

REGIONAL COOPERATION AND INTEGRATION STRATEGY

July 2006

Asian Development Bank

ADB

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Preface

The Asia and Pacific region accounts for about 60% of the world's population and 30% of the world's total land area. With these vast human and natural resources, Asian economies have grown at an unparalleled pace. With the exception of 1998, Asia has been the fastest growing region of the world for several decades. This dynamic growth has been the engine that has lifted hundreds of millions of people in the region out of poverty. Yet Asia-Pacific is a region of enormous disparity in income levels, living standards, and socioeconomic conditions. Nearly two thirds of the world's poor still live in developing Asia.

ADB's vision is an Asia-Pacific region free of poverty. To pursue this vision, regional cooperation and integration (RCI) is an important platform to complement efforts at the country level. By working together countries in Asia and the Pacific can unlock their vast economic potential, achieve sustained, rapid growth, and reduce poverty. Leaders across Asia and the Pacific have, therefore, expressed their shared vision of a thriving regional economy, well integrated within itself, and with the world.

The main purpose of the RCI strategy is to guide ADB support for the ongoing process of RCI in Asia and the Pacific in a coherent way and to facilitate new forms of RCI initiatives that are needed in the future. The RCI strategy will support poverty reduction in Asia and the Pacific through regional collective action that leads to greater physical connectivity; trade and investment expansion; financial market development and regional macroeconomic and financial stability; and improved environmental, health, and social conditions. These will be achieved through four separate, but interrelated activities (four RCI pillars): (i) regional and subregional programs on cross-border infrastructure and related software; (ii) trade and investment; (iii) money and finance; and (iv) regional public goods such as prevention of communicable diseases and environmental degradation.

The RCI strategy paper went through extensive consultations, both internally and externally, since early this year. Issues and concerns raised by member countries, civil society, the Board of Directors, and the Management have been carefully considered and incorporated. It was endorsed by the Bank's Board of Directors on 25 July 2006.

In implementing the RCI strategy, all relevant departments and offices of ADB will cooperate and coordinate their activities. Progress in implementing the RCI Strategy will be closely monitored.

ADB is committed to work closely with all countries in Asia and the Pacific in their fight against poverty by building common strengths, reducing shared vulnerabilities, and bringing economic and social benefits for all.



Haruhiko Kuroda
President
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ABBREVIATIONS

ABM	– Asian Bond Markets Initiative
ACMECS	– Ayeyawady-Chao Phraya-Mekong Economic Cooperation Strategy
ADB	– Asian Development Bank
ADB I	– Asian Development Bank Institute
ADF	– Asian Development Fund
AFTA	– ASEAN Free Trade Area
APEC	– Asia-Pacific Economic Cooperation
APTA	– Asia-Pacific Trade Agreement
ARIC	– Asia Regional Information Center
ASEAN	– Association of Southeast Asian Nations
ASEAN+3	– ASEAN plus People’s Republic of China, Japan, and Republic of Korea
ASEM	– Asia–Europe Meeting
ASP	– ASEAN Surveillance Process
BIMP-EAGA	– Brunei Darussalam, Indonesia, Malaysia, the Philippines-East ASEAN Growth Area
BIMSTEC	– Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BIMSTEC FTA	– Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation Free Trade Area
BIS	– Bank for International Settlements
BPMSD	– Budget, Personnel, and Management Systems Department
CACO	– Central Asia Cooperation Organization
CACOM	– Central Asia Common Market
CAI-Asia	– Clean Air Initiative for Asian Cities
CAREC	– Central Asia Regional Economic Cooperation
CDM	– Clean Development Mechanism
CMI	– Chiang Mai Initiative / Carbon Market Initiative
CSP	– country strategy and program
CWRD	– Central and West Asia Department
DMC	– developing member country
EAFTA	– East Asia Free Trade Area
EARD	– East Asia Department
ECO	– Economic Cooperation Organization
EEI	– Energy Efficiency Initiative
EPA	– economic partnership agreement
ERD	– Economics and Research Department
ERP D	– Economic Review and Policy Dialogue
ESCAP	– Economic and Social Commission for Asia and the Pacific
EU	– European Union
FDI	– foreign direct investment
FTA	– free trade agreement/area
GDP	– gross domestic product
GMS	– Greater Mekong Subregion
IMF	– International Monetary Fund
IDB	– Inter-American Development Bank
LTSF	– long-term strategic framework
MDB	– multilateral development bank
MERCOSUR	– Mercado Común del Sur (Southern Common Market)
MTS II	– medium-term strategy II
NAFTA	– North American Free Trade Agreement
OCO	– Office of Cofinancing Operations
OCR	– ordinary capital resources

OECD	– Organization for Economic Co-operation and Development
OGC	– Office of the General Counsel
OREI	– Office of Regional Economic Integration
PACER	– Pacific Agreement on Closer Economic Relations
PARD	– Pacific Department
PECC	– Pacific Economic Cooperation Council
PDMC	– Pacific developing member country
PICTA	– Pacific Island Countries Trade Agreement
PSOD	– Private Sector Operations Department
RCI	– regional cooperation and integration
RCP	– regional cooperation policy
RCSP	– regional cooperation strategy program
RD	– regional department
REACH	– Renewable Energy, Energy Efficiency and Climate Change
REMU	– Regional Economic Monitoring Unit
RPG	– regional public good
RSDD	– Regional and Sustainable Development Department
SAARC	– South Asian Association for Regional Cooperation
SAFTA	– South Asian Free Trade Area
SARD	– South Asia Department
SARS	– severe acute respiratory syndrome
SASEC	– South Asia Subregional Economic Cooperation
SCO	– Shanghai Cooperation Organization
SECSCA	– Subregional Economic Cooperation in South and Central Asia
SERD	– Southeast Asia Department
SPARTECA	– South Pacific Regional Trade and Economic Cooperation Agreement
TA	– technical assistance
TD	– Treasury Department
UNAIDS	– Joint United Nations Programme on HIV/AIDS
WHO	– World Health Organization
WTO	– World Trade Organization
\$	– US dollars

Executive Summary

The Charter of the Asian Development Bank (ADB) mandates it to play an active role in regional cooperation in Asia and the Pacific. ADB adopted a regional cooperation policy (RCP) in 1994 that, for the first time, articulated ADB's approach to promoting regional cooperation.

Since the early 1990s, ADB has supported various regional and subregional cooperation programs, including the Greater Mekong Subregion (GMS) Economic Cooperation program, the South Asia Subregional Economic Cooperation (SASEC) program, the Central Asia Regional Economic Cooperation (CAREC) program, the Subregional Economic Cooperation in South and Central Asia (SECSCA) program, and the Pacific Plan. In the aftermath of the Asian financial crisis of 1997–1998, ADB was asked by the Association of Southeast Asian Nations (ASEAN) and ASEAN+3 to support their initiatives on regional monetary and financial cooperation. ADB has also started a number of regional initiatives on prevention of communicable and infectious diseases (such as avian influenza, HIV/AIDS, severe acute respiratory syndrome [SARS], and tuberculosis), energy efficiency, environmental management, and governance.

The global and regional economic landscapes have changed extensively since 1994. Intra-regional trade has significantly increased in Asia. The intra-regional trade share in Asia has increased from about 40% in early 1990s to 55% in 2004. Improved physical connectivity, the rapid growth of large emerging market economies such as the People's Republic of China (PRC) and India, and the spread of vertically integrated production networks have brought Asian economies ever closer. Free trade agreements (FTAs) are proliferating. Initial conditions for greater monetary and financial integration in East Asia have emerged through regional processes such as ASEAN Surveillance Process (ASP), the ASEAN+3 Economic Review and Policy Dialogue (ERPD), the Chiang Mai Initiative (CMI), and the Asian Bond Markets Initiative (ABMI).

These emerging trends indicate that economic integration is likely to deepen in a number of regions and subregions in Asia and the Pacific. However, the regional cooperation and integration (RCI) process is likely to follow a multi-

track and multi-speed process. Different regions and subregions will embrace RCI at different speeds, and, even within regions or subregions, the pace of progress for different aspects of RCI will vary. ADB's vision of an integrated, poverty-free, prosperous, and peaceful Asia and the Pacific is, therefore, well within reach. It is likely to be realized through a bottom-up rather than a top-down process. In other words, countries within each of the regions are likely to strengthen their mutual integration and subsequently to establish economic links with other regions in Asia and the Pacific, rather than through a single, "one-size-fits-all" model.

The changing circumstances have highlighted several limitations to ADB's earlier support for RCI, such as fragmented efforts across departments and offices, varied quality of lending and non-lending services for RCI because of the absence of a coherent strategy, and limited support for trade and investment integration, especially in view of the recent proliferation of FTAs in the region. Given the emerging trends and the future vision of RCI in Asia and the Pacific, it is appropriate for ADB to take a fresh look at its RCI activities from a strategic perspective, with a view to overcoming previous limitations. It is time to transform ADB's support for RCI in Asia and the Pacific from stand-alone programs to a coherent and strategically focused approach.

If appropriately designed and managed, RCI can considerably strengthen poverty reduction efforts, as enshrined in ADB's poverty reduction strategy. RCI can help improve cross-border connectivity, increase regional trade and investment, mobilize regional savings for regional investment, reduce macroeconomic vulnerability to shocks, facilitate cooperation in regional public goods, and improve the overall governance standards across the region. RCI offers a "win-win" outcome for the region's economies as more countries covered and the broader the scope of RCI, the greater will be its benefits. Hence, RCI is an additional platform supplementing individual programs at the country level to achieve ADB's overarching goal of poverty reduction. This is consistent with ADB's long-term strategic framework (2001–2015), which identifies RCI as one of the cross-cutting strategic themes for poverty reduction.

ADB's RCI strategy has four pillars: (i) regional and subregional economic cooperation programs on cross-border infrastructure and related software, (ii) trade and investment cooperation and integration, (iii) monetary and financial cooperation and integration, and (iv) cooperation in regional public goods. The aim of these four pillars is to help reduce DMCs' poverty through regional collective action that leads to greater physical connectivity; expansion of trade and investment; development of financial systems and macroeconomic and financial stability; and improved environmental, health, and social conditions.

The four pillars are mutually reinforcing so they can contribute to achieving ADB's overarching goal of poverty reduction. However, individual pillars are assigned different weights. Pillar 1 has so far been the core component of many ADB-supported RCI activities, followed by pillar 3 and pillar 4. Pillar 2 will be given less weight compared with the other pillars. Accordingly, prioritization of the four pillars and selection of priorities within each pillar have to be in line with the priority classifications of the medium-term strategy II (MTS II) and with the specific conditions prevailing in each region or subregion.

