

Integrating Asian Economies

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- **Study coverage**
- Southeast Asia
 - 10 ASEAN members
- East Asia
 - People's Rep. of China
 - Hong Kong, China
 - Japan
 - Korea
 - Taipei, China
- South Asia
 - India

Main Messages

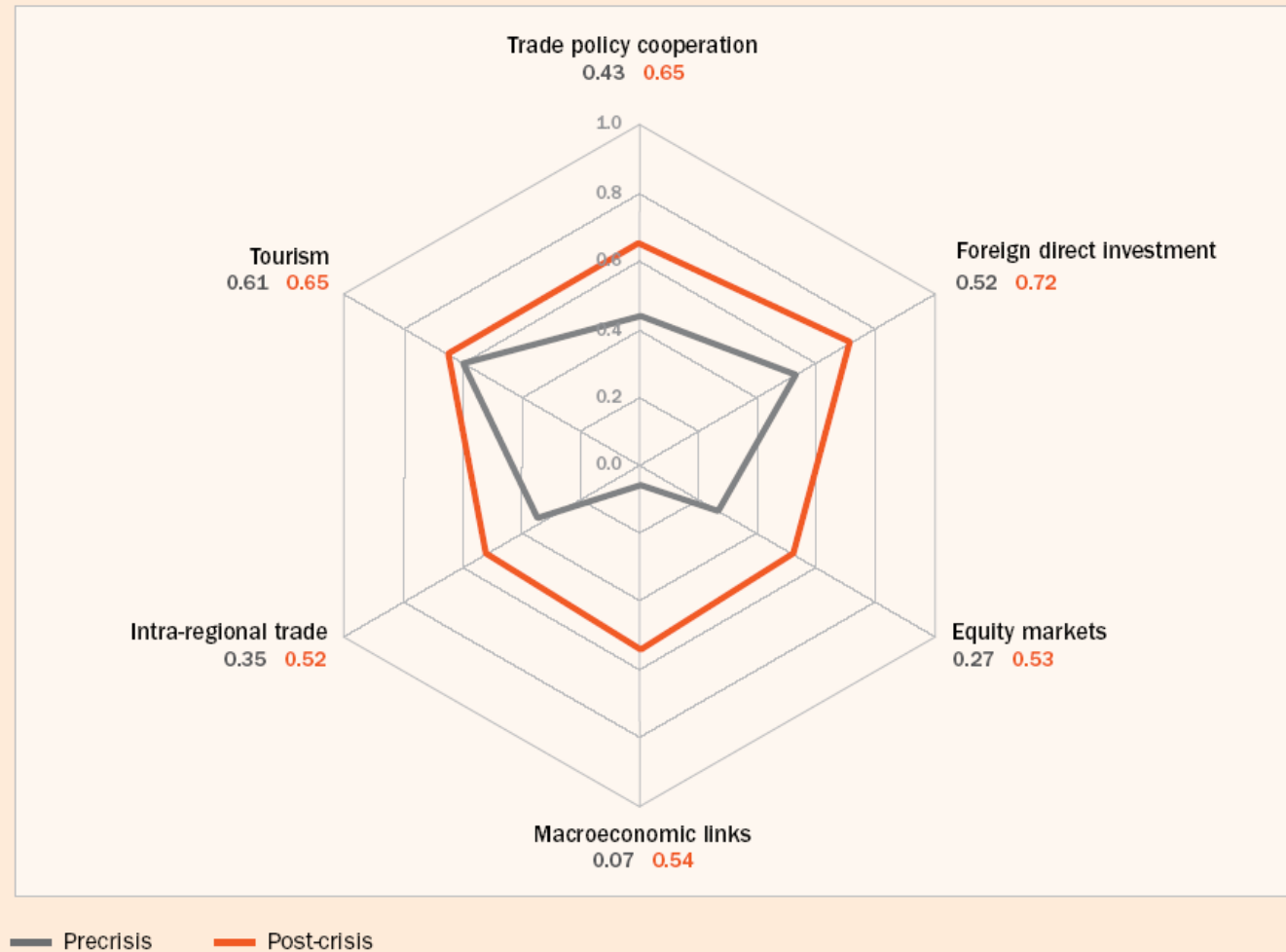
- Asian integration is rapid, broad, with global links
- Asian Financial Crisis of 1997/98 was a watershed
- Cooperation is accelerating, but needs more focus
- Asian regionalism will be distinctive: outward-oriented, multi-speed, multi-track, pragmatic
- Regionalism is good for Asia, good for the world

Priorities and Approaches

- Trade and investment
- Financial systems
- Macroeconomic links
- Social and environmental issues
- Cooperation: style, scope, speed

