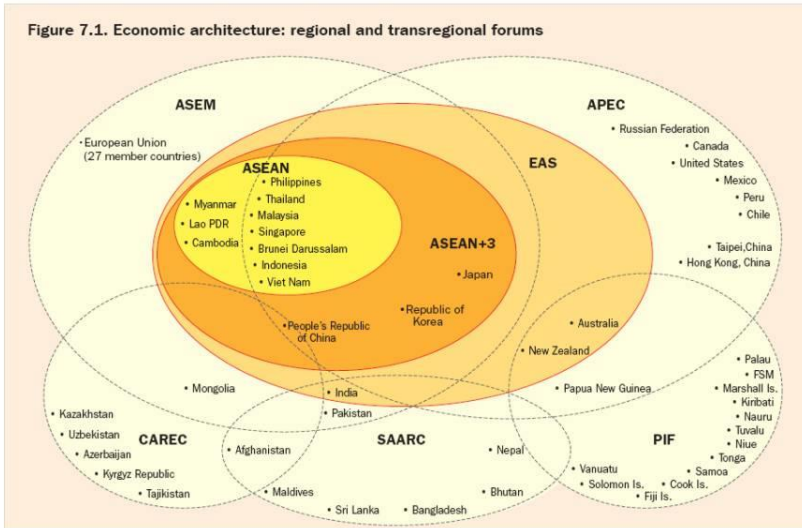
- **Dense web of regional institutions**
- **Scope and structure vary widely**
- **Mostly inter-governmental**
- **Marked by lack of formal rules and legal structures**
- **Few delegated powers from national agencies**

*No grand design: development in response to specific needs*

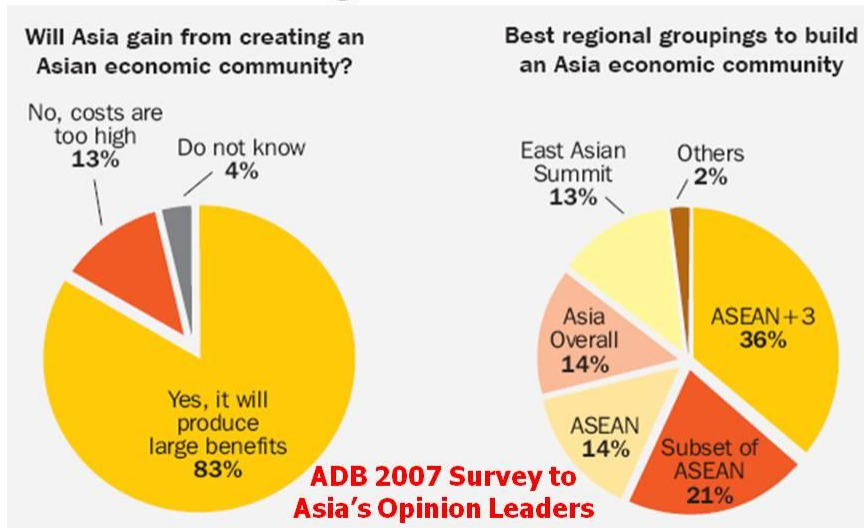
## Inventory of Asia’s Institutions for Regional Integration (IRIs)

	Trans-regional	Pan-Asian	Intra-regional	Subregional					Total
				Central Asia	South Asia	Southeast Asia	Northeast Asia	Pacific	
Overarching	4		2		1	1	1	1	10
Functional	3		8	3	3	5	1	5	28
Facilitating		2							2
<b>Total</b>	7	2	10	3	4	6	2	6	40

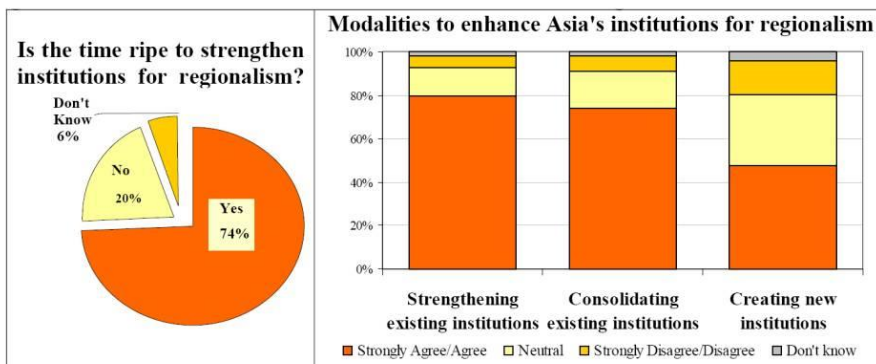
## Existing Main Regional and Trans-regional Forums