As the region's leading development finance institution, ADB is well placed to facilitate RCI in Asia and the Pacific. ADB can play four distinct roles in supporting and promoting RCI: (i) providing financial resources for RCI projects, programs, and related technical assistance and/or helping DMCs mobilize funding and technical assistance (i.e., acting as a money bank); (ii) creating, consolidating,

and disseminating knowledge and information on RCI to the DMCs (i.e., acting as a knowledge bank); (iii) helping DMCs and regional and/or subregional bodies build institutional capacity to manage RCI (i.e., acting as a capacity builder); and (iv) serving as catalyst and coordinator of RCI for the DMCs (i.e., acting as an honest broker). These four functions cut across the four pillars of RCI. They are also mutually supportive and reinforcing, enabling ADB to serve as a facilitator in supporting and promoting RCI.

The strategy requires ADB to commit adequate human and financial resources to its RCI activities. Given the current zero real growth in ADB's overall budget for 2006, this will be a challenge. Additional financial resources will be required. Existing ordinary capital resources (OCR) and Asian Development Fund (ADF) resources within available headroom and additional public funding (particularly from larger economies) and private funding may be utilized. Concessional funds will be needed to finance cross-border infrastructure and related investments. These concessional funds should be in addition to the amounts currently set aside by ADB for regional cooperation projects and programs. Accordingly, the RCI strategy proposes a systematic exploration of possible sources of such funding. Additional technical assistance (TA) resources will also be required for the strategy's nonlending components. While existing TA resources may be rationalized and prioritized to some extent in favor of RCI, additional funds will need to be mobilized for pillars 2, 3, and 4 and for the software component of pillar 1.

I. Background and Objective

1. ADB adopted a regional cooperation policy (RCP) in 1994 that, for the first time, articulated ADB's approach to promoting regional cooperation.¹ The RCP thus fleshed out one of the key mandates of the Agreement Establishing the Asian Development Bank (the Charter): "The purpose of the Bank shall be to foster economic growth and cooperation in the region.... and contribute to the acceleration of the process of economic development of the developing countries in the region, collectively and individually."²

2. The RCP recommended a "phased-approach" to ADB's support for regional cooperation. Three phases of ADB's support to regional cooperation were identified. In the first phase, ADB was expected to raise awareness of developing member countries (DMCs) on the importance of regional cooperation through information dissemination, with the overall aim of building mutual respect, confidence, and trust among DMCs. In the second phase, potential regional projects and programs that could yield quick and tangible results were to be identified. In the third phase, ADB was to finance cross-border projects and national projects with a significant cross-border or regional dimension.

3. Within this overall framework, three key features of the RCP are worth noting. First, its coverage was limited to regional cooperation, and did not include regional integration. Second, the RCP expected ADB to play a catalytic role in regional cooperation: "Regional cooperation demands that the Bank itself cooperate with the DMCs; a situation in which the Bank appears to be leading the DMCs, rather than facilitating them, is likely to impede rather than promote its strategic role." Third, the RCP highlighted that: "... the 'measure' for assessing Bank support for regional cooperation is not the volume or relative share of direct financial assistance to regional cooperation activities per se, but the nature and content of the regional cooperation activities supported, as viewed

against the interests of the Bank and its DMCs..." Many of these basic principles of the RCP still remain valid. However, since 1994, significant changes that have a bearing on ADB's support for regional cooperation have taken place in Asia and the Pacific. This paper will therefore articulate ADB's strategy of regional cooperation and integration to reflect the new realities shaping the regional economies and the emerging needs of DMCs.

4. "Regional integration" here refers to a process through which economies in a region become more interconnected. Such economic interconnection can result from market-led and private-sector-driven actions and/or government-led policies and collective initiatives in a region. The latter—collective policies and initiatives by the governments which, in turn, could be either formally embodied in an intergovernmental treaty or informally agreed upon by the participating countries—is regional cooperation. Regional integration is thus broader in scope than regional cooperation. The two could, however, be mutually reinforcing in the sense that regional cooperation can deepen regional integration and at the same time rising regional integration can prompt, and even compel, governments to cooperate collectively to internalize externalities created by integration.

5. The Asia and the Pacific region, in this paper, is defined to include East Asia, South Asia, Central Asia, and the Pacific. East Asia refers to member economies under the newly realigned East Asia Department (EARD) and Southeast Asia Department (SERD), South Asia refers to members under the new South Asia Department (SARD) plus Afghanistan and Pakistan, and Central Asia refers to the Central Asian republics under the new Central and West Asia Department (CWRD).³ A "subregion" is defined as a subgroup of countries and economies within any of these. A list of the countries/economies under the newly aligned regional departments is given in Table 1 and their membership in regional groupings is given in Table 2.

¹ Asian Development Bank (ADB). 1994. *Bank Support for Regional Cooperation*. Manila.

² ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila. Chapter 1, Article 1.

³ The realignment of regional departments became effective 1 May 2006.

A. Emerging Trends in Regional Cooperation and Integration in Asia and the Pacific

6. Since the adoption of the RCP in 1994, the global and regional economic landscapes have changed extensively. The spread of information technology across the world, the adoption of outward-oriented economic policies by an increasing number of countries, and the rapid growth of large emerging market economies such as the People's Republic of China (PRC) and India have brought the Asia and Pacific economies ever closer together. The private sector has played a major role in the globalization process and in increased regional economic integration. The acceleration of the globalization process and the private-sector-driven vertical integration of production networks across countries have provided considerable impetus to regional economic integration. The collapse of the former Soviet Union led to the creation of independent states in Central Asia and to a new form of regional cooperation.

7. Cross-border physical connectivity has improved across most parts of Asia and the Pacific largely because of national economic development programs supplemented by sub-regional programs. Countries have been increasingly interconnected through land, sea, and air-based transportation networks. Intra-Asian internet connectivity is growing at twice the pace of the trans-Pacific internet connectivity, reflecting growing potential for regional integration through development of e-commerce. The number of air routes within East Asia doubled from 54 in 1985 to 117 in 2000.⁴ Between 1994 and 2006, intraregional passenger traffic in Asia and the Pacific has almost doubled from about 500 billion passenger-kilometers per year to close to 1 trillion passenger-kilometers per year. In regions and subregions with a greater degree of integration, intraregional travel has increased substantially.⁵

8. The Asia Highway project under the aegis of the Economic and Social Commission for Asia and the Pacific (ESCAP) aimed to improve the highway system in Asia. It

was suspended in 1975 for lack of finance, but has now been revived. The Intergovernmental Agreement on the Asian Highway Network, adopted in 2003, identified 55 Asian cross-border highway routes among 32 member countries. This would yield an Asian highway of over 140,000 kilometers. Under this project, existing roads will be upgraded and new roads constructed to establish highway networks. These networks will improve economic links between East Asian countries, India, and Russia. When completed, this project will connect Tokyo to Istanbul and pass through the Korean peninsula, PRC, and other countries in Southeast Asia, Central Asia, and South Asia.⁶

9. A Trans-Asian Railway project, which was hindered by political and economic obstacles for many years, has received new momentum recently. The project is expected to facilitate movement of goods and people across Asia, particularly for landlocked countries such as Mongolia, and the Central Asian republics. When completed, this project will provide 14,000 kilometers of continuous rail link between Singapore and Istanbul with possible further connections to Africa and Europe.⁷

10. Reflecting this improved physical connectivity, the significant trade liberalization in many countries, and increased inflows of foreign direct investment (FDI), the degree of trade integration in Asia has risen rapidly. Intraregional trade now accounts for 55% of Asia's total trade. This is sharply up from about 43% in the early 1990s, higher than the 46% figure for the North American Free Trade Area (NAFTA), and only slightly below the 62% figure for the 15 European Union countries (Table 3).⁸ Most of this increase in intraregional trade has been due to the rising share of intraregional trade in East Asia (from about 43% in the early 1990s to 55% in 2005).⁹ Trade integration in the other regions in Asia and the Pacific is occurring, but more slowly.

11. Between 1980 and 2004, FDI inflows into East Asia as a percentage of world inflows tripled. Over the same period, East Asia's sustained dynamism also fueled an increase in FDI outflows from 5% to 13% of world

⁴ National Institute for Land and Infrastructure Management, Japan, 2005.

⁵ For example, intra-ASEAN travel has increased from 11 million tourists in 1994 to 23 million tourists in 2004. ASEAN Secretariat, available at <http://www.aseansec.org>.

⁶ Available at <http://www.unescap.org/ttdw/index.asp?MenuName=AsianHighway>.

⁷ Available at <http://www.unescap.org/ttdw/index.asp?MenuName=TheTrans-AsianRailway>.

⁸ Available at http://www.aric.adb.org/regionalcooperation/integration_indicators.asp?s=4&ss=12.

⁹ 2005 data are for January–October 2005 and were obtained from the *Direction of Trade Statistics CD-ROM*, International Monetary Fund (IMF).

outflows.¹⁰ Many of these flows were intraregional—from Japan and the newly industrialized economies (Hong Kong, China; Republic of Korea; Singapore; and Taipei, China) to the countries of the Association of Southeast Asian Nations (ASEAN) and the PRC, and more recently from ASEAN countries to one another and to the PRC.

12. In a sense, therefore, regional economic integration is a natural outcome of the globalization process. It makes countries gravitate toward their neighbors while they globalize their economies. Geographical proximity thus acts as a natural catalyst for countries to integrate regionally en route to globalization. This trend of economic integration and the opportunity for greater connectivity have prompted governments to introduce several key regional cooperation initiatives in areas such as cross-border infrastructure development, trade and investment, money and finance, and the provision of various regional public goods (RPGs) in the health and the environment sectors. These regional cooperation initiatives have further reinforced regional integration. Hence, regional cooperation and integration have become mutually interactive.

13. The 1997–98 Asian financial crisis was a landmark in regional cooperation and integration (RCI) in Asia and the Pacific, especially in East Asia. Before the crisis, economic integration in Asia was mostly market-led and private-sector-driven. Few government-led cooperation initiatives existed, and those that did were limited to cross-border infrastructure and trade. These included, for example, the Asia-Pacific Economic Cooperation (APEC), established in 1989;¹¹ the ASEAN Free Trade Area (AFTA), started in 1992; and the South Asian Preferential Trading Arrangement (SAPTA), signed in 1993. However, after the 1997–1998 crisis, the market-led process began to be supplemented by a series of government-led initiatives. In addition, the coverage of such RCI initiatives has extended to include money and finance and RPGs.