All Indicators of Integration are Rising

Figure 2. Advancing integration: regional indicators, pre- and post-crisis



6 Indicators

Foreign Direct Investment

Equity Markets Correlation

GDP Correlation

Intraregional Trade

People-to-people Tourism

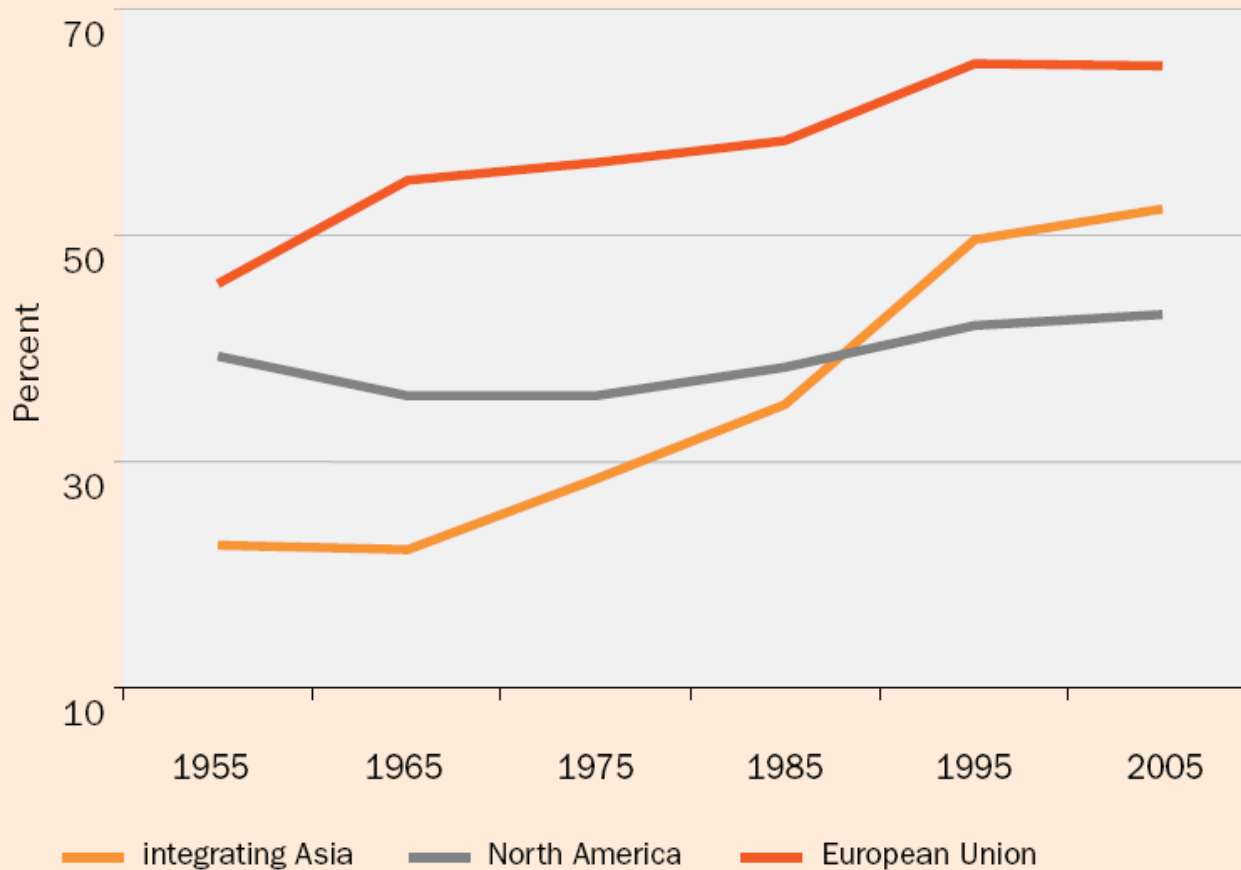
Trade Policy FTA

The Logic of Regional Collective Action

- Providing new regional public goods
- Managing spillovers among economies
- Exercising Asia's influence in global economic forums
- Liberalizing trade and investment
- Adding value to national policy making

