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## Asian Economic Integration and Cooperation: Challenges and Ways Forward for Pan-Asian Regionalism

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Durgesh K. Rai

**No 152**

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## **Asian Economic Integration and Cooperation: Challenges and Ways Forward for Pan-Asian Regionalism**

### **Abstract**

As the Asian economies have grown larger and become more complex, they have also become more integrated at both the regional and the subregional level. Yet although economic integration has increased, regionalism in the sense of economic cooperation at both the pan-Asian and subregional levels has lagged behind. Regionalism or economic cooperation in terms of bilateral or multilateral FTAs is a relatively new phenomenon, but one that has increased rapidly in recent years. However, the progress of Asian regionalism faces several challenges. Also, the increasing number of FTAs could lead to a “spaghetti-bowl effect” and reduce trade volume instead of increasing it. In addition to resolving the existing challenges, actors in the region need to convert some of the existing FTAs into a broader one that can serve as a hub for further integration. Given the potential economic gains and future economic dynamism of the region, this paper suggests the pursuit of the Comprehensive Economic Partnership in East Asia (CEPEA) rather than the East Asia Free Trade Area (EAFTA).

**Keywords:** economic integration, regionalism, economic cooperation, ASEAN, SAARC, spaghetti-bowl effect, FTAs

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## **Zusammenfassung**

### **Wirtschaftliche Integration und Kooperation in Asien:**

#### **Herausforderungen und Perspektiven für panasiatischen Regionalismus**

In dem Maße, in dem die asiatischen Ökonomien gewachsen sind und an Komplexität gewonnen haben, hat auch ihre regionale und subregionale Integration zugenommen. Dennoch hinkt Regionalismus im Sinne ökonomischer Kooperation auf panasiatischer oder subregionaler Ebene hinterher. Bilaterale oder multilaterale Freihandelszonen sind ein relativ neues Phänomen, erleben in jüngster Zeit allerdings ein rapides Wachstum. Gleichwohl steht der Fortschritt des asiatischen Regionalismus vor einer Reihe von Herausforderungen. Die zunehmende Zahl von Freihandelsarrangements könnte zu einem „Spaghetti-Schüssel-Effekt“ führen und das Handelsvolumen eher verringern als steigern. Die Akteure der Region müssen einige der bestehenden Freihandelszonen in eine weiter gefasste überführen, die als Drehscheibe weiterer Integrationsprozesse fungieren kann. Angesichts der potenziellen wirtschaftlichen Zuwächse und des künftigen Dynamismus der Region plädiert der Beitrag dafür, eher die *Comprehensive Economic Partnership in East Asia* (CEPEA) als die *East Asia Free Trade Area* (EAFTA) voranzutreiben.

# **Asian Economic Integration and Cooperation: Challenges and Ways Forward for Pan-Asian Regionalism**

**Durgesh K. Rai**

## **Article**

1. Introduction
2. Regionalism: Concepts and Theoretical Underpinnings
3. Regionalism in Asia
4. Key Challenges and Ways Forward for Pan-Asian Regionalism
5. Conclusion

## **1. Introduction**

Asia's growing economic prowess is one of the most significant phenomena of the late twentieth and early twenty-first centuries. The unprecedented economic growth in the region during the last couple of decades has shifted the world economy's center of gravity from the West to the East. The current financial crisis has further underscored the fact that Asia is the world's growth engine and will continue to be so in the foreseeable future. The Asian economy is equivalent in size to that of Europe or North America, and three out of the four largest economies in the world in terms of purchasing power parity (PPP) are located in Asia. It is estimated that by 2020 the Asian economy will be 50 percent larger than the economies of both Europe and North America (Asian Development Bank (ADB) 2008). These developments are poised to change the world's economic landscape and will certainly affect the existing global governance system. The ongoing Asian economic story represents both challenges and opportunities for

the rest of the world. Given the region's increasing economic and population share in the world, the smoothness of its transition from developing to developed region is a necessity not only for the people of Asia but also for the world community as a whole.

Asia's unparalleled economic growth has been fueled by the continuous unilateral and plurilateral liberalization undertaken by many of its countries during the last couple of decades—at different points of time in the various countries and subregions. Asian economies are becoming increasingly interdependent with other economies of the world through trade, financial transactions, foreign direct investment, technology, labor and tourist flows, and other forms of economic exchange. This has led to unprecedented growth in trade and foreign investment in many Asian countries. As a result, the share of trade and foreign investment in the GDP of many Asian countries has increased phenomenally over time.

It is not only Asia's economic engagement with the rest of the world but also its intraregional trade and investment flows, and hence its economic interdependence, that have increased rapidly over the years. This has resulted in growing intraregional economic integration in Asia in general and in different subregions of Asia in particular. Today Asia trades roughly as much internally as Europe and North America do. Indeed, Asian countries now trade more among themselves than either the EU or North American countries did at the outset of their integration efforts. Other economic integration indicators have also been continuously rising. Moreover, it is worth noting that Asian economic integration has until recently been largely market driven, not policy driven as was the case with European and North American integration. Asian economic integration began with the "flying geese pattern of development," according to which capital, technology, and know-how trickled down, first from Japan to the Asian economic tigers (Taiwan, Korea, Singapore, and Hong Kong) and then to other Southeast Asian countries (Thailand, Malaysia, Indonesia, and the Philippines) (Kumar 2007). The process was further induced by unilateral and plurilateral trade and investment liberalization, along with the increasing fragmentation of production processes and technological change.

In the last few years, especially in the aftermath of the Asian financial crisis (1997/98), economic cooperation and regionalism have become very visible policy instruments in Asian countries, where they have been used to sustain these countries' growth momentum. At present, almost every country in the region is part of some bilateral or regional trade arrangement. This has led to the proliferation of various free trade agreements (FTAs), regional trade agreements (RTAs), preferential trade agreements (PTAs), and comprehensive economic partnership agreements (CEPAs) within and outside Asia in recent years. The growing economic regionalism/cooperation among Asian countries has been encouraged by various factors, such as increasing regionalism in Europe and North America; the perceived success of economic integration in other regions, especially in the European Union (EU) (Kawai and Wignaraja 2009); recognition of the need to further strengthen economic ties; and the slow progress of multilateral negotiations at the World Trade Organization (WTO). Furthermore, the 1997/98 financial crisis underscored Asian interdependence and shared interests and provided the impetus for major

intergovernmental engagements and initiatives striving for Asian regionalism. However, most of these agreements—such as the Association for Southeast Asian Nations (ASEAN), the South Asian Association for Regional Cooperation (SAARC), etc.—are subregional in nature, and progress and cooperation at the broader pan-Asian level is very slow. Major cooperation agreements are not only very subregional or bilateral but also very different from each other, varying a great deal in coverage and scope. Also, with the exception of a few, many lack depth in terms of their commitments. This is despite the fact that various studies have shown that tremendous gains could result from broader and deeper economic cooperation at the pan-Asian level—as opposed to cooperation among a very small group of countries at different subregional levels. It is also anticipated that the overlapping of trade agreements could lead to a “spaghetti-bowl effect”<sup>1</sup> that would be detrimental to enhancing trade volume. Many studies have suggested that in order to facilitate broader integration, a core group that can take the lead in the integration process and attract other Asian countries to join the group should be identified. There are two competing proposals for this potential integration hub: the East Asia Free Trade Agreement (EAFTA) and the Comprehensive Economic Partnership in East Asia (CEPEA). Considering the potential economic gains offered by the latter and the present dynamics of economies such as India in the region, this study favors the creation of CEPEA. However, given the social, economic, and political heterogeneity among the Asian countries, many believe that implementing pan-Asian cooperation would be a difficult task.

Against this backdrop, this study attempts to investigate the extent of integration at the pan-Asian and subregional levels and to identify the challenges to enhancing Asian economic integration and cooperation. It also suggests policy measures and potential ways forward. The study is analytical and exploratory in nature. Relevant studies—for example, by the Asian Development Bank (ADB), the World Bank, the WTO, etc.—have been extensively reviewed in order to gain a thorough understanding of the issues pertaining to Asian regionalism. The main data sources for this study are the Asia Regional Integration Center (ARIC) and the ADB. In addition, discussions have been held with selected experts working on issues related to Asian regionalism.

The paper consists of five sections. The introduction is followed by Section 2, which examines the concepts and theoretical underpinnings of regionalism. Section 3 investigates regionalism in Asia and analyzes the trends and extent of economic integration in Asia, at a broader level and also at the subregional level. Economic cooperation among and between the countries at the regional and subregional levels is also analyzed in the same section. Section 4 discusses the key challenges to broader and deeper economic integration and also suggests ways forward in this area. The final section summarizes the paper’s findings and offers conclusions on the subject.

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<sup>1</sup> When a country signs a number of FTAs, this may reduce overall trade value instead of increasing it due to the overlapping of rules and the complicated rules of origin provisions. This effect has been termed the “spaghetti-bowl effect” by the famous economist Jagdish Bhagwati.