14. The focus of the postcrisis initiatives in regional monetary and financial cooperation in East Asia has been threefold. First, to improve regional economic surveillance, the ASEAN Surveillance Process (ASP) was created in February 1998 and the ASEAN+3 Economic Review and Policy Dialogue (ERPD) process was launched in May 2000. Second, a network of bilateral swap agreements to provide short-term liquidity support was established as part of the Chiang Mai Initiative (CMI). Third, to mobilize regional savings for regional investment and reduce the “double mismatch” problem (the currency mismatch and the maturity mismatch), the ASEAN+3 finance ministers embarked on the Asian Bond Markets Initiative (ABMI), with the aim of deepening and strengthening the region’s local currency bond markets.

15. In the area of trade and investment, the postcrisis years have also seen a growing number of government-led integration initiatives in East Asia and beyond. First, ASEAN accelerated its intraregional trade cooperation initiative by advancing the deadline for the implementation of the ASEAN Free Trade Agreement (AFTA) by 6 years, from 2008 to 2002. Second, ASEAN has established closer economic partnerships with its major trading partners (Australia, India, Japan, New Zealand, PRC, and Republic of Korea), and through a series of intergovernmental agreements. One of the outcomes of these agreements has been the establishment of various free trade areas (FTAs) between ASEAN and these countries.¹² Third, a South Asian FTA (SAFTA) was established in January 2004, and is expected to be fully operational by 2016. The Central Asia Regional Economic Cooperation (CAREC) Program was established in 1997. Fourth, an Asia-Pacific Preferential Trade Agreement (APTA), which replaces the 1975 Bangkok Agreement, is now being negotiated. Finally, a number of regional and bilateral FTAs have been signed or negotiated in recent years. There are at present about 175 FTAs in Asia and the Pacific.¹³ The trend of increasing FTAs is most prevalent in East Asia, but South Asia is also emerging as

¹⁰ UNCTAD Foreign Direct Investment Database.

¹¹ APEC membership includes key East Asian economies as well as several countries in Oceania, the Americas, and Russia.

¹² To date, ASEAN has signed framework agreements on comprehensive economic partnerships with PRC, India, Japan, and Republic of Korea. The negotiations on FTAs with these countries have already started, covering trade in goods, services, and investment. The basis for FTA negotiations between ASEAN and Australia and New Zealand is the Joint Declaration of the Leaders at the ASEAN-Australia and New Zealand Commemorative Summit which was signed in November 2004. The Trade in Goods Agreement with the PRC was signed in November 2004 and its implementation began in July 2005. Other agreements are under negotiation with a targeted completion year of 2007.

¹³ <http://aric.adb.org/regionalcooperation/index.asp>

a major actor. Central Asian economies have also become active in FTAs. The growing number of FTAs in Asia and the Pacific is in part a response to uncertainty on the progress of multilateral trade liberalization under the auspices of the WTO. There is also a precautionary motive behind them as countries seek to avoid being placed at a competitive disadvantage by other regional trading arrangements which are taking shape in the rest of the world. However, a more fundamental factor behind FTAs is the fact that economies that are geographically close to each other and have established a degree of trade and investment relationships now wish to deepen their economic cooperation.

B. Regional Cooperation and Integration: A Perspective from Asia and the Pacific

16. Against the backdrop of these emerging trends, countries in Asia and the Pacific have begun to see greater regional and subregional integration as a means of collectively addressing their development challenges.

17. The ASEAN+3 Summit in Phnom Penh, Cambodia, in November 2002 endorsed 26 recommendations of the East Asia Study Group to accelerate regional integration in East Asia (including measures to establish an East Asia FTA, improve financial stability, and strengthen exchange rate coordination), address poverty reduction, narrow development disparities, and maintain peace and stability in East Asia.¹⁴ The first East Asia Summit in Kuala Lumpur on 14 December 2005 reaffirmed the need for “promoting development, financial stability, economic integration and growth, eradicating poverty and narrowing the development gap in East Asia, through technology transfer and infrastructure development, capacity building, good governance and humanitarian assistance and promoting financial links, trade and investment expansion and liberalization.”¹⁵

18. At the Thirteenth SAARC Summit in Dhaka in November 2005, Member States expressed “determination to work towards significantly accelerating regional

cooperation in economic areas.....They underlined the need to accelerate regional cooperation through all possible means and mechanisms....” Member States stressed the need for greater regional economic integration in the form of an economic union: “The launching of SAFTA marks an important milestone on the road to a South Asian Economic Union”.¹⁶

19. The Fourth Ministerial Conference of CAREC in November 2005 agreed that “the way forward for Central Asia is ‘development through cooperation’, working together to expand development options in an increasingly competitive and integrated world.....Ministers called for sweeping measures to overcome trade and other impediments to development...” For trade, they expressed the need for background studies to “review regional trade agreements and their potential conflict with WTO accession and review lessons that can be learned from regional trade agreements elsewhere...”¹⁷

20. The Pacific Islands Forum leaders endorsed the Pacific Plan in October 2005 for strengthening regional cooperation and integration between countries of the Pacific region and identify the areas where they will gain the most from sharing resources of governance and aligning policies.¹⁸ The Pacific Plan reflects the pressing need for countries to collectively address the challenges faced by Pacific nations and to create a more prosperous Pacific.

21. Ministers of 28 member countries of the Asia Cooperation Dialogue (ACD), which cuts across various regions within and beyond Asia, have dedicated themselves “to enhance economic cooperation and promote regional integration process. While taking an active part in the new round of WTO negotiations, we will vigorously develop intraregional trade, promote investment activity for bilateral and regional economic development, complement each other’s resources needs, and encourage regional trade arrangements”. The ACD ministers also committed themselves to: “promote financial stability, particularly through the development of a sound and solid financial

¹⁴ Press Statement by the Chairman of the 8th ASEAN Summit, the 6th ASEAN+3 Summit, and the ASEAN–China Summit, Phnom Penh, Cambodia, 4 November 2002. Available at <http://www.aseansec.org/13188.htm>.

¹⁵ Kuala Lumpur Declaration on the East Asia Summit, 14 December 2005. Available at <http://www.aseansec.org/4918.htm>.

¹⁶ Dhaka Declaration at the 13th SAARC Summit. Dhaka Declaration, 13 November 2005.

¹⁷ Joint Ministerial Statement of the Fourth Ministerial Conference on Central Asia Regional Economic Cooperation, Bishkek, Kyrgyz Republic, 5–6 November 2005.

¹⁸ The Pacific Plan: <http://www.pacificplan.org/tiki-page.php?pageName=HomePage>.

infrastructure. We will seek to implement the Chiang Mai Declaration on Asian Bond Market Development adopted by the Second ACD Ministers' Meeting in June 2003".¹⁹

**C. Regional Cooperation and Integration:
An Integrated, Poverty-Free, Prosperous,
and Peaceful Asia and the Pacific**

22. Political support for RCI is thus increasing across all of Asia and the Pacific. East Asia has advanced the most in pursuing regional economic cooperation and integration. Progress in other regions, although less comprehensive, is poised to accelerate. As part of its initiative to liberalize trade, investment, and capital flows, South Asia is gradually forging closer ties, both with its immediate neighbors and with the East and Central Asian countries. In Central Asia, despite several constraints, there is a growing awareness of the need for and the benefits of RCI, particularly in the area of transport logistics and trade liberalization and facilitation. The emerging trends have also induced significant debate and thinking on several issues relating to RCI in Asia and the Pacific. The issues that are often addressed in this debate and research include the extent, speed, and sequencing of regional economic integration in Asia and the Pacific.

23. Asia and the Pacific is highly diverse, physically, culturally, socially, economically, and politically. The combined population of Asia and the Pacific is 3.5 billion (55% of the world population), with populations ranging from 11,600 in Tuvalu to 1.3 billion in the PRC. The total GDP of Asia and the Pacific is over \$8 trillion in market prices and about \$17 trillion in purchasing power parity (PPP) terms. Four of the ten largest economies in the world are now in Asia and the Pacific (PRC, Japan, India, and Republic of Korea), but so are some of the smallest and most isolated economies in the world, such as those of Pacific island countries. While Australia; Hong Kong, China; Japan; New Zealand; Singapore; and Taipei, China are among the richest economies in the world, with per capita incomes in the \$20,000–\$40,000 per annum range, countries such as Bangladesh, Cambodia, Kyrgyz Republic, Lao People's Democratic Republic, Mongolia, Myanmar, Nepal, and Tajikistan remain among the poorest with per capita incomes of less than \$500 per annum.

24. Despite these vast differences, the trend toward deeper economic integration is likely to continue in a number of areas and regions. There is significant support from many countries for continued improvements in cross-border physical connectivity through better national, regional and subregional infrastructure. There is also growing awareness that communicable diseases, environmental degradation, and natural disasters require collective and coordinated responses at the regional level. As for regional integration in trade and investment, the time frames indicated in the various FTAs signed or negotiated in recent years suggest that, in the next 10–15 years, most of Asia, and particularly East Asia, will have in place a region-wide FTA, although considerable efforts will be required to streamline the overlapping FTAs, minimize their "noodle bowl effect" (Chart 1), and bring coherence to the integration process. There will be further moves to integrate the East Asian FTA with the South Asian FTA and with Australia and New Zealand, and to promote similar cross-regional trade and investment cooperation initiatives. Although the long-term prospects for regional monetary and financial cooperation initiatives are less clear at this stage, the ASEAN+3 countries are moving in the direction of expanding and multilateralizing the CMI, intensifying efforts at the development of regional bond markets through the ABMI, and slowly moving towards greater exchange rate coordination.

25. Overall, therefore, the most pragmatic scenario would be an RCI process in Asia and the Pacific that follows a multi-track, multi-speed approach over the next 5–10 years, as has already been articulated by the leaders of Asia and the Pacific. According to this scenario, different regions, or even different countries within regions, would embrace RCI at different speeds. Given the large economic and social disparities in Asia and the Pacific (which are much higher than in Europe) and the differences in the level of political commitments to RCI among regions and even among countries within each region, a multi-track approach is appropriate. Even within East Asia, for example, progress may be faster in such areas as greater physical interconnectivity and trade and investment integration than in, say, monetary and financial integration. A small group of countries may move more quickly than others in areas such as exchange rate coordination. An Asia-wide

¹⁹ Declaration on Asia Cooperation, "Hand in Hand for a Better Asia," ACD Ministerial Meeting, Qingdao, PRC, 22 June 2004.

broadening and deepening of the RCI process is thus likely to be cautious and gradual; countries will integrate in an area and at a pace that is appropriate to their needs, readiness, and development level.