## Asian Economic Community: Long-Term Goal

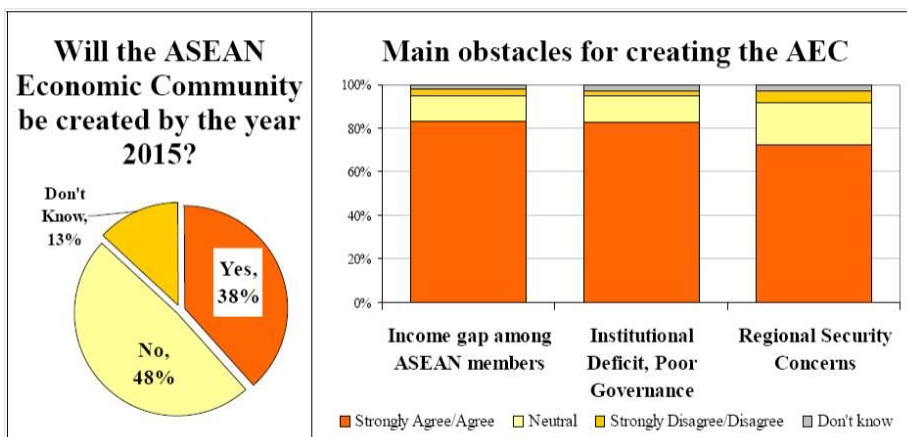


## Enhancing Regional Institutions



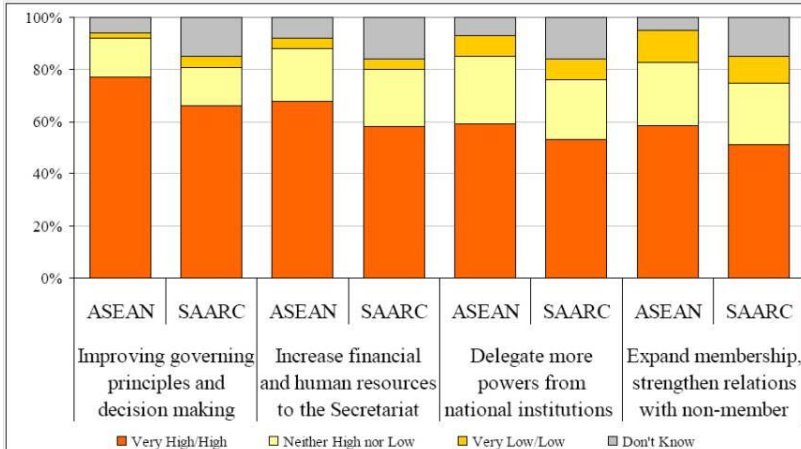
ADB 2010 Survey to Asia's Opinion Leaders

## Skepticism on the ASEAN Economic Community



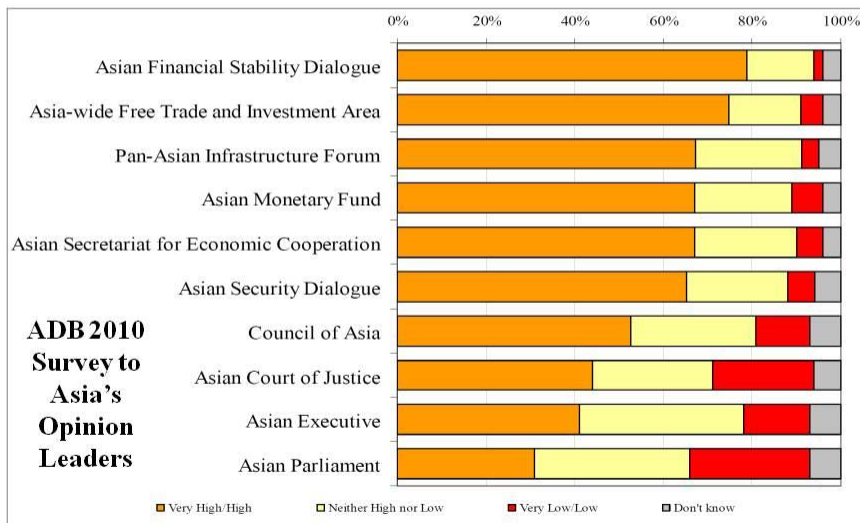
ADB 2010 Survey to Asia's Opinion Leaders