## 2. Regionalism: Concepts and Theoretical Underpinnings

The concept of regionalism is related to the notion of region. A region can be intranational or international. This study deals with international regions/regionalism. Since there are no widely accepted fundamental characteristics of a region, regionalism is also defined in a variety of ways. Although regionalism is as old as the emergence of the earliest political communities, the basic characteristics of contemporary regionalism are its internationality and quality in terms of coverage of issues (Beeson 2005). According to Joseph S. Nye an international region can be defined broadly as a limited number of states linked by a geographical relationship and some degree of mutual interdependence. Which of the large number of potential regions become relevant in international politics depends on the political and economic decisions of both the regions and the global community. International regionalism in the descriptive sense is the formation of interstate associations or groupings on the basis of regions, and in the doctrinal sense, the advocacy of such formations. More precisely, regionalism is the political process in which states drive cooperative initiatives (Beeson 2005).

Regional cooperation and integration are linked to the notion of regionalism. Regional cooperation is a process in which a group of countries (generally in the same region) with common interests cooperate to solve tasks and create improved conditions in order to maximize economic, political, social, and cultural benefits for all the participating countries (Lee 2003).<sup>2</sup> Regional economic cooperation is related to a range of interstate activities and agreements to act collectively or to collaborate in different policy spheres such as macroeconomic policy alignments, information sharing, currency-swap arrangements, etc. PTAs, FTAs, and CEPAs are the best examples of economic cooperation between the various countries in a particular region. Economic integration, on the other hand, is a process which aligns disparate national markets more closely. This integration can be policy induced, that is, the result of regional cooperation, or market driven. It varies in intensity and scope. In the case of full economic integration, goods, services, and factors of production flow freely across the region. When economic integration is essentially the consequence of private sector activities or market driven it is known as regionalization (Breslin and Higgot 2000). Hence, cooperation is a state- and institution-led process whereas integration can be market driven or state or institution driven (Bisley 2007). However, economic cooperation neither always strives for nor always leads to economic integration among the participating countries.<sup>3</sup>

Several theories have attempted to explain the causes and consequences of regionalism. In the theory both economic and political factors are combined to explain the emergence of a region. According to interdependence theory, the growing intensity of economic ties deteriorates the authority of states and prompts them to cooperate through various arrangements. The

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<sup>2</sup> Mukamunana and Moiti (2005).

<sup>3</sup> For instance, the OECD and the G20 are bodies which foster cooperation but do not have any explicit economic integration purpose.

functionalist theory states that an increase in economic interdependence between countries also increases the interest of the states in cooperating by means of institutional agreements. A more pragmatic approach based on empirical elements suggests the conception of a region as the expression of economic cooperation between (often, but not always) neighboring states, something which is mainly the result of preferential agreements between them (Porfilio 2002).

The rationale for economic integration and cooperation is mainly explained by the customs union theory, which was formally developed by Viner (1950). Under a customs union agreement the member countries agree to phase out tariff and nontariff restrictions on imports from within the region and to impose a set of common external tariffs on imports from nonmember countries. It is important to highlight the fact that the main difference between a customs union and an FTA is that under an FTA member countries do not impose any collective set of tariff and nontariff measures on imports from nonmember countries. The customs union entails both positive and negative welfare effects. The positive effect is referred to as the trade-creation effect and results from the replacement of high-cost domestic products with low-cost imports from member countries. Positive effects also arise because domestic exporters are subject to lower tariffs in the region's market than exporters from nonmember countries. The negative effect is referred to as the trade-diversion effect. It occurs when a member country replaces low-cost imports from nonmembers with higher-cost imports from member countries and is a result of the fact that nonmembers face higher tariffs than the members of the customs union. This reduces welfare within the member countries because the formation of the union has enhanced access to more costly sources of supply. Therefore, the ultimate benefit of a customs union or any other trade arrangement depends on the difference between its trade-creation and trade-diversion effects.

### **3. Regionalism in Asia**

Regionalism has existed for many decades, but the last two decades have witnessed a rapid and unprecedented increase in the phenomenon. Since the 1980s the world has seen a growing number of regional arrangements in different forms and scopes, and at present almost all countries in the world either belong to one or more regional blocks or are at least negotiating with potential partners. This trend has been described by many as "new regionalism."

Asia has been a latecomer in terms of this phenomenon. Regionalism began to emerge there mainly after the 1992 signing of the Association of Southeast Asian Nations Free Trade Agreement (AFTA), which became operational in 2002. However, since the Asian financial crisis in 1997 there has been rapid growth in various regional economic arrangements, both within and outside of the region. Although formal regional economic cooperation in Asia started later, economic integration among the Asian countries, especially in East Asia, began as early as 1950s with the rapid industrial growth in Japan, which was later followed by the newly industrialized economies (NIEs) or Asian tigers. This integration started with the "fly-

ing geese effect"<sup>4</sup> (Kumar 2007) and was followed by unilateral and plurilateral trade and investment liberalization, which coincided with the increasing fragmentation of production processes and technological change.

### 3.1. Emerging Trends in Economic Integration in Asia

Economic integration is a multidimensional process that encompasses deepening interdependence in various spheres of economic activity among the various economies in a particular region. Technological advances in transportation and telecommunications along with reduced trade and investment barriers have resulted in two contradictory processes: globalization and regionalization (regional integration). Due to the increasing unilateral and multilateral liberalization of its trade and investment sectors, Asia has had the fastest rate of economic growth during the last few decades and has become the center of the world economy's economic activities. As the Asian economies have grown larger and become more complex, they have also become more integrated through trade, foreign investment, financial transactions and other forms of economic exchange, and peoples' movement. This section (3.1) examines the trends in and extent of economic integration at both the pan-Asian and the subregional level. Economic integration is measured in terms of trade integration, FDI integration, and financial integration.

#### 3.1.1. Trade Integration

Trade integration is the most commonly used and most important measure of economic integration. The two most vital measures used to examine the degree of regional interdependence are intraregional trade share (IT share)<sup>5</sup> and intraregional trade intensity (IT intensity).<sup>6</sup> IT share is a very straightforward measure of trade interdependence that shows the relative importance of internal versus external trade dependence. A higher share indicates a higher degree of dependency on regional trade. IT intensity, on the other hand, is a more sophisticated meas-

<sup>4</sup> The concept of "flying geese" was developed by the Japanese economist Kaname Akamatsu in 1935 to describe how industrialization spreads from developed countries to developing countries through international trade.

<sup>5</sup> IT share is the percentage of intraregional trade to the total trade of the region, calculated using export data. It is calculated as:

$$\frac{X_{ii}}{\{(X_{iw} + X_{wi}) / 2\}}$$

where  $X_{ii}$  is exports from region  $i$  to region  $I$ ,  $X_{iw}$  is exports from region  $i$  to the world, and  $X_{wi}$  is exports from the world to region  $i$ . A higher share indicates a higher degree of dependency on regional trade.

<sup>6</sup> IT intensity is the ratio of intraregional trade share to the share of world trade with the region, calculated using export data. It is calculated as:

$$\frac{[X_{ii} / \{(X_{iw} + X_{wi}) / 2\}]}{[\{(X_{iw} + X_{wi}) / 2\} / X_{ww}]}$$

where  $X_{ii}$  is exports from region  $i$  to region  $I$ ,  $X_{iw}$  is exports from region  $i$  to the world,  $X_{wi}$  is exports from world to region  $I$ , and  $X_{ww}$  is total world exports.

ure showing the region's bias for trading within its borders. It determines whether trade within the region is greater or more limited than expected on the basis of the region's importance in world trade. An IT intensity value of more than 1 indicates that trade flows within the region are larger than expected given the importance of the region in global trade. Figure 1 highlights the IT share in Asia as whole and in the various subregions.<sup>7</sup> As can be observed from the figure, Asia as whole is much more dependent, in terms of trade, on itself compared to different subregions dependent on themselves. Not only was intraregional trade in Asia as a whole higher than in the various subregions in the last two decades, but it has also grown substantially, with the IT share increasing from less than 48 percent in 1990 to more than 57 percent in 2008.<sup>8</sup> Among the subregions, East Asia is the most integrated and SAARC is the least integrated. Although integration in Asia as a whole and in the various subregions has generally increased over the time period pictured in the figure, there has been a decline in Asia and all the subregions since 2004/05. This indicates that exports from Asia and its subregions to rest of the world have grown faster than exports within the region in the post-2004/05 period. It is noteworthy that ASEAN has not been able to substantially increase intraregional trade, even with the implementation of the ASEAN free trade agreement (AFTA) in 2002. This highlights the limited ability of the ASEAN subregion to absorb a major share of its exports as well as the limited effectiveness of the FTA as a tool to enhance trade within the subregion.