26. Intergovernmental collective efforts toward RCI are expected to revitalize private-sector-led economic activity, reduce poverty, bring about prosperity, and thereby contribute to peace in Asia and the Pacific. In this sense, the vision of an integrated, poverty-free, prosperous, and peaceful Asia and the Pacific is well within reach. It is likely to be achieved by using a bottom-up rather than a top-down process. In other words, countries within each region are likely to strengthen their mutual integration and subsequently form economic links with other regions in Asia and the Pacific, rather than through a single “one-size-fits-all” model.

D. ADB’s Support for Regional Cooperation and Integration: A Stocktaking

27. Since the adoption of the RCP in 1994, ADB has assisted various subregional cooperation programs, including the Greater Mekong Subregion (GMS) economic program, the South Asia Subregional Economic Cooperation (SASEC) program, the CAREC program, the Subregional Economic Cooperation in South and Central Asia (SECSCA) program, and the Pacific Plan (Appendix 1). The GMS Program has significantly improved physical connections across member countries (Appendix 2). Under the GMS Program, land and air routes connect Cambodia, PRC, Lao People’s Democratic Republic, Myanmar, Thailand, and Viet Nam; a major cross-border road has the potential to provide a continuous land route between the Indian Ocean and the South China Sea, and a network of power grids provides electricity across national borders.

28. Similar initiatives are under way in South and Central Asia. For example, in South Asia, where establishing cross-border physical connections has been somewhat slower, land and rail transportation facilities now connect several countries. In particular, for the first time in many years, land and rail transportation now connects India and Pakistan. In Central Asia, a regional Transport Sector Roadmap for the next five years was adopted by the governments in 2005. These two regions have joined hands in an effort to connect landlocked Central Asia with

seaports in South Asia via Afghanistan. In the Pacific, the Pacific Aviation Safety Office was created with ADB’s support to provide aviation safety and security oversight, inspections, and technical assistance (TA) to airlines, airports, and civil aviation authorities of Pacific countries.²⁰

29. In the aftermath of the Asian financial crisis, ADB was asked by ASEAN and ASEAN+3 to support their initiatives on regional monetary and financial cooperation. In response, ADB established a Regional Economic Monitoring Unit (REMU) and supported transregional initiatives such as APEC and the Asia-Europe Meeting (ASEM). REMU supported these initiatives by (i) facilitating the annual policy dialogues of ASEAN, ASEAN+3, APEC, and ASEM finance ministers; (ii) preparing reports on regional economic prospects and policy issues (such as the semiannual *Asia Economic Monitor* and *Asia Bond Monitor*) for senior officials’ meetings; (iii) carrying out capacity development and institutional strengthening, including establishing national surveillance units in selected ASEAN+3 countries and providing training on economic and financial monitoring, financial sector supervision, and regulations for government officials; and (iv) conducting research on issues related to regional monetary and financial cooperation and integration.

30. ADB has started a number of regional initiatives on prevention of communicable and infectious diseases (such as avian influenza, HIV/AIDS, SARS, and tuberculosis), energy efficiency, environmental management, and good governance. ADB has strengthened cooperation with UNAIDS to fight against HIV/AIDS in Asia and the Pacific. It has worked on many fronts to assist regional surveillance and control of avian influenza, including support for the regional outbreak response team based at the World Health Organization (WHO) Western Pacific Regional Office in Manila. ADB also supported ASEAN in mitigating cross-border impacts of haze pollution. It responded rapidly to the tsunami disaster in December 2004 by launching the largest grant program in its history. To date, ADB’s total approved funding for the tsunami-affected countries amounts to \$860 million, of which nearly 80% was grant funding. ADB helped establish Clean Air Initiative (CAI)-Asia to address urban air pollution problems in 2001, contributed substantially to development of the ASEAN Agreement on Transboundary Haze Pollution signed in 2002, and formed a regional partnership to respond to

²⁰ Board Document R224-05, September 2005.

dust and sandstorm events in Northeast Asia in 2003. ADB also has worked with the Global Mechanism of the UN Convention on Drought and Desertification to support the Central Asian Countries Initiative for Land Management, which is dealing with that region's serious land degradation problems.

31. ADB has supported the development of regional energy markets, regional power transmission, gas pipelines, and related institution building efforts to promote energy efficiency. ADB has brought together donor trust funds²¹ under its Renewable Energy, Energy Efficiency and Climate Change (REACH) Program to support capacity development and institutional development. In August 2003, ADB set up a Clean Development Mechanism (CDM) facility to provide additional support to projects in the area of renewable energy and energy efficiency, carbon sequestration, and adaptation. In July 2005, ADB established an energy efficiency initiative (EEI).

32. In 1995, ADB became the first multilateral²² development bank to adopt a comprehensive governance policy at the regional level. The policy identified four essential elements of good governance: accountability, predictability, participation, and transparency. ADB also adopted an anticorruption policy to improve governance and enhancing the investment climate in DMCs.

33. ADB's support for regional cooperation has been largely activity-based. An activity-based approach can secure interests, sense of ownership, and generate tangible results—through enlarged economic space, reduced economic distance, and regional public goods—to create initial momentum for cooperation. This approach is particularly relevant in subregions where mutual trust and confidence among participating countries are not in place at the outset. The GMS is typical of such an activity-based approach. The GMS initially focused on physical connectivity, and has gradually expanded to include trade, investment and other issues. However, activity-based arrangements tend to be fragmented, and sometimes uncoordinated, because of the lack of a region-wide strategic perspective. It is therefore time for ADB to go beyond activity-based arrangements and develop a comprehensive RCI strategy.

E. Importance of a New Regional Cooperation and Integration Strategy

34. Given the emerging trends and the future vision of RCI in Asia and the Pacific, it is appropriate for ADB to take a fresh look at its RCI activities from a strategic perspective, with a view to overcoming previous limitations. First, ADB's support for RCI so far has been fragmented across various departments and offices, without much strategic coordination within ADB. Second, the extent and the quality of ADB's lending and non-lending support for RCI have varied across the regions and subregions, partly because of the absence of a coherent strategy. Third, although ADB (through REMU) has assisted several regional initiatives in the area of monetary and financial cooperation, it needs to expand and strengthen this support, as the scope of the recent monetary and financial integration initiatives has been broadened. Fourth, ADB has provided only limited support to ongoing trade and investment integration in the region, and this gap needs to be filled, especially to help DMCs and regional forums exploit physical connections for trade and investment opportunities and to bring coherence to the FTA-led trade and investment integration initiatives with the WTO process.

35. Overall, ADB's support for RCI has not been commensurate with its role as a regional development bank. As the pace of economic globalization and regional integration accelerates, RCI in various forms can be crucial, and even imperative, for the economic development of Asia and the Pacific. This has important implications for ADB's role and operations. For ADB to play a greater role in supporting RCI in Asia and the Pacific, it must not only consolidate its fragmented efforts, but should also take a more coherent, strategic approach to supporting and promoting RCI. Thus, an RCI strategy for ADB that responds to the new global and regional realities and meets the increasing demand of DMCs in the Asia-Pacific is required.

36. Against this backdrop, ADB has recently made four important moves. First, on 1 April 2005, it established the Office of Regional Economic Integration (OREI), replacing and expanding REMU as ADB's focal point for its RCI activities. OREI is expected to enhance ADB's role in

²¹ From the governments of Canada, Denmark, Finland, and the Netherlands.

²² ADB. 1995. *Governance: South Development Management*. Manila.

supporting and promoting RCI in Asia and the Pacific. Second, three special advisors to the President in charge of RCI and RCI-related issues have been appointed.²³ The advisors counsel the President on coordinating and streamlining the various RCI activities being undertaken by many departments at ADB and on the strategic measures and initiatives needed to enable ADB to play an enhanced role in furthering RCI in Asia and the Pacific. Third, the medium-term strategy II (MTS II) for 2006–2008 identified RCI as one of five strategic priorities for ADB’s operations, with several other priorities also strengthened through RCI.²⁴ Fourth, ADB realigned its regional departments and their country coverage to improve the coherence of its regional operations, and to strengthen the synergy between country and regional operations.

37. Building on these measures, the key objective of this strategy paper is to guide ADB’s support for the ongoing process of RCI in a coherent way and to facilitate new forms of RCI initiatives that are needed in the future. The actions suggested in this strategy paper reflect emerging trends in RCI in Asia and the Pacific and the need to extend ADB’s limited support for RCI in the past. Given the numerous and often overlapping RCI initiatives within Asia and the Pacific, there is a need for a regional multilateral organization, such as ADB, to serve as an effective facilitator to support and promote RCI in Asia and the Pacific.

F. Regional Cooperation and Integration and Poverty Reduction

38. From ADB’s perspective, RCI is not an end in itself, but only a means to achieve its overarching objective of poverty reduction in Asia and the Pacific (Chart 2). Overall, RCI can help sustain pro-poor economic growth, which is a key element of ADB’s poverty reduction strategy,²⁵ through improved cross-border physical connectivity, expansion of regional trade and investment, promotion of regional financial intermediation and stability, and provision of regional public goods. This is also consistent with ADB’s LTSF (2001–2015), which identifies RCI as one of the cross-cutting strategic themes for poverty reduction.

39. Improved cross-border physical connectivity can contribute to poverty reduction by providing greater opportunities for the poor to participate in market activities. Cross-border infrastructure projects—e.g., transport, energy, and telecommunications—are essential for the movements of goods, services, people, and information across countries. They enlarge market access, reduce economic distance and facilitate trade, investment, and labor flows. The resulting intensification of cross-border economic activities can create employment, particularly in the labor-intensive sectors of DMCs, thus contributing to poverty reduction.

40. Acceleration of trade and investment integration of DMCs with regional and non-regional economies can help reduce poverty. Economic opening and globalization, if appropriately managed, can have significant impacts on poverty reduction. Trade openness and FDI inflows can connect developing economies with global markets where there is demand for developing country products. As developing economies have a comparative advantage in labor-intensive products, creating demand for such products can increase demand for labor or small piece of land, which are typically the only assets that the poor own. Trade and investment cooperation and integration at the regional level has a similar, and even greater, impact on poverty reduction. The reason is that it is very difficult for a small, poor country to have direct access to global markets. Such countries usually need physical connectivity, market expertise, and distribution networks. By integrating these economies with neighboring, larger economies, they will be more able to participate in the regional and global supply chain.