Asia's trade integration is comparable to Europe-North America

Figure 1. Increasing intraregional trade



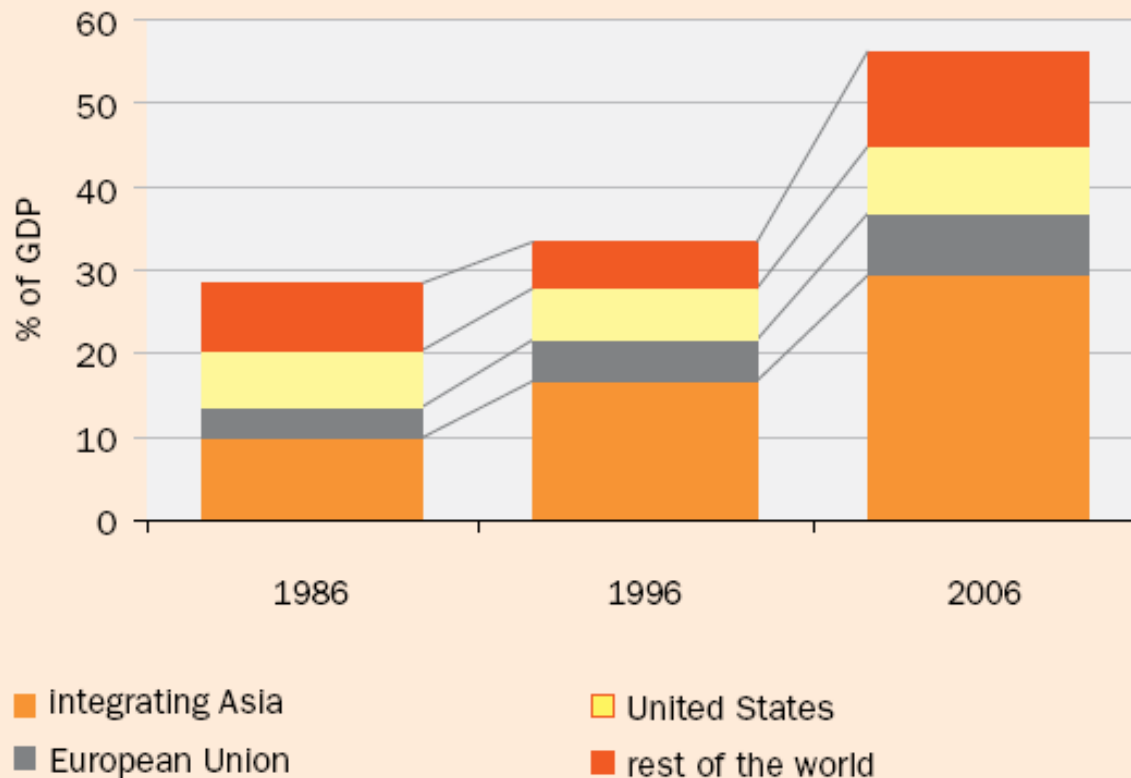
Intraregional trade is increasing fast

Higher than Europe's at its early stages

Asian Economic Regionalism is not building a Fortress Asia

Figure 3. Increasing trade links

Trade of Integrating Asia as a share of GDP, by destination



Asian
Regionalism
is creating
bridges with
the rest of
the world

Production Networks and Asian Trade

Figure 4. Networking: sourcing of parts and components for a hard disk drive



Market-driven regionalism

Trade-investment nexus

Fragmented production and trade

Multinational corporations

Technology policy and technology upgrading

Building Physical Connectivity Corridors in Great Mekong Subregion



Building physical infrastructure

Key for regional connectivity

Role of regional development banks for development financing

Creating development opportunities through trade and services

Trade Policy in a Fractious Global Environment

Table 3. Integrating Asia's free trade agreements

Negotiating body	Status as of December 2007					
	Concluded	Under negotiation	Proposed	Total	of which	
					Inside IA	Outside IA
ASEAN	2	4	0	6	4	2
Brunei Darussalam	3	0	4	7	3	4
Cambodia	1	0	2	3	2	1
China, People's Republic of	7	6	9	22	8	14
Hong Kong, China	1	1	0	2	1	1
India	8	10	12	30	8	22
Indonesia	3	1	6	10	4	6
Japan	8	7	4	19	12	7
Korea, Republic of	6	5	11	22	9	13
Lao People's Dem. Rep.	3	0	2	5	3	2
Malaysia	4	5	4	13	5	8
Myanmar	1	1	2	4	2	2
Philippines	2	0	4	6	3	3
Singapore	11	10	5	26	6	20
Taipei, China	4	2	1	7	0	7
Thailand	6	6	6	18	7	11
Viet Nam	1	1	2	4	3	1
Total ^a	44	49	41	134	30	104