Figure 2 shows the trends in IT intensity. As can be observed from the figure, the Central and West Asia subregion has had the highest bias towards itself compared to any other subregion. However, this bias has declined substantially, especially since 1998, indicating that the subregion's share of trade with itself has risen more slowly than its share of the world market. This is mainly because many of the economies in Central and West Asia were previously part of the former Union of Soviet Socialist Republics (USSR) and were highly dependent on Russia for trade during the early and mid-1990s. However, over the period under investigation they have diversified their export destinations, and this has increased their trade with the rest of the world faster than that within the subregion itself. SAARC is another subregion that has shown a high degree of bias towards internal trade, but unlike Central and West Asia, its IT intensity was increasing before 2003. In 2003 it reached 5.31, up from 3.03 in 1990. This indicates that during the period 1990–2003 the subregion's share of trade with itself increased more quickly than its share of the world market. In Asia as a whole, the IT intensity has remained around 2

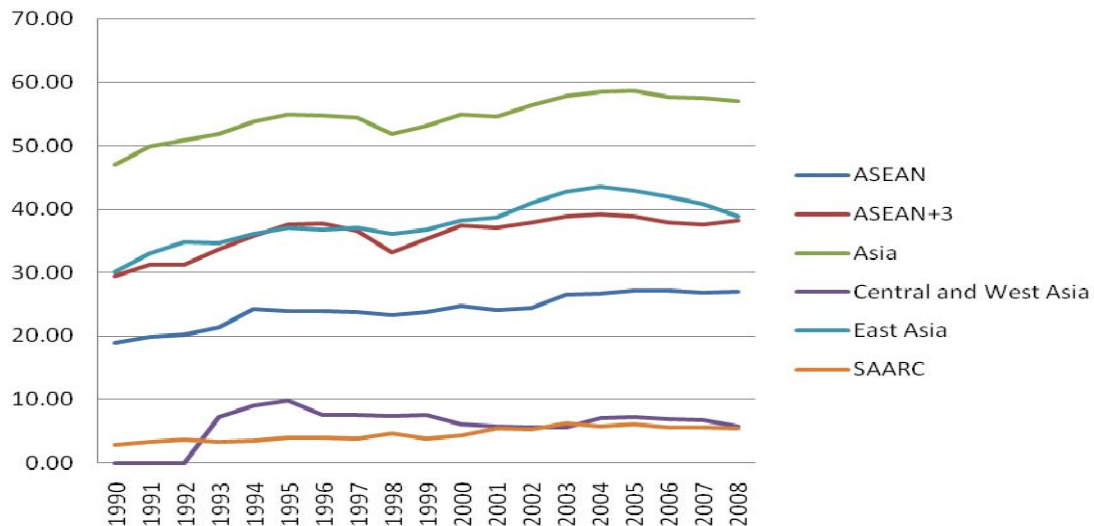
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<sup>7</sup> In this study Asia includes the 48 regional members of the Asian Development Bank (ADB). ASEAN (Association of Southeast Asian Nations) includes Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam. ASEAN+3 consists of the 10 ASEAN member countries and the People's Republic of China, the Republic of Korea, and Japan. Central and West Asia consists of Afghanistan, Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Pakistan, Tajikistan, Turkmenistan, and Uzbekistan. East Asia consists of the People's Republic of China; Hong Kong, China; Japan; the Republic of Korea; Mongolia; and Taipei, China. SAARC (South Asian Association for Regional Cooperation) consists of Afghanistan, Bangladesh, Bhutan, India, Maldives, Pakistan, Nepal, and Sri Lanka.

<sup>8</sup> IT shares in NAFTA and the EU were approximately 44 percent and 66 percent, respectively, in 2006.

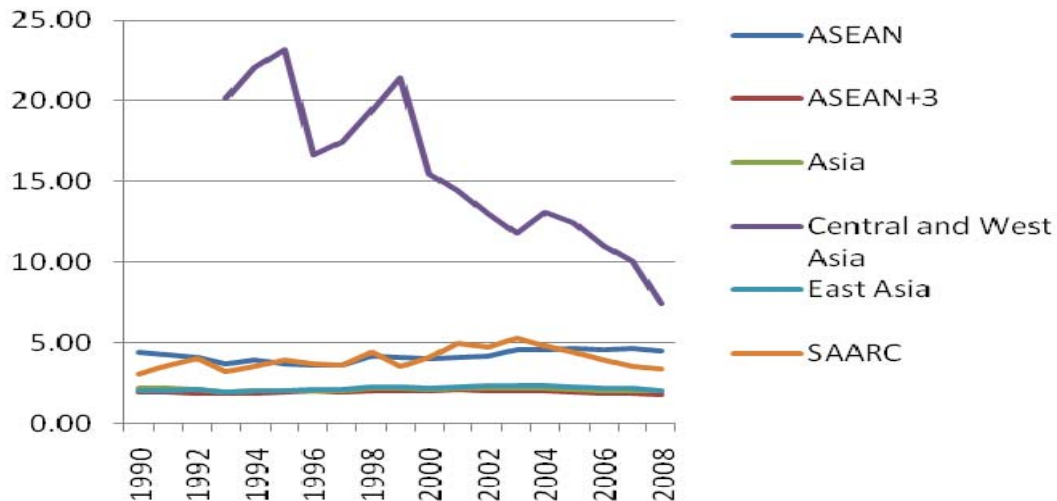
with a slight decline in recent years; the latter indicates a marginal decline in the region's bias towards trading internally.

**Figure 1: Intraregional Trade Share of Asia and Asian Subregions (in percent)**



Source: Asia Regional Integration Center (ARIC).

**Figure 2: Intraregional Trade Intensity**



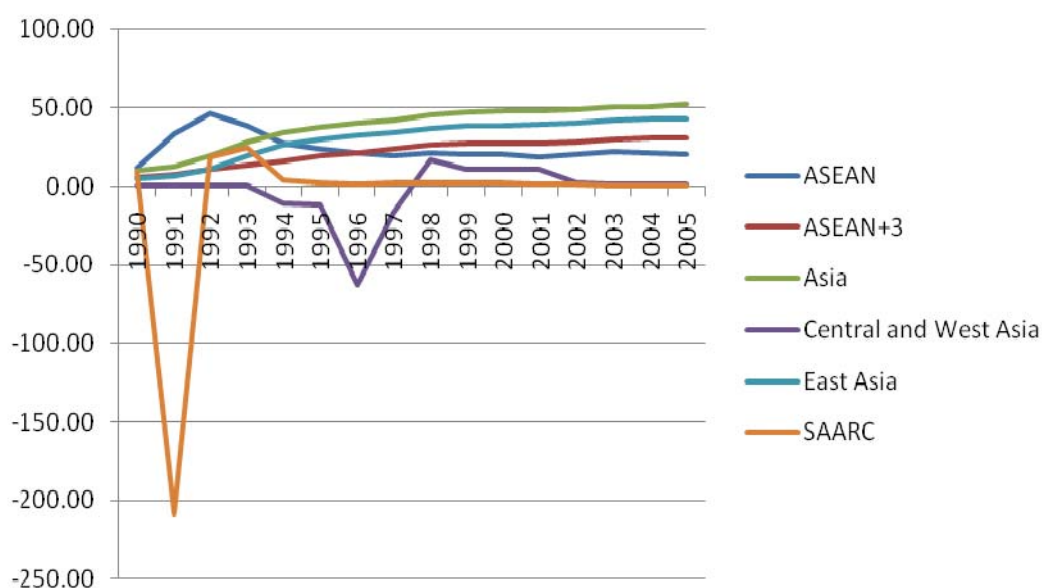
Source: Asia Regional Integration Center (ARIC).

### 3.1.2. FDI Integration

Intraregional FDI investment is one of the major indicators of economic integration. To examine investment integration, this study uses two measures: cumulative foreign direct investment (CFDI) share and annual foreign direct investment (AFDI) share. CFDI share is the percentage of regional FDI inflows to total FDI from the investing region. A higher share indicates a stronger preference for the receiving region and a higher degree of integration. Data is avail-

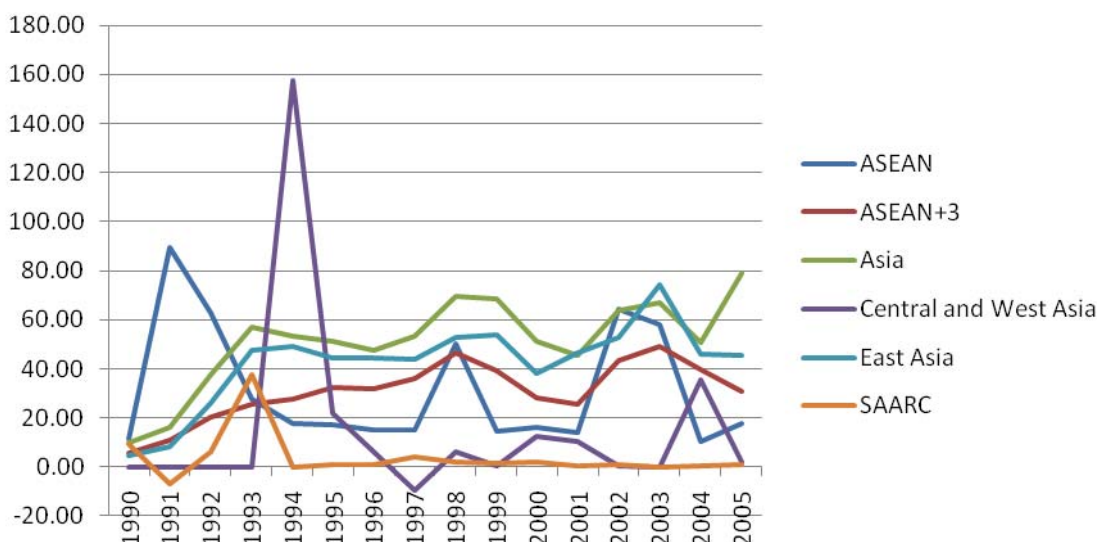
able for 26 regional member countries. Figure 3 shows the cumulative foreign direct investment share in Asia and its various subregions. As can be observed from Figure 3, the AFDI share in Asia increased substantially from less than 10 percent in 1990 to more than 52 percent in 2005, indicating that Asian countries are investing more and more within the region. Among the subregions, East Asia was the outlier during the same period, with the highest CFDI share; this share increased continuously during the period of investigation. SAARC, on the other hand, was the least interdependent subregion in terms of CFDI share. The CFDI share in the subregion was not only very low but also experienced a negative CFDI in the period 1990/91. This was mainly due to massive capital outflow from India to the world during this period.