41. FDI inflows also have a positive impact on poverty reduction. FDI brings in not only capital but also production and management expertise and regional and global distribution links, thus relaxing DMCs’ constraints, generating higher economic growth and employment, and reducing poverty. FDI provides an excellent vehicle through which the recipient DMCs can participate in regional and global supply networks and maximize their comparative advantage. Developing countries with large flows of

²³ The three advisors are respectively in charge of (i) regional and subregional economic cooperation programs; (ii) pan-Asian activities in trade, investment, money and finance; and (iii) cooperation in regional public goods such as environmental protection and prevention of communicable diseases.

²⁴ MTS II identifies the following as strategic priorities: (i) catalyzing investment, (ii) strengthening inclusiveness, (iii) promoting regional cooperation and integration, (iv) managing the environment, and (v) improving governance and containing corruption.

²⁵ ADB. 2004. *Fighting Poverty in Asia and the Pacific: The Poverty Reduction Strategy of the Asian Development Bank*. Manila.

investment are more successful in reducing poverty. For example, the PRC and Southeast Asian countries, which have received most of FDI over the last three decades, also accounted for the bulk of the decline in poverty over those decades.

42. Maintaining regional macroeconomic and financial stability is crucial to sustain robust growth and reduce poverty. The 1997–1998 Asian financial crisis was testimony to this. The crisis brought about large macroeconomic contractions and exposed the weakly-regulated East Asian financial sectors to unexpected shocks. As a consequence, economic growth plunged in many crisis-affected countries and the impressive achievements in poverty reduction over the previous three decades encountered a major setback. In the aftermath of the crisis, the incidence of poverty increased significantly in all crisis-affected countries (Appendix 3). The Asian financial crisis thus underscores the critical importance of maintaining macroeconomic and financial stability for sustaining robust growth, continued poverty reduction, and social improvements. For the DMCs, RCI provides an additional platform that can supplement, complement, and even strengthen national policies and programs aimed at socioeconomic development and poverty reduction, and the global efforts to achieve global financial stability.

43. Provision of RPGs is critical to support poverty reduction efforts. By working together to promote RPGs, DMCs can deal with the adverse impact of cross-border issues. This has been highlighted by the region's recent experience in dealing with the outbreak of communicable diseases, environmental problems, and other transnational issues. It is the poor who suffer the most from these regional threats, which are accentuated by the increasing interdependence of regional economies.

44. RCI can therefore, enhance DMCs' efforts to develop their economies and reduce poverty, widening the range of options available to them. In particular, it eases the constraints of national boundaries on factors of production, production activities, and markets. It allows RCI participants to have greater access to key inputs, resources, technologies and knowledge, and enlarges the market for their products. It helps realize the development potential of DMCs, including gains through increases in production and wealth, as well as the emergence over time of a more competitive economic structure. RCI is especially important for countries with limited access to markets and

resources and for poorer or lagging areas within national economies. In part, this is because it enables less developed economies in a region to take advantage of the improved connectivity and access to markets, and to benefit more from greater cross-border flows of goods, services, capital, and people.

45. The more developed countries in a region also benefit from RCI, since deeper regional integration eases constraints on their growth by allowing them to relocate labor-intensive industries and activities to their less developed neighbors and to import labor-intensive products and services from these neighbors at cheaper prices. These are significant if RCI also involves freer movement of people across national borders. Once regional integration reaches an advanced stage, say, monetary and financial integration, it will give a big boost to regional capital markets which, in turn, will facilitate more efficient intermediation of a region's savings for the region's long-term investment.

46. In essence, RCI, if properly designed and managed, offers a "win-win" outcome for a region's economies, rich and poor. This is because it facilitates resource allocation across the region in line with the principle of comparative advantage. The larger the number of countries covered and the broader the scope of RCI, the greater the benefits. RCI has similar socioeconomic effects to globalization, especially in a region such as Asia and the Pacific, which now accounts for about 56% of world trade and about 25% of world GDP at current exchange rates. In this sense, RCI can also be considered as a policy tool for countries to manage their globalization processes. The challenges and opportunities offered by globalization can be managed at three distinct levels—national, regional, and global. To maximize the benefits of RCI, it is important to ensure that it complements national and global initiatives. This is "open regionalism"—a theme that is central to ADB's proposed RCI strategy. As a result, RCI is a means, the adhesive, for linking the less developed countries to the more developed countries in the region, so that the former can converge toward higher levels of per capita income—achieving inclusiveness at the regional level or reducing disparities across countries. RCI is a means for moving together without leaving anyone behind.

47. Just as countries and sectors may incur adjustment costs in the process of globalization, regional integration may also involve short-term adjustment costs. While most

of the benefits of integration become visible only over time and are indirectly spread over the population at large, creation of a more open and larger regional market will require individual economies, sectors, firms, and labor to adjust and restructure. The burden of such adjustment may be felt more by less developed countries and regions, less efficient companies, communities reliant on less

competitive activities, and the poor. Unless they are cushioned, public focus on these immediate and direct costs may cloud recognition of the longer-term benefits, eroding support. Drawing on experience elsewhere, especially in Europe, these adjustment costs will need to be managed effectively to maximize the benefits of RCI.

II. ADB's Regional Cooperation and Integration Strategy: Four Interrelated Pillars

48. As one of the instruments to achieve ADB's objective of reducing poverty in Asia and the Pacific, RCI offers substantial scope for ADB's operations, both lending and non-lending. Recognizing this, MTS II identified RCI as one of ADB's five priority areas. In line with MTS II, ADB will prioritize the areas where it can make the most tangible contribution, rather than spreading its support thinly across many areas. The RCI strategy will promote "open regionalism" in Asia and the Pacific, making regionalism a building block of a more liberalized global economy. Client orientation, prioritization, and open regionalism will thus guide the strategy.

49. The RCI strategy has four pillars: (i) regional and subregional economic cooperation programs on cross-border infrastructure and related software; (ii) trade and investment cooperation and integration; (iii) monetary and financial cooperation and integration; and (iv) cooperation in regional public goods (Chart 3). The aim of these four pillars is to reduce DMCs' poverty through regional collective action that leads to greater physical connectivity; an expansion of trade and investment; development of financial systems and macroeconomic and financial stability; and improved environmental, health, and social conditions.

50. In response to DMC demand, ADB has been providing support for pillars 1, 3, and 4—(see section D). However, ADB has provided only limited support for pillar 2. This gap in ADB's RCI support needs to be filled, as trade and investment cooperation and integration has become increasingly important in Asia (as evidenced by the growing volume of regional trade and investment and by the rapid proliferation of FTAs). Against this backdrop, a comprehensive ADB strategy for RCI should clearly include pillar 2 as one of its key components.

A. Pillar 1: Regional and Subregional Economic Cooperation Programs (Cross-Border Infrastructure and Related Software)

51. Measures to boost economic integration will have limited success in the absence of regional or subregional infrastructure that adequately connects national markets. Physical connectivity is the bedrock of many economic cooperation and integration efforts. Physical connections—particularly robust transport and communication links—are essential for the movement of goods, services, capital, people, and information across countries. There are immense potential benefits to greater connectivity in Asia in terms of economies of scale, larger markets, and greater cross-border economic transactions. Connectivity is hence a central element of regional and subregional cooperation programs in Asia and the Pacific.

52. Physical connectivity can be enhanced by a combination of cross-border hard infrastructure and related software—harmonization of regulations, procedures, and standards. Technical project-related software is always inseparable from hard infrastructure, but the concept of software is broader. Improvements in roads and railways can reduce transport and logistics costs, but they are not sufficient to encourage cross-border trade if different legal and regulatory frameworks, inefficient systems of customs clearance, and other barriers are not removed. In this sense, greater physical connectivity requires regional/subregional cooperation for both cross-border hard infrastructure and related software.

53. Regional and subregional programs typically involve an asymmetrical distribution of costs and benefits across countries. It is therefore critical to make objective quantitative assessments of benefits and costs, and of the distribution of benefits across countries, for any regional or subregional cross-border infrastructure project, and to set up a mechanism from inception that allows for fair

distribution of costs across countries. In view of significant externalities in the provision of cross-border infrastructure, it is important that countries coordinate in the design, planning, and implementation of infrastructure, from a regional or subregional perspective. Countries must have sufficient incentives for regional infrastructure initiatives that can exploit economies of scale and externalities in a way that will overcome disparities in financial and technical capacity among the participating countries. A regional development institution such as ADB can thus play a key role in coordinating and developing such regional and subregional infrastructure projects.

54. Regional and subregional cooperation has a different dimension for the island economies in the Pacific, which are characterized by their small size in terms of population and land area, and by their geographical isolation. Small size, geographical remoteness and isolation, vulnerability to natural disasters and climate change, limited scope for economic diversification, and lack of human capacity are serious obstacles to economic development. Building physical infrastructure is a major challenge in these economies and is subject to greater complexities than elsewhere.

55. Supplementing ADB's support for regional and subregional economic cooperation programs aimed at developing cross-border infrastructure is a new focus on developing links across the various regional and subregional programs. The focus will be on identifying commercially sound projects in energy, water, transport, tourism, and other sectors that span regions and subregions in Asia and promote connectivity, trade, and market integration.

56. ADB's support for regional and subregional economic cooperation programs in developing cross-border infrastructure and related software will cover significant lending as well as non-lending operations. The key lending activities will involve provision for (i) regional and subregional infrastructure projects and programs; (ii) national infrastructure projects and programs that involve significant regional or cross-border dimensions; and (iii) harmonization of regulations, procedures and standards affecting connectivity, and evaluation and monitoring of cross-border infrastructure projects and programs. Implementing such a lending program would also require substantial non-lending financial assistance, including objective analysis and technical support to develop the required software, trade and investment facilitation

measures, coordination and harmonization of sector regulations, procedures and standards, and a range of cross-border policy measures. To support these operations, development of coordinated approaches for the creation of regional and subregional networks of transportation, energy, water resources, and communication will be covered by non-lending activities.

B. Pillar 2: Trade and Investment Cooperation and Integration

57. In terms of trade liberalization, the WTO-led process of multilateral trade negotiation is the most important mechanism for Asia and the Pacific, as the region's economic future depends to a significant extent on the openness of global markets. At the same time, new trade and investment frameworks have been rapidly emerging in Asia, particularly since 2000. Many economies have been increasingly participating in bilateral or regional free trade agreements (FTAs). Many of these FTAs overlap. Since the end of the 1990s, a large number of FTAs have been signed or are being negotiated in Asia and the Pacific. ADB estimates that there are currently over 175 bilateral and subregional FTAs that have been either signed or are under negotiation in Asia. East Asian economies have been involved in 95 of these and have been the major driver of FTAs in the region.