Proliferation of FTA

Asian Noodle Bowl Effect

Rules of origin and scope of FTAs

Low rate of utilization

Integrating Production and Trade

Building an Asian economic community: the way forward

Priorities

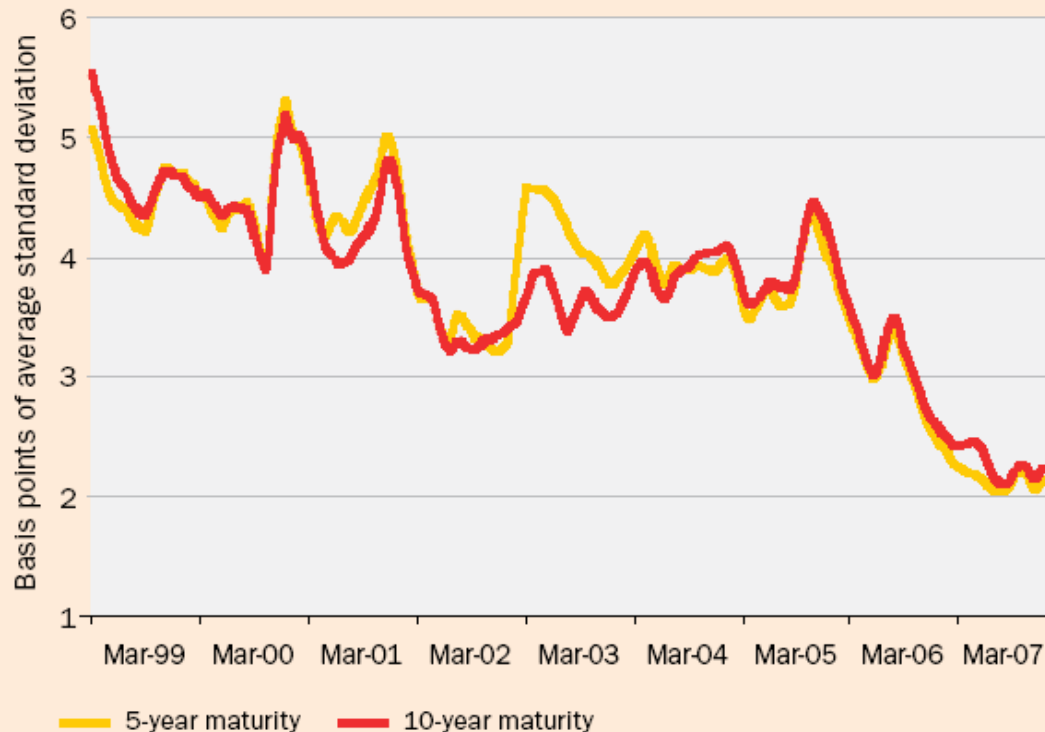
- Enhance investment in and the productivity of regional economies
- Strengthen comparative advantage derived from integrated regional production chains
- Promote technological upgrading and development of a knowledge economy

Policy solutions

- Support the global trading system
- Pursue regional cooperation as widely and deeply as possible
- Develop guidelines for best practices in subregional trade agreements
- Enhance regional connectivity

Financial Integration is Less Advanced, but Under Way: Price Indicators

Figure 6. Converging bond yields
(standard deviation of cross-market bond-yield spread differentials)



Notes: Average standard deviation (61-day) of government bond yield spreads of 10 Asian currencies (for which data are available) over the dollar. The currencies are the yuan, Hong Kong dollar, rupiah, yen, won, ringgit, peso, Singapore dollar, New Taiwan dollar, and baht.
Source: Data from Bloomberg. Available at <http://www.bloomberg.com>.

Improving Asian financial markets since the crisis

Still very close link to global markets

Recycling of Asian savings into Asian investment

Development of global financial centers in Asia

Financial Integration is Less Advanced, but Under Way: Quantity Indicators

Table 4: Deepening financial integration: portfolio investment (\$ billion)

Reporting economy	Assets Invested In				Total	Liabilities received from				Total
	IA less Japan	Japan	IA	US		IA less Japan	Japan	IA	US	
2001										
IA less Japan	48.6	20.0	68.6	63.6	324.8	48.6	21.8	70.4	125.0	354.0
Share	15.0%	6.2%	21.1%	19.6%	100.0%	13.7%	6.1%	19.8%	35.3%	100.0%
Japan	21.75		21.8	490.2	1,289.8	20.0		20.0	197.8	542.3
Share	1.7%		1.7%	38.0%	100.0%	3.7%		3.7%	36.5%	100.0%
IA	70.4	20.0	90.4	553.8	1,614.6	68.6	21.8	90.4	322.8	896.3
Share	4.4%	1.2%	5.6%	34.3%	100.0%	7.7%	2.4%	10.1%	36.0%	100.0%
2006										
IA less Japan	238.4	28.2	266.6	136.8	941.9	238.4	50.8	289.1	467.4	1,233.4
Share	25.3%	3.0%	28.3%	14.5%	100.0%	19.3%	4.1%	23.4%	37.9%	100.0%
Japan	50.6		50.6	797.6	2,343.5	28.2		28.2	585.6	1,434.9
Share	2.2%		2.2%	34.2%	100.0%	2.0%		2.0%	40.8%	100.0%
IA	289.1	28.2	317.4	934.4	3,285.3	266.6	50.8	317.4	1,053.0	2,850.4
Share	8.8%	0.9%	9.7%	28.4%	100.0%	9.4%	1.8%	11.2%	36.9%	100.0%