**Figure 3: Cumulative Foreign Direct Investment (CFDI) Share (in percent)**



Source: Asia Regional Integration Center (ARIC).

The AFDI share is the percentage of regional FDI inflows to the total FDI from the investing region. A higher share indicates a stronger preference for the region and a higher degree of integration between the economies of the region/subregion in terms of investment. Data is available for 26 regional member countries. Figure 4 highlights the evolution of intraregional AFDI flows in Asia. As the figure shows, Asia's share of intraregional AFDI increased approximately eightfold between 1990 and 2005, from less than 10 percent to approximately 80 percent. East Asia appears to have been an outlier among the subregions as its intraregional AFDI share increased from less than 5 percent in 1990 to more than 45 percent in 2005. SAARC, on the other hand, as in the case of the CFDI share, was least integrated in terms of this measure. One noteworthy point here is that except for SAARC all the subregions and Asia as a whole witnessed an overall upward trend in their intraregional AFDI share. This measure also indicates that Asia became increasingly interdependent in terms of investment over the period under investigation.

**Figure 4: Intraregional Foreign Direct Investment (FDI) Share (in percent)**

Source: Asia Regional Integration Center (ARIC).

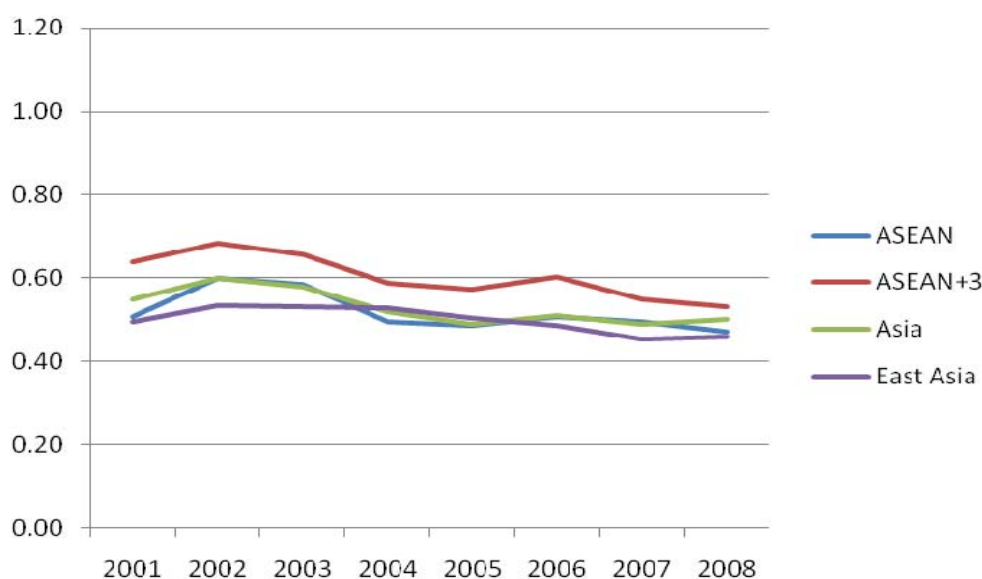
### 3.1.3. Financial Integration

Finance is one of the most vital sectors of any economic system, and it is expected that when the real sectors of different economies become interconnected the financial sector will also follow in the same direction. Various tools are used to examine financial integration between the economies of a region. On the basis of data availability, this study has used three measures to have a closer look at financial integration in Asia and its subregions. The coefficient of variation is a measure of dispersion calculated as the standard deviation of lending market rates divided by the mean. It is calculated for the lending market for selected country groupings. A lower coefficient indicates a higher degree of convergence of rates in the region's markets. Figure 5 shows the trends in the coefficient of variation of lending market rates during the period 2001–2008. As can be observed, Asia as a whole and all the Asian subregions have experienced the continuous decline in the value of the coefficient of variation of lending market rates. This indicates a convergence in the rates of different economies in the same region or subregion. However, the value of the coefficient of variation of lending rates has always been higher in ASEAN+3, highlighting the fact that the region is the least integrated on this measure.

Another indicator used here to examine the extent of and trends in financial integration in Asia and its subregions is the coefficient of variation of money market rates. The coefficient of variation is a measure of dispersion calculated as the standard deviation of money market rates divided by the mean. A lower coefficient indicates a higher degree of convergence of rates in the region's markets. Depending on the availability of data it is calculated for the money market for the country groupings selected here. Figure 6 highlights the trends in and dynamics of the coefficient of variation of money markets in Asia and its subregions. As can be observed from the figure, the value of the coefficient declined for Asia and all the

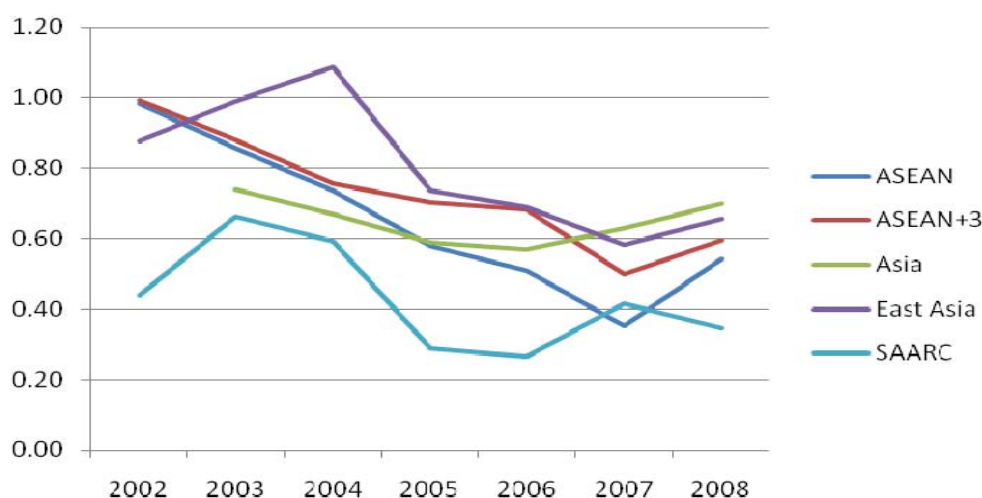
subregions during the period under investigation. This indicates an increasing degree of convergence of money market rates among the various economies in the particular region or subregion, as in the case of lending rates. It is important to note that the value of the coefficient declined during the period 2002–2006 for Asia but increased thereafter, indicating divergence in the money market rates among the various economies of Asia in the post-2006 period. The East Asia and ASEAN+3 subregions appear to have been outliers in terms of increasing convergence in money market rates as the values of the coefficient of variation for both subregions declined sharply between 2002 and 2008.

**Figure 5: Coefficient of Variation of Lending Market Rates**



Source: Asia Regional Integration Center (ARIC).

**Figure 6: Coefficient of Variation of Money Market Rates**

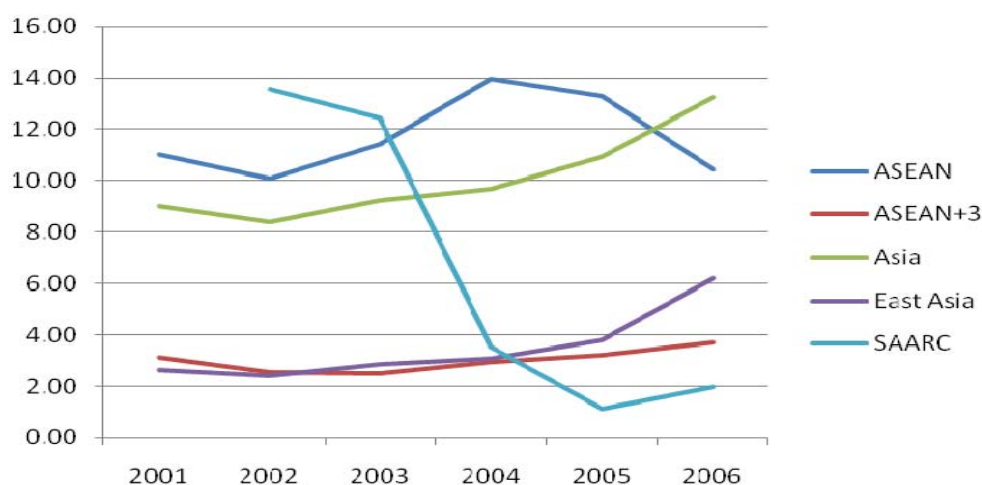


Source: Asia Regional Integration Center (ARIC).



The intraregional portfolio share is also used in examining the trends in and extent of financial integration. The portfolio share is the percentage of intraregional portfolio assets to total portfolio assets held by countries in a particular region or subregion. A higher share indicates a higher degree of integration in the financial sector. As can be seen in Figure 7, the intraregional portfolio share in Asia increased continuously during the period 2001–2006. This indicates increasing financial integration in the region. However, SAARC and ASEAN performed differently: SAARC experienced a decline in the intraregional portfolio share from 2001 to 2005, then a marginal increase in 2006. On the other hand, a declining trend began in ASEAN in 2004.