58. There are positive and negative implications of the spread of FTAs in Asia. On the positive side, the proliferation of FTAs can help DMCs to pursue their dynamic comparative advantage and allocate resources efficiently. Against a backdrop of slow progress in global trade negotiations, FTAs can promote continuing liberalization, induce domestic and structural reforms in the countries concerned, and widen market access across the region. Trade arrangements with dynamic, competitive partners can also encourage the spread of efficient production practices.

59. However, FTAs pose a number of challenges to DMCs. First, the demands of negotiating many trade agreements place increasing strains on the scarce trade negotiation resources of many Asian countries, especially given the expanding scope, content, and increasing complexity of recently negotiated FTAs in the region. These capacity constraints are particularly acute in some DMCs, which also suffer from a lack of institutions to provide continuous support for their trade, finance, and customs

officials. Also, these countries may not be well equipped to manage the analytical and the technical aspects involved in designing, negotiating, and implementing FTAs. This is particularly the case with the many DMCs that need to pursue significant domestic structural reforms to particular sectors or to the economy as a whole in the face of greater openness and increasing competition. Accordingly, assistance from ADB for capacity building in structuring, negotiating, and implementing these FTAs is of critical importance.

60. Second, little is known about the economic effects of alternative FTA arrangements. The dearth of high quality, policy-oriented empirical studies on FTAs in Asia makes it difficult for policymakers to map the net economic benefits of FTAs for DMCs, assess trade-offs between costs and benefits of FTAs, and formulate appropriate national/regional responses. Particularly, the link between FTAs (trade policy) on the one hand and competition policy, trade adjustment assistance, and structural reforms on the other hand is poorly understood. As a result, there is an emerging need for empirical studies on important aspects of the spread of FTAs in Asia, including the effects of FTAs on business activity and how DMCs can benefit from trade liberalization through FTAs, and the domestic reforms necessary to ensure that benefits are broadly shared. There is also a need for identifying best practices in designing, negotiating, and implementing FTAs to guide the process of forming effective FTAs in Asia through consolidation and deepening of trade agreements. Therefore, it is desirable that ADB assesses this important trend through a series of studies, and identifies the future course of actions required to maximize the net economic benefits of FTAs for DMCs.

61. Finally, regional and bilateral FTAs may also affect incentives to engage in multilateral negotiations. Once countries have secured preferential treatments, they prefer to keep them, which may prevent further multilateral liberalization. Preferential treatment arrangements that are inconsistent with the principle of the WTO, that countries cannot normally discriminate between their trading partners, may lead to an increase in closed regionalism that may be detrimental to some DMCs. The rapid increase in the number of FTAs may also have harmful effects on DMCs. These effects are due to multiple rules of origin (e.g., value-added rules or changes in customs

classification) arising from overlapping agreements among members of different FTAs. Complex rules increase administrative and business costs, particularly for small- and medium-sized enterprises (SMEs), which have limited capacity to adhere to them. Such rules can also deter foreign direct investment and trade. As a result, there is considerable merit for ADB in supporting regional and subregional trade policy dialogue to help expand DMCs' trade and investment. As a regional development bank, ADB is well placed to provide overall policy support as to (i) how regional trade arrangements can be productively used to expand trade and investment intraregionally and extraregionally; (ii) how to make the regional trade arrangements a building block of global trade and investment integration; and (iii) how to reconcile the treatment of "rules of origin" among the various FTAs, so that the administrative burden on resource-constrained DMCs is minimized. Comprehensive frameworks for trade and investment expansion that are consistent with the multilateral trading system have to be developed to guide the consolidation of the various FTAs to the benefits of DMCs.

62. In terms of regional cooperation in trade facilitation, how to improve transparency, efficiency, and procedural uniformity of cross-border transportation of goods has increasingly become a major concern for DMCs. According to an APEC study,²⁶ clearing the red tape at country borders would generate approximately twice as much GDP than tariff liberalization would. Trade facilitation measures would particularly benefit developing countries, where the inefficiencies are sometimes more costly to industries than are tariff barriers. However, many DMCs do not have the resources necessary to undertake trade facilitation measures (e.g. updating their customs procedures to more modern technological standards and harmonization of standards). With a track record of supporting trade facilitation in its regional and subregional cooperation programs such as CAREC and GMS, ADB is well placed to provide capacity building support to DMCs in promoting trade facilitation.

63. Taking these factors into account, ADB's role in trade and investment cooperation and integration, which is primarily of a non-lending nature, will include: (i) support to regional and subregional forums (such as ASEAN, ASEAN+3, SAARC, CAREC, GMS, BIMSTEC, and BIMP-

²⁶ APEC. 2000. *Cutting Through Red Tape: New Directions for APEC's Trade Facilitation*. Canada.

EAGA) by playing a facilitating role in regional trade and investment policy dialogue; (ii) capacity and institutional development for DMCs on issues related to FTAs and trade facilitation; (iii) research and information dissemination, including support for establishing a database on FTAs in Asia and the Pacific; and (iv) building stronger partnerships with other stakeholders and institutions that support RCI in trade and investment in Asia and the Pacific as well as elsewhere (e.g., WTO, World Bank, Inter-American Development Bank, OECD, ESCAP, and PECC).

C. Pillar 3: Monetary and Financial Cooperation and Integration

64. The 1997–1998 Asian financial crisis provided a major impetus to regional monetary and financial cooperation. In East Asia, the crisis seriously jeopardized the achievement of decades of rapid economic growth and poverty reduction. In the aftermath of the crisis, the proportion of people in extreme poverty and without jobs or access to essential services increased significantly. Unemployment doubled in Thailand and soared in the Republic of Korea. In Indonesia, formal sector employment dropped sharply and workers shifted to informal self-employment. School drop-out rates increased and private and public health care resources declined in all crisis-affected countries.

65. The crisis revealed the vulnerability of East Asian countries to sudden changes in the increasingly globalized financial markets. It also underscored the need to develop a robust regional financial architecture. Consequently, various postcrisis initiatives have been launched to strengthen regional monetary and financial cooperation to ensure economic and financial stability. The ASEAN and ASEAN+3 finance ministers were the primary drivers of these initiatives, whose principal impetus came from the need to (i) manage deepening economic and financial interdependence in East Asia through trade, investment, and financial flows; (ii) establish regional “self-help” mechanisms for effective prevention, management, and resolution of financial crises; and (iii) to secure regional financial stability, which contributes to both national and global financial stability, a prerequisite to sustained poverty reduction.

66. Among the various regional mechanisms for information sharing, policy dialogue, and economic surveillance,²⁷ the ASEAN+3 Economic Review and Policy Dialogue (ERPD) is the most important multilateral peer review mechanism. The purpose of the process is to strengthen policy dialogue, coordination, and collaboration on financial, monetary, and fiscal issues of common interest. Its primary focus is on global, regional and country economic monitoring, regional capital flow monitoring, macroeconomic risk assessment and management, and financial sector assessment. Steps have been taken to strengthen cooperation in developing a regional early warning system to assess regional financial vulnerabilities.

67. The Chiang Mai Initiative (CMI) is a regional liquidity facility for crisis prevention and management. The Asian financial crisis highlighted the importance of establishing an effective reserve pooling arrangement so that the economies can prevent currency crises or respond effectively to crises once they occur in a world of increasing financial globalization. Efforts are underway to expand and multilateralize the CMI. The Asian Bond Markets Initiative (ABMI) was also launched to develop well-functioning, local-currency bond markets in Asia that can reduce incentives to rely too heavily on domestic bank financing and external short-term borrowing. In addition, efforts to develop regional bond markets have been given further impetus from the introduction of the Asian Bond Fund (ABF) in 2003.

68. These initiatives have demonstrated a commitment by the region’s leaders to seek cooperative regional solutions to the major economic and financial shocks affecting countries. The East Asian countries have also strengthened ties with North America and some South American countries through the APEC Finance Ministers’ Process and with the European Union through the ASEM Finance Ministers’ Process.

69. ADB’s role in these regional forums and initiatives has been significant. At the request of the countries and regional groupings, ADB supports regional policy dialogue and other initiatives such as ASEAN, ASEAN+3, APEC, and ASEM. ADB also plays a key role in capacity building and institutional strengthening of many of these regional

²⁷ Other major mechanisms include the ASEAN Surveillance Process, Executives’ Meeting of East Asia and Pacific Central Banks, and transnational forums such as APEC and the Asia-Europe Meeting (ASEM).

groupings. ADB undertakes policy-relevant analytical work on various issues related to regional monetary and financial cooperation and integration, regional economic surveillance, early warning systems, capital flows and capital market developments, financial sector reforms and restructuring, and regional exchange rate arrangements. As the financial openness of regional economies increases and financial integration deepens within a region and the rest of the world, external shocks can be easily transmitted to the region and serious contagion may result. This requires even greater efforts to strengthen regional financial safeguards. Since sound national financial systems (banks, nonbanks, and capital markets) are prerequisites to achieve regional financial stability, efforts are needed to strengthen national financial systems through regulatory and supervisory reforms.

70. It is also important to examine issues related to greater monetary and financial cooperation and integration. Given the large volumes of savings in the region, there are clear benefits to removing the institutional and regulatory impediments that continue to constrain the development of more integrated regional financial markets. A key focus is, therefore, to harmonize accounting, reporting, and regulatory standards; simplify tax and registration procedures; strengthen regional credit rating agencies; and remove regulatory hurdles that hamper the development of financial instruments. These measures will improve financial intermediation between savers and investors within Asia and the Pacific. Developing the basic financial infrastructure—credit enhancement agencies and clearance and settlement systems—requires consensus as part of a coordinated approach to developing regional financial markets. A further set of issues includes measures to promote greater exchange rate stability in the region and closer coordination of monetary policies for this purpose.

71. ADB will intensify its support for regional monetary and financial cooperation and integration. It will facilitate an open and dynamic consultation process among all countries and stakeholders concerned to ensure a broad-based consensus and a greater sense of ownership in implementing and managing initiatives related to monetary and financial cooperation and integration. ADB's support in this area will be through non-lending knowledge products and will include support for (i) the regional

economic policy dialogue process, both for the organizations that have already been established (such as ASEAN, ASEAN+3, APEC, and ASEM) and for those that may be established in the future (under the auspices of regional forums such as SAARC and CAREC); (ii) capacity building and institutional strengthening of DMCs; (iii) analysis, research, and information dissemination; and (iv) partnership building with other stakeholders and/or institutions that support monetary and financial integration in Asia and the Pacific and elsewhere e.g., IMF, Bank for International Settlements (BIS), and Organization for Economic Co-operation and Development (OECD).