Capital accounts still not completely liberalized
Developing local-currency-denominated bond markets

Integrating Financial Markets

Building an Asian economic community: the way forward

Priorities

- Increase resilience against financial crises
- Develop larger, deeper regional financial markets
- Improve returns for investors and reduce capital costs to firms by strengthening the regional intermediation of savings

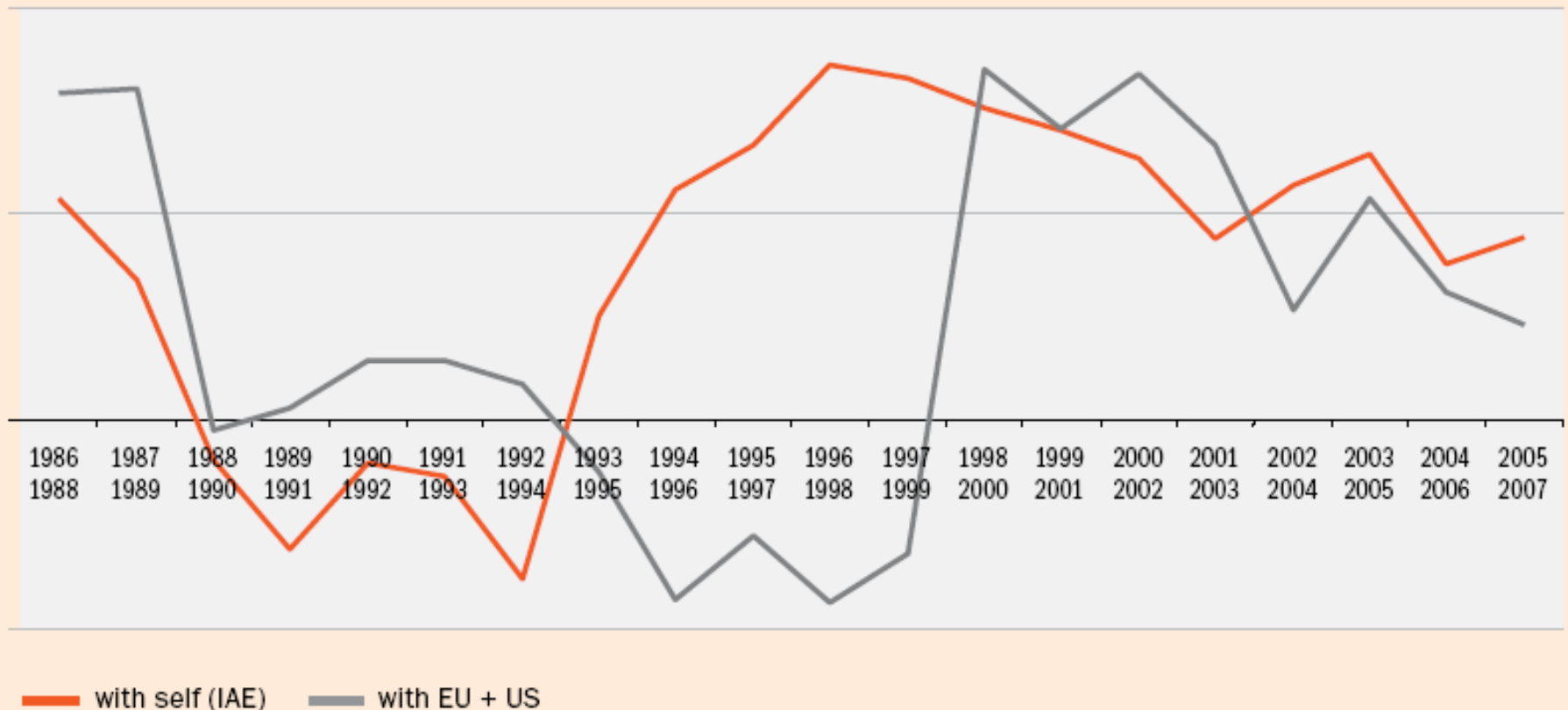
Policy solutions

- Improve financial market surveillance and create an “Asian Financial Stability Dialogue”
- Promote consistent standards and mutual recognition
- Strengthen financial markets (especially including local currency bond markets) and their infrastructure
- Liberalize capital accounts and cross-border financial services prudently