**Figure 7: Intraregional Portfolio Share (in percent)**



Source: Asia Regional Integration Center (ARIC).

### 3.2. Economic Cooperation in Asia

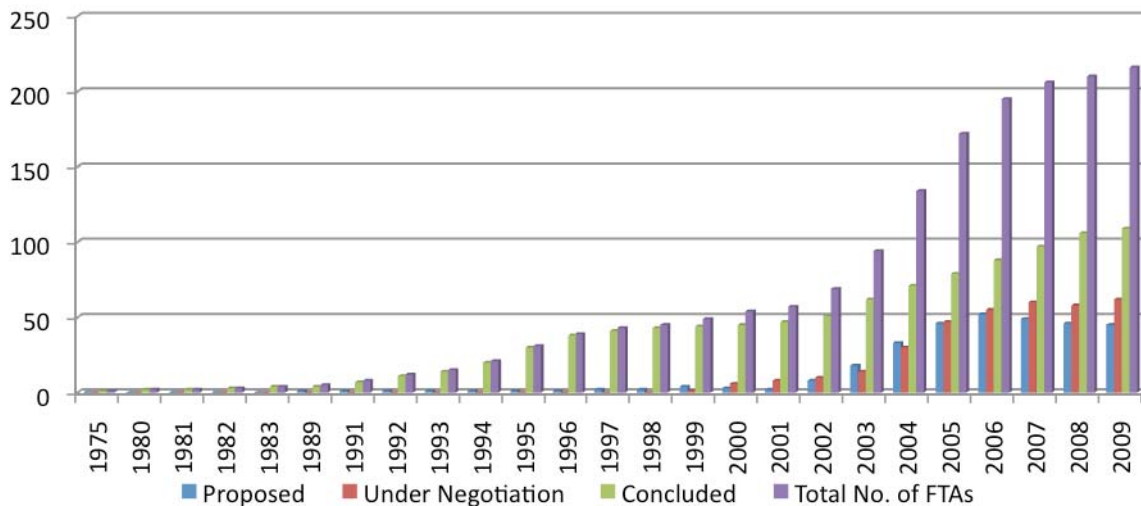
As mentioned in the preceding sections, although economic integration in Asia, particularly in Southeast and East Asia, began much earlier, economic regionalism or formal economic cooperation among Asian countries is rather a new phenomenon. Such economic cooperation is wide-ranging, stretching from subregional groups such as the Greater Mekong Subregion (GMS)—which undertakes cross-border projects for infrastructure development, trade liberalization, trade facilitation, and other focused initiatives—to transregional bodies such as the Asia-Pacific Economic Cooperation (APEC) and the Asia-Europe Meeting. This paper discusses only those cooperation agreements that fall within the Asian region.

#### 3.2.1. Trade Cooperation

Economic cooperation in terms of FTAs, PTAs/RTAs or CEPAs; monetary and financial cooperation; and infrastructure cooperation in Asia and its subregions began to emerge mainly after the signing of the AFTA in 1992 but gained momentum only after the Asian financial cri-

sis in 1997. As can be observed in Figure 8, the number of trade agreements involving Asian economies increased rapidly after the late 1990s, reaching 216 in 2009.

**Figure 8: Cumulative Number of FTAs in Asia (as of June 2009)**



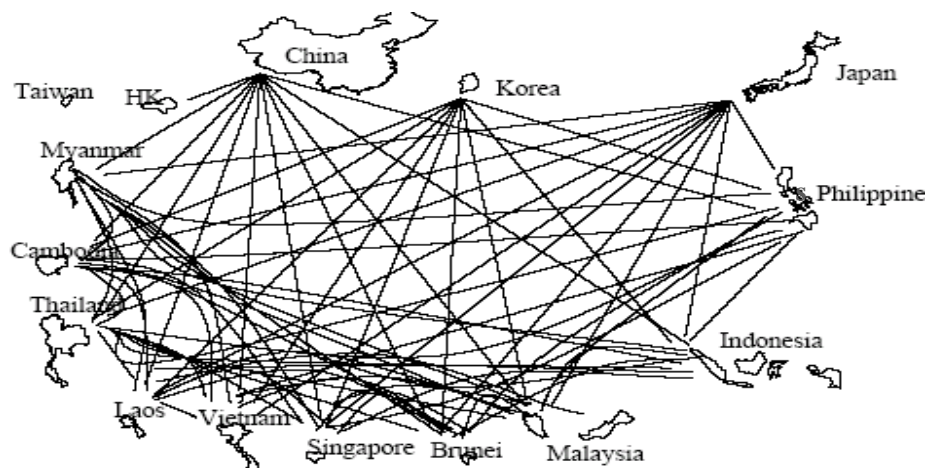
Source: Asia Regional Integration Center (ARIC).

Several factors have contributed to the phenomenal increase in economic agreements in the Asian region. Many believe that growing regionalism in Asia is a defensive response to increasing regionalism in North America and Europe, instead of an offensive policy instrument intended to enhance the region's economic prosperity (Lamberte 2005). Regional integration in Europe has been perceived as a success and has motivated Asian countries to enhance their own intraregional cooperation. Regionalism in North America and Europe has also created a sense of fear among the Asian countries that the two giant blocks might dominate the rule-setting in the global trading system, thereby marginalizing Asia (Kawai and Wignaraja 2009). Other important factors include the slow progress of multilateral negotiations and the continuous failure of the Doha Round negotiations at the WTO, increasing competition for foreign investment, and countries' desire to institutionalize the de facto integration process and manage the spillover effects. In addition, the Asian financial crisis of 1997/98 forced Asian leaders to work together and cooperate in various economic spheres to sustain growth and stability by addressing common challenges. Trade agreements are also seen as a means of promoting liberalization. Finally, the findings of a number of studies have highlighted the benefits of close economic engagements among the countries of the region.

The increasing number of FTAs, PTAs/RTAs and CEPAs in Asia highlights the growing interest of Asian countries in regional economic cooperation or regionalism. These trade agreements are both bilateral and plurilateral, but the bilateral agreements are far greater in number

than the plurilateral agreements.<sup>9</sup> For instance, of the 216 FTAs, PTAs/RTAs, and CEPAs in Asia in 2009, 166 were bilateral and 50 plurilateral. The growth in regional cooperation has been spurred by the leading subregions and economies. ASEAN is emerging as the hub of regional integration in Asia, particularly in East Asia, with the signing or negotiation of FTAs with all the major economies within Asia, such as China, Japan, India, and South Korea, and outside Asia, such as the EU, etc. However, the spectacular increase in the number of FTAs in Asia has raised several concerns among policy makers and experts. One important concern is the overlapping nature of these FTAs, which may lead to reduced trade volume due to increased transaction costs, that is, to “spaghetti-bowl” or “Asian noodle-bowl” effects. Figure 9 provides a glimpse of overlapping FTAs in Southeast and East Asia. These overlaps have recently become more complicated as countries from South Asia, especially India, have joined groups such as ASEAN and have signed SAFTA within their own subregion.

**Figure 9: Web of FTAs in East Asia**



Source: Baldwin 2006.

These trade agreements have also led some trade economists to believe that the growing number of FTAs will pave the way to broader or pan-Asian cooperation or regionalism, which is currently confined to the bilateral and subregional levels. Many experts, such as Kawai and Wignaraja, have been advocating for the creation of a broader and plurilateral FTA that incorporates all the major subregions and economies in Asia. It has been argued that ASEAN+3 or the East Asia Summit<sup>10</sup> should form an economic region through the signing of an FTA by the member countries. ASEAN+3 and the East Asia Summit forums currently envisage a broader or pan-Asian FTA in terms of an East Asia Free Trade Area (EAFTA), which would include East Asia and Southeast Asia, and a Comprehensive Eco-

<sup>9</sup> Bilateral: when a preferential-trading or free trade arrangement involves only two parties. Plurilateral: when a preferential-trading or free trade arrangement involves more than two parties.

<sup>10</sup> The East Asia Summit consists of ASEAN, Australia, China, India, Japan, New Zealand, and South Korea. It is also known as ASEAN+6.

conomic Partnership in East Asia (CEPEA), which would include East Asia, Southeast Asia, and three leading economies: India, Australia, and New Zealand. Several studies (such as that by Francois and Wignaraja 2008) have highlighted the economic gains for members and losses for nonmembers that would result from the formation of both the EAFTA and CEPEA. They have found that the gains would be greater and the losses more limited if CEPEA were implemented. However, on the basis of political-economy considerations Kawai and Wignaraja (2008) suggest that the consolidation should be gradual and that EAFTA should be formed first, with the eventual inclusion of India, Australia, and New Zealand to follow. Nevertheless, given the increasing economic and political importance of these countries, especially India, this paper argues for CEPEA.