## Needed Reforms in ASEAN and SAARC



ADB 2010 Survey to Asia’s Opinion Leaders

## Needed new Institutions for Asian Integration



ADB 2010 Survey to Asia’s Opinion Leaders



## Complementarity between Global and Asian Institutions

Function	Global Institutions	Asian Institutions
Macroeconomic Stability	<b>International Monetary Fund</b> <i>Global and national surveillance, crisis lending, systemic stability</i>	<b>Asian Monetary Fund</b> (to evolve from CMIM) <i>Regional surveillance, crisis lending, stability</i>
Development Finance	<b>World Bank</b> <i>Global public goods: poverty, environment, food and energy</i>	<b>Asian Development Bank</b> <i>Regional development priorities, regional infrastructure lending</i>
Trade Liberalization	<b>World Trade Organization</b> <i>Global disciplines, dispute resolution, Article XXIV</i>	<b>Asia-wide Free-Trade Agreement</b> (to be forged by consolidating existing FTAs) <i>Deeper and wider regional trade agreement</i>
Financial System Stability	<b>Financial Stability Board</b> <i>Standards of global financial markets, colleges of regulators</i>	<b>Asian Financial Stability Dialogue</b> (to be created) <i>Asian financial markets' regulatory initiatives</i>

## Asian Regionalism: Partnership for Shared Prosperity

Asian economies in the long-run are likely to have

- a single market for goods and services
- deep, liquid and integrated financial markets
- effective macroeconomic policy coordination
- workers moving much more freely than today
- collective efforts to address social issues
- stronger voice in global policy forums
- more effective regional institutions



## What is happening in Europe?

- Euro-zone members are struggling to get closer: in front of a regional crisis they are finding a solution within the region by strengthening it.
- Reaction to crises has proven, so far, the most effective way for regionalism to progress => **Europe is doing well** and it is working fast (*criticism often does not realize the political component of European regionalism and the fact that the union is much more than the sum of its units and members contribute differently to its strengthening*).
- The ‘euro’ project is lacking of an effective mechanism to provide fiscal discipline for its members – *Eurozone* countries finally agreed on a fiscal compact to strengthen its foundations, enabling effective intervention from regional institutions (ECB), and counting markets will be able to price this long-term solution.

## What didn’t work in Europe?

- The design of the euro did not include any explicit agreement for *fiscal integration* apart from the growth and stability pact
- The design of the euro did not include an escape clause: *exiting the euro is not in the treaty*
- The *fiscal surveillance mechanism* did not work properly: it is governed by an intergovernmental process under the Council, not directly by the European Commission
- *Sanctions* were not imposed to countries that did not respect the growth and stability pact and cheated on their accounts
- The role of the *ECB as a lender of last resort* in the case of banking and sovereign debt crises needs to be further clarified

## **Can Asia learn from Europe?**

- Pronounced diversity: Minority (or small country) bias; subsidiarity principle
- Institutions: Strengthening resources and global voice
- Variable geometries: Balancing the open coordination method (no sanctions) with rule-enforcement mechanism
- Economic integration: rules and regulations are needed to govern the common regional market (NTB, trade and investment facilitation, capacity building)
- Financial integration: the creation of a common currency requires not only the unification of monetary policy but also a fiscal compact. Macroeconomic coordination, esp. exchange rate policy coordination, implies a looser form of monetary policy and fiscal policy coordination, at least in the form of intensified macroeconomic surveillance

## **Can Europe learn from Asia?**

- **Growth-orientation**
  - Regionalism to promote national, regional, and global prosperity
  - Market-led process focused on production networks
  - R&D investment to enhance productivity (i.e. South Korea)
- **Flexibility**
  - Flying-Geese model of industrial development (continuous shift)
  - Labor market flexibility
- **Pragmatism**
  - Efficiency: doing doable things a-la Monnet (back to the future)

*Asia should not look at Europe as an example for integration but it can learn several technicalities*