Deepening Macroeconomic Interdependence

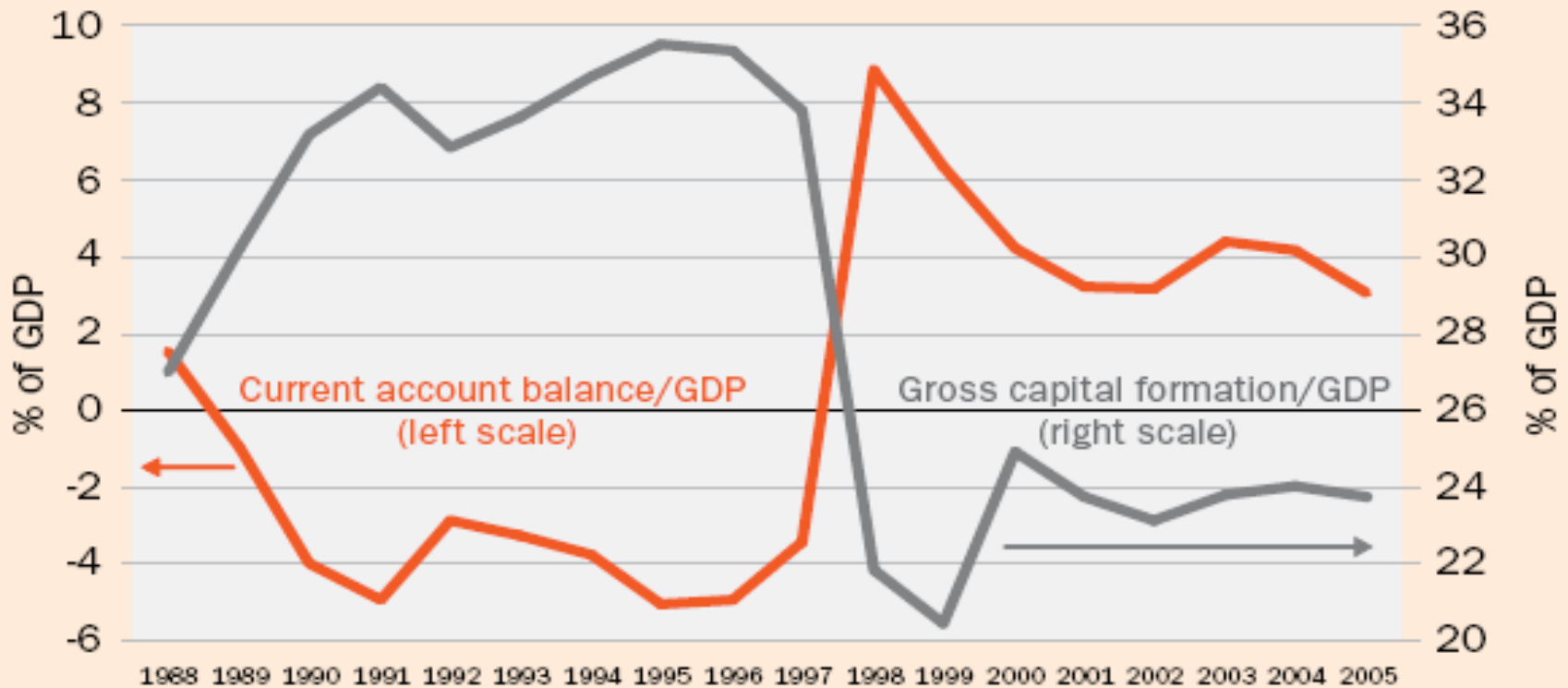
Figure 7. Increasing intra-regional links: output correlation

(detrended quarterly GDP growth correlation of the IAEs with itself and with the EU + US)



Needing Adjustments Ahead

Figure 8. Declining investment and rising current account surpluses
(simple average of the 5 most crisis-affected Asian countries)



Managing Macroeconomic Interdependence

Building an Asian economic community: the way forward

Priorities

- Increase macroeconomic and exchange rate stability
- Smoothen global economic adjustments, including reallocation of the region's external savings to regional demand
- Increase investment and growth in slower-growing economies

Policy solutions

- Make macroeconomic consultation and surveillance more effective by creating an Asian Secretariat for Economic Cooperation
- Strengthen Asia's short-term financing facility (Chiang Mai Initiative)
- Cooperate in exchange rate and macroeconomic policy management

Many are Still Left Behind

Table 6. Gains in the battle against poverty

Economy	Poverty index				Survey year	
	\$1-a-day		\$2-a-day		Initial	Final
	Initial	Final	Initial	Final		
China, People's Rep. of	28.3	10.8	64.5	37.8	(1993)	(2004)
Cambodia	25.5	18.5	76.5	61.6	(1993)	(2004)
India	41.8	35.1	85.1	79.6	(1993)	(2004)
Indonesia	17.4	7.7	64.2	52.9	(1993)	(2002)
Lao PDR	47.8	28.8	89.9	74.4	(1992)	(2002)
Malaysia	0.0	0.0	19.2	9.8	(1993)	(2004)
Philippines	18.1	13.2	52.7	43.6	(1994)	(2003)
Thailand	6.0	0.0	37.5	25.8	(1992)	(2002)
Viet Nam	27.3	8.4	73.5	43.2	(1993)	(2004)