Although India is a relative latecomer to the economic liberalization process in Asia, its interdependence with the rest of Asia has increased rapidly in recent years; as it is entering into trade agreements with many Asian countries and subregions, this interdependence is likely to further increase.<sup>11</sup> Flows of FDI suggest that India's bond with Asia is becoming ever greater. India is now the second most popular investment destination globally, behind China only, and much of this investment is coming from Asian countries, especially from East Asia. In fact, according to a survey by the Japan Bank for International Cooperation, India is overtaking China as the top destination for Japanese foreign investment. India has also become a priority for South Korean policy makers.<sup>12</sup> In addition, India's own willingness to join the Asian integration process as well as the eagerness of several countries in both Southeast Asia and East Asia to welcome India into any broader Asian architecture make a strong case for the creation of CEPEA. India's inclusion in any group that aims to expand cooperation in Asia will increase the comfort level, especially in the political and strategic sense, of several countries in East and Southeast Asia and will further enhance the integration process in the region.<sup>13</sup> However, such a process will not be without challenges. These challenges and potential ways to address them are discussed in Section 4.

### ***3.2.2. Monetary and Financial Cooperation***

Although monetary and financial integration among the Asian countries is not as developed as trade integration, given the importance of the sector's stability in overall economic growth it has been an important agenda item in their regional cooperation. Cooperation in this sector varies both in terms of coverage of issues and the number of countries. For instance, the Asia Cooperation Dialogue (ACD) forum is the largest group within Asia in terms of membership, but its function in the monetary and financial sector is limited to policy dialogue and infor-

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<sup>11</sup> Out of 32 FTAs that India has either concluded or is negotiating, 22 are with countries from Asia and the Pacific region.

<sup>12</sup> *The Economist*, 19 November 2009.

<sup>13</sup> Several experts, especially political scientists, are of the view that India's inclusion would be in the interest of small economies in East Asia and Southeast Asia.

mation exchange only. On the other hand, ASEAN, which is one of the smallest subregional bodies in terms of membership, covers the most areas of cooperation relating to the sector. Important areas of cooperation on monetary and finance issues within the various forums in Asia include policy dialogue and information sharing, surveillance and peer review, regional financing arrangements, regional capital market development, capacity building, and research. Policy dialogue, information sharing, and capacity building are agenda items within all the forums, large and small, that deal with monetary and financial cooperation, with the exception of the ACD, which only deals with policy dialogue and information exchange. Surveillance, peer review, and regional financing arrangements are dealt with only within the ASEAN and ASEAN+3 forums. A research function is also part of all the forums except the ACD and SEANZA<sup>14</sup> (Yap 2007). ASEAN+3 has been quite successful in regional financing arrangements through its widely discussed Chiang Mai Initiative (CMI) in the East Asian and Southeast Asian regions.

The CMI is the center of East Asian financial cooperation. It is a network of bilateral swap arrangements created by ASEAN+3 countries in May 2000 to provide short-term liquidity assistance to the member countries.<sup>15</sup> Due to its bilateral nature and the small size of the arrangements, it was not well received initially among experts. However, since its inception in 2000 it has evolved and has now adopted a collective decision-making procedure for swap activation. The total value of swaps had also grown to US\$90 billion as of April 2009. Moreover, since May 2006 the ASEAN+3 countries have started to work on multilateralizing the CMI. They have also reached agreement on several pertinent issues including the total value of swaps (US\$120 billion), the funding of the swaps through self-managed reserve pooling, legally binding contractual agreements, and the issue of contribution. Now the contribution has become proportional, with ASEAN contributing 20 percent and the +3 countries (China, Japan, and South Korea) contributing 80 percent. The multilateralization process is very important as its success will lead to the creation of a regional monetary fund or Asian Monetary Fund. This was proposed by Japan in 1997 but has failed to materialize (Chey 2009).

Two main initiatives are in place to develop a regional capital market in Asia: the Asian Bond Market Initiative (ABMI) and the Asian Bond Fund Initiative (ABFI). The ABMI is part of the framework of ASEAN+3. Its objective is to develop efficient and liquid markets in Asia and to improve the use of Asian savings in Asian investment. The ABMI also contributes to the mitigation of currency and maturity mismatches in financing. As part of this initiative the

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<sup>14</sup> SEANZA = South East Asia New Zealand and Australia (includes the Reserve Bank of Australia, Bangladesh Bank, People's Bank of China, Hong Kong Monetary Authority, Reserve Bank of India, Bank Indonesia, Central Bank of Iran, Bank of Japan, Bank of Korea, Monetary Authority of Macao, Bank Negara Malaysia, Bank of Mongolia, Nepal Rastra Bank, Reserve Bank of New Zealand, State Bank of Pakistan, Bank of Papua New Guinea, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore, Central Bank of Sri Lanka, Bank of Thailand).

<sup>15</sup> The idea for the CMI was proposed at the ASEAN+3 Summit in November 1999. The member countries agreed to enhance self-help and support mechanisms in East Asia.

Asian Development Bank (ADB) has provided technical assistance for regional studies examining the feasibility of establishing a regional guarantee mechanism and a regional clearing and settlement system, as well as the feasibility of introducing new securitized debt instruments and an improved local credit rating system. The ABFI is a program of the Executives' Meeting of East Asia Pacific Central Banks (EMEAP).<sup>16</sup> The first phase of the Asian Bond Fund (ABF1) was launched in June 2003 in order to harness the sizable official reserves held by Asian economies and channel them into investment instruments issued by EMEAP member economies. The ABF1 invests in a basket of US dollar-denominated bonds. These bonds are issued by sovereign and quasi-sovereign Asian issuers in EMEAP economies (excluding Japan, Australia, and New Zealand). Following on the success of the ABF1, the ABF2 was launched in December 2004. The ABF2 has two components. The first is the Pan-Asian Bond Index Fund (PAIF) and the second is the Fund of Bond Funds (FoBF). The PAIF is a single-bond fund index that invests in sovereign and quasi-sovereign local currency bonds issued in eight EMEAP countries. The FoBF, on the other hand, is a two-tiered fund. A parent fund invests in eight single-market funds, each of which invests in local currency sovereign and quasi-sovereign bonds issued in their respective markets (Suk and Bum 2008).

### 3.2.3. *Infrastructure Cooperation*

Most of the Asian economies suffer from a huge deficit of infrastructure facilities. The lack of proper infrastructure has also been one of the most important impediments to economic integration within and between Asia's subregions. Infrastructure facilities such as transport, communications, and energy links among the Asian economies and subregions are poorly integrated into the Asian production system or chain but are critical to regional integration. According to an estimate by the ADB (2008), developing the Asian infrastructure will require US\$4.7 trillion of investment during the period 2006–2015. Power and roads will account for two-thirds of this investment, and 80 percent will go to India and China (Capannelli, Lee and Petri 2009). To fill the gap between required and real investment, cooperation in infrastructure development has become a key element of regional economic cooperation at various regional and subregional levels. The infrastructure sector is a major area of cooperation for many small subregional groups, such as the Indonesia-Malaysia-Thailand Growth Triangle (1993), and for big groups such as the ACD. Important areas of cooperation include energy; information and communications technology; and transport, especially the linking of rail and road networks across the region.

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<sup>16</sup> EMEAP is an organization promoting cooperation among the central banks and monetary authorities in the East Asia and Pacific region. The organization's main objective is to strengthen cooperative relations among its member countries. It includes the central banks of 11 economies: Reserve Bank of Australia, People's Bank of China, Hong Kong Monetary Authority, Bank Indonesia, Bank of Japan, The Bank of Korea, Bank Negara Malaysia, Reserve Bank of New Zealand, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore, Bank of Thailand, online: <[www.emeap.org/](http://www.emeap.org/)>.

### 3.2.4. *Emerging Cooperation Architectures in Asia*

All the regional economic cooperation agreements, in their various forms and scopes, are anchored in forums of varying nature and status at various subregional and regional levels. This subsection reviews all the major economic cooperation groups in the Asian region.

**(i) Asian Cooperation Dialogue (ACD):** The ACD was established in 2002 and is the biggest economic cooperation forum in Asia in terms of membership. It is a continent-wide forum, the first of its kind in Asia, and has a membership of 30 countries.<sup>17</sup> The ACD aims to consolidate Asian strengths and fortify Asia's competitiveness by maximizing the utilization of Asia's diversity and resource wealth. The forum provides a platform where Asian countries can freely discuss issues of common interest and put forward measures to enhance mutual cooperation in all areas. There are two vital dimensions of the ACD, namely, dialogue and projects. The dialogue dimension aims to promote the interaction and participation of ACD ministers and government officials. The project dimension encourages countries to volunteer to become "prime movers" in areas of cooperation that match their interests and to develop each project to the advantage of Asian countries. The areas of cooperation include a range of issues, from road safety to biotechnology, and are organized according to the concept of prime-mover and co-prime-mover countries.

**(ii) The Association of Southeast Asian Nations (ASEAN):** ASEAN was established on 8 August 1967 in Bangkok, Thailand with the signing of the ASEAN Declaration or Bangkok Declaration. The association's objective was to improve peace and prosperity through collective efforts. Until recently this was the main focus of regional economic integration in Asia. In 1992, however, the ASEAN Free Trade Area (AFTA) was launched, with the aim of creating a free trade area within 15 years. Since January 2002, AFTA has been in effect among the six original signatory countries: Brunei, Indonesia, Malaysia, Singapore, Thailand, and the Philippines. These six countries are expected to eliminate tariffs altogether by 2010, and the four latecomer countries (Cambodia, Lao PDR, Myanmar, and Viet Nam) are expected to do so by 2015. The ASEAN Framework Agreement on Services (AFAS) was signed in 1995 to substantially reduce restrictions in service trade among the member countries. The ASEAN Investment Area (AIA) was adopted in 1998 with the objective of making the region more competitive, open, and conducive to investment through the liberalization of investment rules and policies. There has been some progress on AFAS liberalization, but progress on the AIA has been very limited (Kawai and Wignaraja 2008). The ASEAN economic community is expected to make ASEAN a single market and production base by 2015.