D. Pillar 4: Cooperation in Regional Public Goods

72. A regional public good (RPG) is a benefit shared by two or more countries in a region. RPGs can be promoted by (i) coordinated actions to supply RPGs such as clean air, environmental protection, control of communicable diseases, and management of natural disasters; and (ii) dissemination of analysis and research findings in the public domain through publications, workshops, and shared standards.

73. As greater connectivity results in higher flows of goods, traffic, and people across borders, regional integration brings benefits and costs. A negative side effect is the spread of communicable diseases as people move across regions. Avian influenza in 2004 and the rapid spread of HIV/AIDS along new economic corridors have severely affected the poor. ADB is working in partnership with the WHO to quickly assess country readiness to contain disease outbreaks and to mobilize financial support. ADB's project, Community Action for Preventing HIV/AIDS,²⁸ funded by the Japan Fund for Poverty Reduction, focuses on HIV/AIDS prevention in Cambodia, Lao People's Democratic Republic, and Viet Nam. ADB is also facilitating the provision of RPGs to combat HIV/AIDS by providing access to adequate information and knowledge about the epidemiology of HIV/AIDS and about ways to prevent the disease. To strengthen regional approaches in this area, more commitments from regional governments are needed. Preventing and controlling avian influenza, HIV/AIDS, and other communicable diseases will therefore be factored into ADB's RCI strategy.

²⁸ Board Document R 290-05, October 2005.

74. Rapid economic growth has brought unprecedented benefits to Asia, but there is also rising concern over its adverse environmental consequences, which can undermine economic gains. Many environmental consequences cross borders, and addressing them requires coordinated regional actions. The current challenges range from dealing with serious air pollution and global climate change to managing cross-border rivers and protected areas.

75. These issues are fundamental to Asia's economic future as well as to the health and well-being of its people. With its development partners, ADB seeks to address these concerns. Coordinating the cross-border dimensions of the environment is a key area of ADB's support for providing RPGs, as there are few regional frameworks for managing the environment. Major actions will include coordinating environmental initiatives among national and regional organizations; harmonizing standards, regulations, and laws; addressing air pollution, land degradation, and global climate change; and widening the range of financing sources for environmental investments. ADB has played a leading role in helping the East Asian countries find ways to solve the problem of dust and sand storms arising primarily from the overuse of fragile dry lands in western PRC and Mongolia. ADB has also played a key role in the ASEAN Agreement on Transboundary Haze Pollution (June 2002), which provides a legal framework to facilitate regional cooperation in addressing the cross-border impacts of haze pollution. In partnership with ESCAP, UNEP, and the UN Convention on Drought and Desertification, ADB has worked with the governments of Japan, Mongolia, PRC, and Republic of Korea to develop an action plan and to design a regional network for prediction and monitoring of major storm events. As host to the secretariat of the Clean Air Initiative for Asian Cities, ADB also supports work on a range of other national and regional air pollution concerns.

76. A major portion of the environmental problems faced by the region, particularly the deteriorating air quality and increasing greenhouse gas emissions, have their origin in the energy sector. Energy use in Asia is characterized by rapid growth and the dominant use of fossil fuels. The current pattern of energy sector growth is becoming unsustainable. ADB's energy policy emphasizes renewable energy and energy efficiency in the DMCs. The policy also recommends focusing on regional and global

environmental impacts, and enhancing regional cooperation and trade in the energy sector. In terms of RPGs, ADB's contribution in the area of clean energy includes systematically studying the implementation barriers across countries. However, the application of cleaner energy technology alternatives in developing countries is constrained by inadequate finance and capacity; ADB proposes to address this through its Carbon Market Initiative (CMI) that aims to steer the development agenda in DMCs towards clean energy and environmental sustainability.

77. The Indian Ocean tsunami in December 2004 highlighted the cross-border impact of natural disasters, and underlined the need to provide appropriate RPGs to address such problems collectively. A key RPG for natural disasters is the establishment of early warning systems. This is being addressed with the help of donor support. In addition, there is a need to build an effective, well-resourced, and capable regional disaster response system by disseminating knowledge about the optimum response to immediate and potential disasters.

78. The governance-related challenges facing Asia and the Pacific are expected to intensify as economies become more developed, complex, and integrated. Collective efforts to address these issues need to intensify quickly before governance problems become sources of friction threatening the future growth of the region. Transnational corruption and crime is a key governance issue that poses serious threats to the market stability of the region. This requires strong regional mechanisms for communication and coordination.

79. Asia and the Pacific accounts for about half of the total global trafficking-related prosecutions—human and drugs. This problem needs to be addressed at both national and regional levels. ADB has contributed to these efforts with other stakeholders. The current approach of the donor community includes regional research; minimizing and mitigating the vulnerabilities of women and children in donor-funded projects; and policy dialogue. With others, ADB has also facilitated policy dialogue within or between different subregions of Asia, including the GMS countries. Having gained more experience in this area, there is a need to adopt a programmatic, comprehensive regional approach that is linked to regional corridors and connectivity planning.

80. ADB's support for providing RPGs will mainly focus on (i) supporting regional and subregional policy dialogue and initiatives to protect the environment, control communicable diseases (e.g., avian influenza, HIV/AIDS, and SARS), manage the impact of natural disasters, promote clean energy and energy efficiency, improve governance, and prevent human and drug trafficking; (ii) conducting research on these cross-border issues; (iii) supporting capacity building and institutional strengthening of DMCs to respond to cross-border issues; and (iv) supporting regional partnership building through various regional forums and exchange programs.

E. Relationships among the Pillars

81. The four pillars are mutually reinforcing so they can contribute to ADB's overarching goal of poverty reduction. In particular, increased physical connectivity (pillar 1) helps to link markets and resources. This sets the stage for corresponding benefits in terms of economies of scale and greater competition. However, benefits from improved physical connectivity may be constrained if the volume of trade and investment flows is small. Therefore RCI in trade and investment (pillar 2) is important to maximize the benefits of cross border and physical connectivity.

82. As more economies are physically connected, there is more cross-border trade and investment. Labor mobility across borders grows. Monetary and financial transactions increase through formal and informal channels. However, monetary and financial links mean that a country's financial instability may be transmitted to its neighboring economies. The 1997–1998 Asian financial crisis showed clearly that, unless countries in Asia maintain macroeconomic and financial stability, their economic development is at risk. Greater monetary and financial cooperation and integration (pillar 3) is therefore essential to maintain macroeconomic and financial stability and prevent financial crises. This is why, for nearly a decade after the crisis, ADB has supported affected countries in Asia, particularly in East Asia, to improve their economic surveillance, strengthen regional reserve pooling, and develop regional financial markets.

83. Improved cross-border physical connectivity, expansion of regional trade and investment bring major benefits to DMCs, but they may also have adverse cross-border impacts on the environment and people. Environmental degradation, threats of communicable diseases (e.g., avian influenza, HIV/AIDS, and SARS) and natural disasters can affect the poor disproportionately and undermine the economic gains that have been achieved. Prevention of these threats can protect the poor and help accelerate poverty reduction efforts. Consequently, the provision of RPGs (pillar 4) has become a key element of ADB's approach to RCI.

84. Although the four pillars are mutually supportive and interactive, the overall weights that will be assigned to the individual pillars in ADB's support for RCI will vary significantly across regions and countries. Pillar 1 has been the core component of many ADB-supported RCI activities, followed by pillar 3 and pillar 4. In line with the MTS II, pillar 2 will be given less weight compared with the other pillars. Moreover, for individual countries, subregions and regions, emphasis on the four pillars will vary, depending on their needs, priorities, level of mutual trust and confidence, and their readiness. For example, for many middle-income East Asian countries, all pillars would be relevant. ASEAN member countries adopted the Bali Concord II, at the 9th ASEAN Summit in October 2003, which envisions the establishment of an ASEAN Community. Such community building requires ASEAN cooperation and integration through all four pillars.

85. However, for many DMCs in South Asia, Central Asia, and Pacific Islands, pillar 3 would be the least relevant. The allocation of weights among pillars would also vary depending on different stages of RCI. Some DMCs may start cooperation with pillars 1 and 4 at the initial stages, as these pillars can generate quick and tangible results. The coverage is expanded to include all four pillars in subsequent stages, when mutual trust and confidence are being built among participating countries. As noted earlier, the GMS program initially focused on cross-border infrastructure investments, i.e., on physical connectivity, and subsequently expanded to cover trade, investment, and management of shared resources. Currently GMS countries are expressing interest in further developing capital markets, partly to strengthen the resilience of their financial sectors, and partly because they recognize that trade, investment, and finance are mutually interactive.

III. Operational and Resource Implications

A. Operational Implications

86. ADB will play four distinct roles in supporting and promoting RCI in Asia and the Pacific: (i) providing financial resources for RCI projects, programs, and related TA and/or helping DMCs mobilize funding and TA (i.e., acting as a money bank); (ii) creating, consolidating, and disseminating knowledge and information on RCI to DMCs (i.e., acting as a knowledge bank); (iii) helping DMCs and regional and/or subregional bodies build their institutional capacity to manage RCI (i.e., building capacity); and (iv) acting as catalyst and coordinator of RCI for the DMCs (i.e., serving as an honest broker). These four functions cut across the four pillars of RCI. They are also mutually supportive and reinforcing, enabling ADB to serve as an effective facilitator in supporting and promoting RCI.

87. Within ADB, the responsibility for pillar 1—regional and subregional economic cooperation programs in infrastructure and software—rests with the five regional departments. This institutional arrangement will continue. The Private Sector Operations Department (PSOD) and Office of Cofinancing Operations (OCO) have important roles to play, in collaboration with the regional departments, in catalyzing private sector participation and mobilizing grant funds in operational activities of pillar 1. The primary responsibility for pillars 2 and 3 will be with OREI. The primary responsibility for pillar 4—cooperation in RPGs—will continue to be borne by the Regional and Sustainable Development Department (RSDD), supported by OGC. OREI will also facilitate and coordinate ADB’s RCI support by providing “horizontal links” across concerned departments and by implementing RCI initiatives that cut across regions. Finally, other offices and departments (RDs, ADBI, ERD, OGC, and TD) will be involved in all pillars as appropriate.

88. The above division of labor within ADB will help transform ADB’s support for RCI in Asia and the Pacific from stand-alone, activity-based programs to a coherent and strategically focused RCI program.

89. First, lending and non-lending services will be increased for high-quality cross-border projects and programs. This will require a closer alignment of regional cooperation strategy programs (RCSPs) and country strategy and programs (CSPs). This is crucial for mainstreaming RCI activities in ADB’s lending and non-lending programs.