Several major groups have been left behind

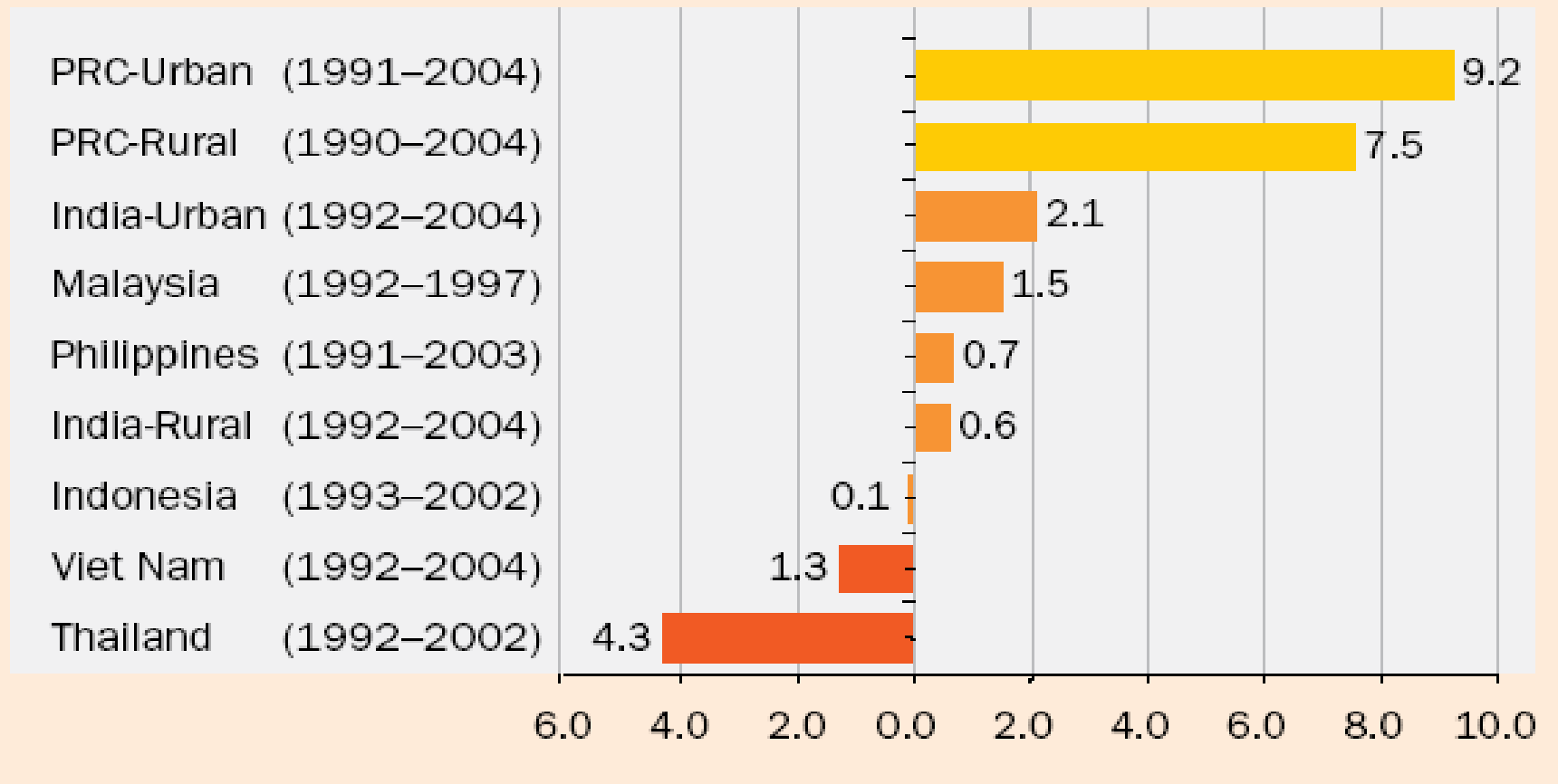
Labor market and investment policies can help alleviate poverty and exclusion

Increased migration can produce large social benefits

Managing threats to health and safety is a priority

Fighting Poverty and Exclusion

Figure 9. Growing inequality
(changes in the Gini index)



Making Growth Inclusive and Sustainable

Building an Asian economic community: the way forward

Priorities

- Reduce poverty and income disparities
- Improve social safety nets and provide support for the aged
- Fight epidemics and mitigate the impact of disasters
- Address environmental issues