**(iii) ASEAN+3:** The ASEAN+3 forum came into being when the leaders of China, Japan, and South Korea were invited to attend an informal ASEAN meeting in December 1997, in the

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<sup>17</sup> The ACD consists of Bahrain, Bangladesh, Brunei Darussalam, Bhutan, Cambodia, China, India, Indonesia, Iran, Japan, Kazakhstan, the Republic of Korea, Kuwait, Lao PDR, Malaysia, Mongolia, Myanmar, Pakistan, the Philippines, Oman, Qatar, Russia, Saudi Arabia, Singapore, Sri Lanka, Thailand, United Arab Emirates, Vietnam, Tajikistan, and Uzbekistan.

midst of the Asian financial crisis. This framework has evolved over time and has resulted in many ministerial processes for foreign affairs, economics and trade, macroeconomics and finance, environment, energy, health, labor, science and technology, and social welfare. Some countries, particularly China, consider it to be a natural grouping for East Asia's trade and investment cooperation and have thus proposed the implementation of the EAFTA (Kawai and Wignaraja 2008). The East Asia Study Group (EASG 2002) has identified several short-, medium-, and long-term measures to move East Asian cooperation forward. The key long-term measures include the formation of EAFTA and the East Asia investment area through the expansion of the AIA and the promotion of investment by small and medium-sized enterprises (SMEs). Some of the key initiatives of this forum include financial and economic review, policy dialogue, the Chiang Mai Initiative, the ABMI, and the promotion of joint research. Most of these initiatives, which are in finance, have been by and large successful.

**(iv) East Asia Summit (EAS or ASEAN+6):** The idea of EAS grew out of ASEAN+3. The ASEAN agreement in November 2004 to convene a forum that included ASEAN+3+Australia+India+New Zealand was instrumental in the creation of the EAS. The first EAS was held in December 2005 in Kuala Lumpur (Malaysia), and the fourth one was recently held in Hua Hin, Thailand on 25 October 2009. This forum has focused on a range of issues including the avian flu, education, energy, finance, and natural disasters. Japan considers ASEAN+6 to be natural grouping for East Asia's trade and investment cooperation and has thus proposed the CEPEA.

Considering the two competitive proposals for economic cooperation in East Asia (EAFTA and CEPEA) and the already established ASEAN forum, it seems that the creation of an East Asian economic community will evolve through ASEAN, ASEAN+1, ASEAN+3 and ASEAN+6, or EAS. It is likely that the ASEAN economic community (to be realized by 2015) will serve as a hub for East Asian economic integration (Kawai 2007). The two-tiered approach to community building—with the ASEAN+3 Summit at the core and the East Asia Summit playing a supportive role—appears to have been accepted in principle by the participant countries. However, due to the open, inclusive, and outward-looking nature of the EAS, the issue of membership may complicate the community-building process (Tanaka 2006).

**(v) East ASEAN Growth Area (EAGA):** The EAGA consists of Brunei Darussalam, Malaysia, the Philippines, and certain provinces of Indonesia. It was formally launched in 1994 with the aim of realizing socially acceptable and sustainable economic development which would lead to its full participation in the ASEAN development process. Its immediate goal was to increase trade, investment, and tourism in the subregion by facilitating (i) the freer movement of people, goods and services; (ii) the development of vital infrastructure in the subregion; and (iii) the coordination of ecosystem and resource management to ensure sustainable development. The EAGA's short- to medium-term goal is to ensure that its member countries become major locations within ASEAN for the high-value-added agro industry, natural resource-based manufacturing, and high-grade tourism; in the longer term it aims to ensure that a non-resource-based manufacturing industry is established in the subregion.



**(vi) Central Asia Regional Economic Cooperation (CAREC):** Due to its natural resources and strategic location, Central Asia has been the focus of international attention since the breakup of the Soviet Union. The CAREC is an ADB-supported initiative launched in 1997. It seeks to encourage economic cooperation among countries in the Central Asia region. The members of the CAREC include Afghanistan, Azerbaijan, Mongolia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan, and certain provinces of China. The initiative's objective is to promote economic growth and improve living standards by encouraging economic cooperation in the Central Asian region. The program has focused on financing infrastructure projects and improving the policy environment for promoting cross-border activities in the areas of transport (especially road transport), energy (including the water-energy nexus), trade policy, and trade facilitation (especially customs cooperation). A study by the United Nations Development Program concluded that strengthening regional cooperation among the Central Asian republics would produce substantial political and economic gains, including increases in income of 50 to 100 percent over the next ten years (UNDP 2005). To harness this potential, many of the Central Asian countries have signed bilateral FTAs with each other; however, it would be immensely beneficial if they were able to convert these into a subregional FTA.

**(vii) The South Asian Association for Regional Cooperation (SAARC):** The SAARC was established on 8 December 1985 by the heads of state or government of Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka. Afghanistan joined the group in 2007 and became the eighth member country. The type of regional cooperation that SAARC initially emphasized was that at the political level, for which the foreign ministers of the member countries met. The members also intended to explore possibilities for cooperation on economic and social issues, but this was secondary to political cooperation (Das 2007). The Agreement on South Asian Free Trade Area (SAFTA) was signed on 6 January 2004 during the Twelfth SAARC Summit in Islamabad, Pakistan. This was the most important subregional economic initiative after the formation of SAARC. The agreement entered into force on 1 January 2006. Complete trade liberalization is to take place by 2016. However, the sensitive lists of products, rules of origin, and technical assistance, as well as a mechanism for compensation of revenue loss for the least developed member states, are under negotiation. Under the trade liberalization program, scheduled to be complete in 2016, the customs duties on products from the region will be progressively reduced. However, under an early harvest program for the least developed member states, India, Pakistan, and Sri Lanka were to reduce customs duties on products from these states to 0–5 percent by 1 January 2009. The least developed member states are also expected to benefit from additional measures under the special and differential treatment accorded to them under the agreement. However, the less ambitious commitment in merchandise trade and the exclusion of services from the agreement limit SAFTA's role in South Asia's economic cooperation and integration process (Kumar 2008).

**(viii) Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC):** The BIMSTEC was created on 6 June 1997. It is a very unique group as it connects South Asia with Southeast Asia. Its members include Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, and Thailand. The aims of the forum are to create an enabling environment for rapid economic development, to accelerate social progress in the subregion, to promote active collaboration and mutual assistance on matters of common interest, to provide assistance between the countries in the form of training and research facilities, and to cooperate cross-nationally on projects that can be dealt with most productively at the subregional level in order to make the best use of available synergies. So far the group has been able to cooperate in some sectors, such as the creation of the BIMSTEC highway that links India with Thailand through Myanmar, but is still far from achieving its potential.

**(ix) Greater Mekong Subregion (GMS):** In 1992 six countries of the Mekong river basin area, with the assistance of the ADB, launched this joint subregional economic cooperation program. The program was designed to enhance economic relations among the member countries. The GMS comprises Cambodia, the People's Republic of China, Lao PDR, Myanmar, Thailand, and Viet Nam. The GSM program has contributed significantly to the development of infrastructure intended to enable the development and sharing of the resource base along with promoting the free flow of goods and people across the subregion. The subregion has been internationally recognized as a growth area. During the third GMS Leaders Summit, held at Vientiane, Lao PDR, in March 2008, the comprehensive five-year Vientiane Plan of Action (PoA) for GMS Development was agreed. The PoA aims to enhance economic growth, reduce poverty, and promote social development along with environmental protection and conservation.

**(x) Mekong-Ganga Cooperation (MGC):** The MGC was established in November 2000 at Vientiane, when the group's first ministerial meeting took place. It is a loose grouping of six countries—India, Thailand, Burma, Cambodia, Lao PDR, and Viet Nam—and aims to strengthen connectivity by building a joint physical and social infrastructure in these countries. This infrastructure includes road, rail, and air links; information and communications technologies; education; culture; and the imparting of skills in development management and other technical areas. Sectoral cooperation is undertaken according to the lead-country concept. The organization's annual ministerial meeting takes place back to back with the ASEAN ministerial meeting. The platform has been particularly useful for the region in terms of the development of road and rail links; for example, there is a proposal to set up a railway line from Delhi to Hanoi, the preliminary study for which was completed in 2006. India has also proposed extending the BIMSTEC highway (India–Myanmar–Thailand Trilateral Highway) to Lao PDR and Cambodia. In the education sector there are scholarship exchanges, along with a cooperatively administered entrepreneurship development program.

#### 4. Key Challenges and Ways Forward for Pan-Asian Regionalism

The preceding above discussion demonstrates that there has been progress in terms of both economic integration and cooperation in Asia, both at the pan-Asian and at the subregional level. However, economic cooperation is much more limited and has progressed more slowly than economic integration. Also, regionalism in Asia is still at a very nascent stage: not only is the coverage of issues in the agreements limited, but cooperation also remains very subregional in nature. The ongoing development of economic regionalism in Asia faces a number of challenges that need to be carefully addressed. Some of the key challenges and ways forward are given below.

**Developing a Shared Vision and Leadership:** One of the major challenges to Asian regionalism, which is often cited as a key impediment, is the lack of shared vision and leadership. In fact, there is a problem of competitive visions. Given the socioeconomic-political heterogeneity in Asia, it is vital that Asian leaders develop a vision that is inclusive of all and open towards the future. It should be developed in such a way that it not only accommodates the interests and aspirations of the countries that are part of the ongoing integration and cooperation processes, but also incorporates the interests and aspirations of those economies in the region that may join in future when they are ready. A lack of leadership or competition for leadership has been another reason for the slow progress of Asian regionalism. However, the CMI's progress has shown that Japan and China, which were formerly seen as competitors, can work together and develop joint leadership to move forward. This lesson should be extended to other areas of cooperation, and the idea of joint leadership should be accepted as a way to take the integration and cooperation process forward.

**Developing an Asian Consciousness:** Many feel that an important obstacle to developing broader cooperation is the differences in the consciousness of being "Asian" (Ogura 2007). In this regard it would be useful to develop a "sense of Asianess." This could be done mainly by involving civil society and enhancing peoples' mobility across the region's borders through various exchange programs.

**The Path to Regionalism:** Given the social, political, cultural, and geographical differences among the Asian countries, it is important to follow a gradual path towards cooperation. Such a path should begin with efforts to deepen and broaden ongoing economic cooperation, beginning with trade cooperation. Successful economic cooperation can then pave the way to broader cooperation efforts and integration in other areas as well. This lesson has come from the Asian experience itself, as observed in the previous sections. Ongoing economic integration among Asian countries, which started many years ago, has forced the governments to cooperate more closely in recent years, especially in the financial sector.

**Avoiding the "Spaghetti-Bowl" Effect:** As highlighted previously, Asia has witnessed the rapid proliferation of FTAs, PTAs, RTAs, and CEPAs during the last few years. Although no study that clearly shows the problem of the "spaghetti-bowl effect" in Asia has been completed to date, as more and more FTAs are signed and implemented, adverse impacts

cannot be ruled out. The “spaghetti-bowl effect” arises mainly due to the great differences in and complexity of rules of origin (ROO) provisions in many of the agreements. This problem can acutely affect the SMEs that are the backbone of many Asian economies. Hence, it is necessary to encourage the rationalization of ROOs and to simplify their administration in order to minimize their negative impact. It would be useful for the FTA partner countries to follow international best practices, such as increasing the use of IT, in administering the ROOs.

**Consolidating the FTAs, PTAs, RTAs, and CEPAs:** Since there is a growing need for broader economic cooperation, Asian countries should work to integrate the various subregional and bilateral agreements into a broader or pan-Asian agreement. This could be done by consolidating the various FTAs into a single region-wide FTA. This broader FTA would bring complementarity to the grouping, something that does not presently exist in any of the subregions. This consolidation should not be undertaken in one go, but should rather be carried out in a gradual manner. First of all, a subregional group that could work as an integration hub in Asia should be identified. The obvious choice is ASEAN, not only because it is the most institutionalized or integrated subregional group but also because the key production networks are rooted in ASEAN and all the major economies are FTA partners through ASEAN+1 FTA arrangements. These arrangements could be converted into a single FTA. Two main proposals are competing to take on the role of the hub: EAFTA, comprising the ASEAN+3 countries, and CEPEA, comprising the ASEAN+6 countries. Given the present geopolitical environment, implementing EAFTA would be easier than implementing CEPEA. However, if one considers the extent of economic gains to member countries and the potential losses to nonmember economies that would result from forming EAFTA or CEPEA, along with the current and near-future economic dynamics of countries such as India, it appears that pursuing CEPEA would be more appropriate.<sup>18</sup>

**Strengthening the Domestic Financial Sectors and Regional Financial Cooperation:** Although many Asian countries have improved their financial sectors since the Asian financial crisis, weaknesses remain and establishing resilient financial systems at the domestic level is essential for national and regional financial stability. At the regional level measures such as the CMI, the ABMI, and the ABFI need to be further strengthened; other economically important countries, such as India, should also be involved. In the case of the CMI, as Kawai (2008) has suggested, as the swap arrangements are being multilateralized, the quality of economic surveillance needs to be improved, the rules for activating a multilateral CMI need to be clarified, a move from the present information sharing system to a more rigorous peer review needs to be made, and the establishment of a professional secretariat to monitor all issues relating to the CMI is necessary. The ABMI and ABFI schemes should be further developed to increase the size and liquidity of local-currency bond markets, and the risk manage-

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<sup>18</sup> An ADB estimate shows that the gains to member countries and losses to non-member countries would be higher and lower, respectively, in the case of the CEPEA than in the case of the EAFTA.

ment capacity of financial institutions should be strengthened through better regulatory and supervisory frameworks. Corporate governance also needs to be improved.

**Enhancing Cooperation and Coordination among Asian Institutions and Think Tanks:** In order to promote broader economic integration and cooperation, it is vital to enhance cooperation and coordination among various Asian institutions. The existing networks of institutions and policy think tanks should be strengthened to further improve the exchange of ideas among Asian scholars. The institutions should also work on capacity building for those countries which lack the appropriate capabilities to participate in trade or economic negotiations.

**Managing Regional Public "Bads":** Growing economic integration has increased the mobility of people across borders and has thus led to several problems in the region: a high risk of the spread of diseases like swine flu and H1N1, drug trafficking, etc. These issues call for coordinated action at various levels. Growing economic development in the region has also put huge pressure on the environment, and this is another issue that needs to be addressed in a collective way. Additionally, the ongoing efforts towards sustainable development through cooperation programs such as the MGC, GMS, etc. need to be further strengthened and extended to other subregions.

**Bridging the Infrastructure Gap:** One of the major obstacles to developing enhanced regional cooperation in Asia is the lack of infrastructure facilities in the border areas of many countries. Such facilities are critical if countries are to be connected. Cross-border infrastructure development is expected to create a sound environment for promoting trade and investment in the geographically proximate areas of neighboring countries. Hence it is not sufficient simply to strengthen ongoing initiatives; project-specific initiatives that involve local, national, and international organizations should also be undertaken to facilitate and implement the infrastructural initiatives within a given timeframe.

## 5. Conclusion

During the last couple of decades Asia has experienced rapid economic growth, which has largely been induced by the unilateral and multilateral liberalization undertaken by many Asian countries. As the Asian economies have grown larger and become more complex, they have also become more integrated through increased trade, foreign investment, and financial interaction. Trade integration in Asia, in terms of IT share, has seen an upward trend and has increased substantially during last two decades. Today Asia trades more with itself than with rest of the world. Asia's subregions have also improved their trade interdependence, with East Asia being the most integrated and SAARC the least. However, the IT intensity for Asia has declined slightly, indicating a decrease in regional bias. Among the subregions, Central and West Asia has been an outlier, showing a decline in its trading bias towards itself. Asian integration has also increased in terms of investment, as intraregional FDI has increased significantly during the last two decades. Again, East Asia has been found to be the most inte-

grated subregion in terms of this measure and SAARC the least. The interdependence of financial markets in Asia has also increased as the intraregional portfolio share has increased; the coefficient of variation of lending market rates and money market rates declined between 2001 and 2008. As for the subregions, the intraregional portfolio share has increased and seen an upward trend in East Asia and ASEAN+3 but has drastically declined for SAARC. There was convergence in money market rates in ASEAN, ASEAN+3 and East Asia during the period 2002–2008, further underscoring the increased integration.

However, economic integration in Asia has, until recently, been largely market driven. Regionalism or formal economic cooperation, in the form of FTAs, PTAs, RTAs, CEPAs or monetary or infrastructural cooperation, is a relatively new phenomenon. This has mainly been driven by regionalism in North America and Europe, the slow progress of multilateral negotiations and the continued failure of the Doha Round negotiations at the WTO, the need to manage the spillover effects of increasing market-driven integration, the perceived benefits of regional cooperation, etc. Economic cooperation has increased mainly in terms of a rapid proliferation of both bilateral and plurilateral FTAs between Asian countries and other countries within and outside of Asia. This phenomenal increase in FTAs has generated concern among experts and policy makers that the overlapping nature of these agreements could lead to the “spaghetti-bowl effect,” but others are of the view that it could pave the way to broader integration. These FTAs could be converted into a broader or pan-Asian FTA that could serve as hub for further integration.

Although economic integration and cooperation in Asia have been increasing, there exist numerous challenges. One of them is the development of an inclusive vision and shared leadership. A related problem is the lack of a single Asian consciousness among Asia’s people, something that is critical to all kinds of regional cooperation efforts. Given the heterogeneity of the Asian region, the path to regionalism is not an easy one. Since more and more FTAs are being signed and implemented, the occurrence of a “spaghetti-bowl effect” cannot be ruled out. Hence it is important that the rationalization of ROOs be encouraged and that international practices to administer the ROOs be adopted. If Asia wants to obtain maximum benefit from the FTAs, all the existing FTAs should be converted into a broader, single FTA. There are two competing proposals for doing this: an EAFTA and a CEPEA. Given the potential economic gains to the region and the future economic dynamism of countries like India, the CEPEA would be a better option. In addition, the countries in the region should work to strengthen the ongoing financial cooperation and to involve other economically important countries such as India. Asia needs a strong network of institutions that can promote the exchange of ideas regarding broader and deeper cooperation among its countries.

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