Policy solutions

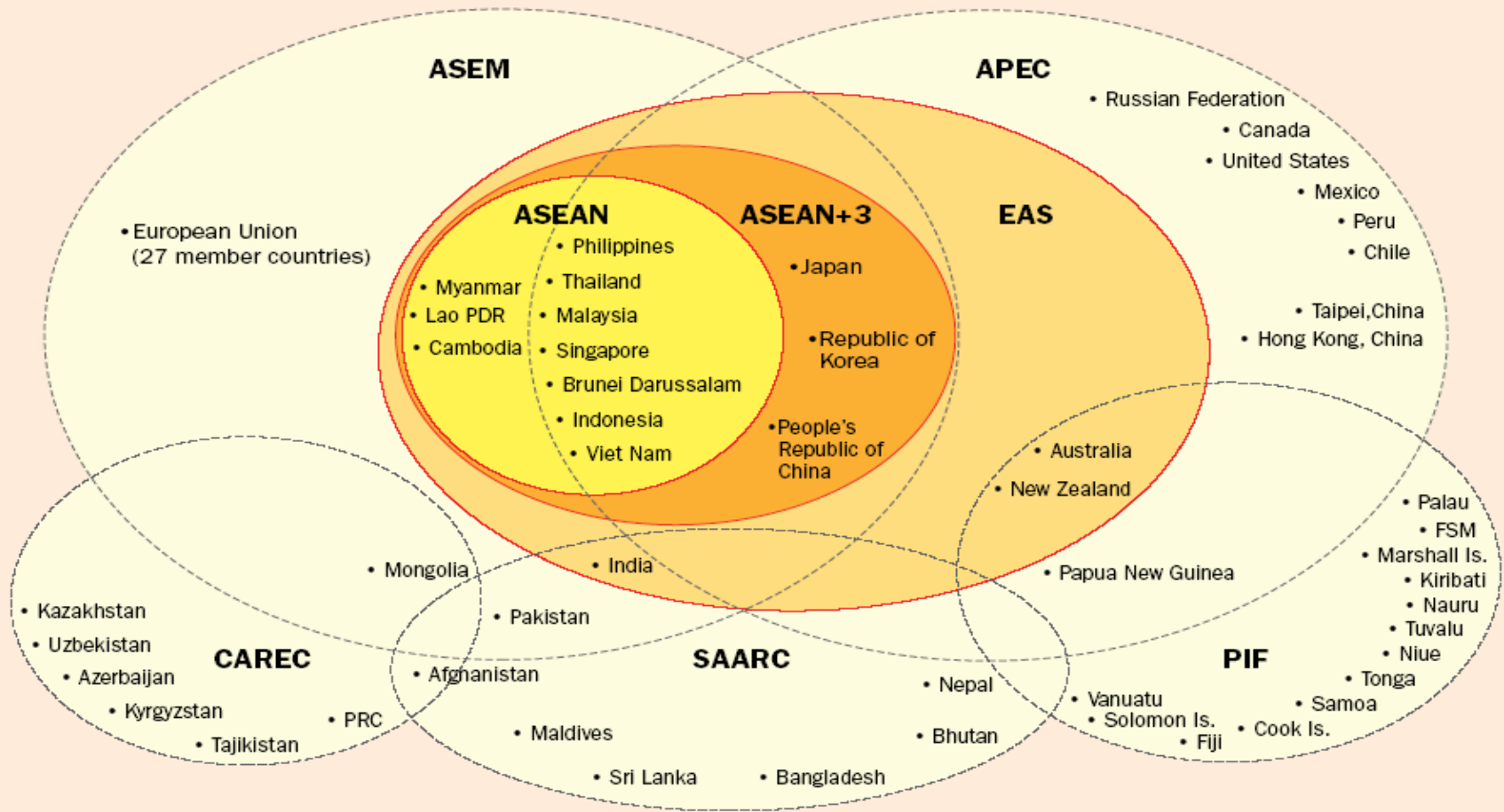
- Connect the poor to the thriving regional economy
- Develop cost-effective social protection systems
- Facilitate and manage labor migration
- Protect regional health and safety
- Make development sustainable

Regionalism with Asian Characteristics

- Outward-oriented, multi-speed, multi-track, pragmatic, bottom-up
- Develop deeper institutional capabilities
- ASEAN, ASEAN+3, and EAS as the strategic regional forums
- Empower bottom-up leadership (coalitions and civil society)
- Pursue long-term goals through constructive, pragmatic steps

Regional and Transregional Forums

Figure 10. Economic architecture: regional and transregional forums



A Partnership for Shared Prosperity

- Asian economies in the long run are likely to have
 - a single market
 - deep and liquid financial markets
 - effective macroeconomic policy coordination frameworks
 - a common currency
 - workers moving much more freely than today
 - collective efforts to address social issues
 - stronger voice in global policy forums
 - more regional institutions