90. Second, the strategy will support initiatives to develop links across regions and subregions. These include the establishment of cooperative relations between East Asia and South Asia, implementation of projects that connect different regions and subregions, and enhancement of cooperation partnerships between ADB and regional bodies such as ASEAN, SAARC, and CAREC. Operationally, this will be underpinned by greater coordination of subregional programs by the various regional departments to achieve ADB-wide and/or region-wide coherence.

91. Third, a stronger and more coordinated policy-relevant research capacity will be established to enable ADB to serve as a knowledge bank on RCI. The purpose is to create, consolidate, and disseminate knowledge, as well as to identify opportunities, needs, benefits, and lessons on what works well and what does not. OREI will enhance its research capacity in pillar 2 and pillar 3. Greater coordination and information sharing across OREI, RSDD, ERD, and ADBI will be needed to minimize duplication and maximize synergies.

92. Finally, the implementation of the RCI strategy will require substantial cooperation and coordination between ADB and other international and regional organizations. ADB has been working closely with its development partners on several RCI efforts and will accelerate efforts to enhance synergies between ADB and other institutions (e.g., ASEAN, CAREC, SAARC, World Bank, WTO, regional MDBs, IMF, UN, UNESCAP, EU, and Boao Forum for Asia), researchers, media, NGOs, and other stakeholders in promoting RCI. Several multilateral and

bilateral development partners, particularly the governments of Japan, France, and the Nordic countries, are collaborating with ADB on several RCI initiatives. An MOU was signed between ADB and the SAARC secretariat in 2004 to strengthen cooperation between them. Another MOU is being negotiated to formalize the partnership between ADB and the ASEAN secretariat. ADB has signed an MOU with the Boao Forum for Asia to improve partnership.

B. Resource Implications

93. The strategy requires ADB to commit adequate human and financial resources to its RCI activities. Given the current zero real growth in ADB's overall budget for 2006, this will be a challenge. The additional staff resources required to implement ADB's proposed RCI support will initially be met from staff rationalization and reallocation, while maintaining support for national programs. Currently, about 50 professional staff are allocated for pillar 1, one professional staff for pillar 2, 10 professional staff for pillar 3, and 10 professional staff for pillar 4. While pillar 1 will continue to absorb most of the staff resources that ADB will allocate for RCI, a gradual increase in staff allocations for the other pillars will be needed.

94. Additional financial resources will also be required. Two types of financial resources are needed to implement the strategy effectively. First, with regard to the lending component of the strategy, for the immediate future, it is proposed to use existing OCR and ADF resources within available headroom and to catalyze additional public funding (particularly from larger economies) and private funding. Concessional funds will be needed to finance cross-border infrastructure and related investments. These concessional funds should be in addition to the amounts currently set aside by ADB for regional cooperation projects and programs.²⁹ Accordingly, the RCI strategy proposes systematic exploration of possible sources of such funding.

95. Second, additional TA resources will also be required for the strategy's non-lending components. While existing TA resources may be rationalized and prioritized

in favor of RCI, additional funds for pillars 2, 3, and 4 and for the software component of pillar 1 will need to be mobilized. ADB will do its best to establish new TA facilities to fund the non-lending support envisaged in the strategy adequately.

C. Results Framework

96. The overall objective of the RCI strategy is to reduce poverty in the DMCs through the four pillars. Pillar 1 aims to increase cross-border physical connectivity among DMCs; pillar 2 to promote international trade and investment of DMCs with regional and non-regional economies; pillar 3 to develop regional financial markets and maintain regional macroeconomic and financial stability; and pillar 4 to help protect the regional environment and improve health and social conditions. All of these outcomes are expected to contribute to poverty reduction, assuming that global economic environments are conducive and that other strategies and policy frameworks and good governance of DMCs are able to deliver effective outcomes.

97. A results-based monitoring framework that includes a set of indicators to monitor the progress of the RCI strategy has been developed (Table 4). The framework identifies broad outcomes to be achieved and the proposed contribution of ADB's support for RCI on those outcomes. The indicators for each pillar in the framework will be continually fine-tuned in consultation with concerned departments. However, for impact assessment at the project and program level, it is often difficult to distinguish the impact of a regional project or program from that of national activities. This makes it difficult to segregate the impact of ADB interventions from those of other factors, and the impact of regional cooperation programs from that of national programs. ADB is conducting a study on quantifying benefits from subregional cooperation, and appropriate methodologies will be developed to address this concern.

98. The baseline data and targets to measure the progress on indicators will be established by departments

²⁹ The need for these funds is identified in the ADB's long-term strategic framework: "Regional cooperation is a crosscutting theme of ADB's strategic agenda. To date, such cooperation has been largely financed out of individual country assistance programs. Regional cooperation involves, indeed is premised on, significant externalities beyond individual country borders, and responds to regional public goods issues. ADB will therefore examine and develop new funding mechanism for such activities.... These will require innovative financial arrangements, because the distribution of benefits and costs and the sharing of responsibility for loan repayment are complex issues. The development and effective operation of such facilities are keys to the institution's successful support for regional cooperation in the future."

for their respective sectors. Data sources for monitoring will be both external and internal to ADB. For pillar 1, RCSP and RCSP update reviews and evaluations will be primary source documents, especially where results-based RCSPs have been developed in recent years. For the other pillars,

annual reporting from OREI and RSDD on key results achieved from their work programs and progress reports from specific projects will be the primary sources of information.

IV. CONCLUSION

99. The MTS II identifies RCI as a strategic priority. RCI is one of the key instruments that ADB will use to reduce poverty. It is therefore not an end in itself but a means to achieve a poverty-free Asia and Pacific. RCI provides an additional platform that complements national policies and programs aimed at socioeconomic development and poverty reduction.

100. The RCI strategy has been prepared to guide ADB's support for RCI during the next three to five years. The strategy developed in this paper identifies four interrelated pillars: (i) regional and subregional economic cooperation programs (cross-border infrastructure and related software); (ii) trade and investment cooperation and integration; (iii) monetary and financial cooperation and integration; and (iv) cooperation in RPGs.

101. Given the large economic and social disparities in Asia and the Pacific, a multi-speed and multi-track

approach is appropriate for RCI. This is the approach recommended in various statements and declarations by leaders in Asia and the Pacific. Different regions will pursue RCI at different speeds and will focus on different pillars; even within regions, the pace of progress on the four pillars of RCI will vary. Accordingly, the prioritization of ADB's support in terms of the four pillars for RCI will be different across regions, depending on the priorities of DMCs.

102. The strategy requires ADB to commit adequate human and financial resources to its RCI activities. While pillar 1 will continue to absorb most of the staff resources that ADB will allocate for RCI, a gradual increase in staff allocations for the other pillars will be needed. Additional financial resources will also be required to finance both the lending and the non-lending components of the Strategy. The RCI strategy proposes systematic exploration of possible sources of such funding.

Appendix 1

ADB's Regional and Subregional Cooperation Programs³⁰

A. South Asia

1. The South Asia region in the ADB context, before its organizational realignment in May 2006, included Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. The region is home to about 410 million of the 720 million poor living in Asia and the Pacific. Intra-regional trade (as a ratio of South Asia's total foreign trade) is lower (5.3% in 2004) than that of Association of Southeast Asian Nations (ASEAN) member countries (22.4%) and Greater Mekong Subregion (GMS) countries (18.9%, excluding the People's Republic of China (PRC)). Existing regional cooperation initiatives in South Asia include the (i) South Asian Association for Regional Cooperation (SAARC), covering seven developing member countries (DMCs) in South Asia. The 13th SAARC Summit, held in Dhaka in November 2005, accepted Afghanistan as the eighth member, subject to completion of some requirements; (ii) Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC); and (iii) Economic Cooperation Organization (ECO). Greatly diverse country size, economic and social development, geography, political systems, languages, and cultures make regional cooperation in South Asia a particular challenge. Coupled with long-standing political tensions between some of the countries until the early 2000s, region-wide cooperation made limited progress.

2. Against this backdrop, when ADB initiated economic cooperation in South Asia, it adopted a project-based and subregional approach as an alternative modality to facilitate cooperation among a group of countries in South Asia. At the request of Bangladesh, Bhutan, India, and Nepal, ADB launched the South Asia Subregional Economic Cooperation (SASEC) Program in 2001. The SASEC Program promotes economic cooperation in six priority sectors: transport; trade, investment, and private sector cooperation; tourism; energy and power; environment; and Information Communication Technology.

In western South Asia, the Subregional Economic Cooperation in South and Central Asia (SECSCA) Program started in 2003, comprising two countries in South Asia: Afghanistan and Pakistan; and countries in Central Asia, including Tajikistan, Turkmenistan, Uzbekistan, and Iran (as an observer). The SECSCA Program promotes transport and trade facilitation along the road corridors connecting the Central Asian republics to the Arabian Sea and the Persian Gulf via Afghanistan. These subregional cooperation programs provide forums for the participating countries to meet, discuss, identify, and prioritize cooperation projects. Overall, these programs have been progressing well.

3. Since 2004, prospects for region-wide cooperation have improved, particularly following the 12th SAARC Summit held in Islamabad in January 2004, and the associated improvements in political relations within the region. In April 2004, ADB and SAARC signed a Memorandum of Understanding, which provided the basis for ADB to approve the first regional technical assistance (TA) to SAARC for the SAARC Regional Multimodal Transport Study. The 13th SAARC Summit held in November 2005 in Dhaka also reinvigorated the process of regional cooperation in South Asia, here the SAARC leaders agreed to translate pledges into concrete actions and programs. The Dhaka Declaration of the 13th SAARC Summit referred to the study as an effective measure for enhancing regional cooperation. After the Dhaka summit, SAARC requested ADB's assistance for follow-on TA for cooperation in the energy and finance sectors. Cooperation under the SAARC framework has gained momentum, and a major achievement has been made in the area of trade within a relatively short time after the summit. All SAARC member countries signed the South Asian Free Trade Area (SAFTA) Agreement in 2004, and ratified it. This is a milestone and a significant step toward the integration of South Asia.

4. South Asia has shown a growing interest in forging closer ties with neighboring regions. South Asia

³⁰ The stocktaking refers to regional and subregional programs that have been implemented before the realignment of ADB's regional departments in May 2006. Thus, the country coverage is not necessarily the same as that of the newly realigned regional departments. See Table 1 for the country coverage of the new regional departments.

could play a key role for wider Asian integration. SECSCA, a subregional initiative but also facilitating cross-regional cooperation, would be a key program in developing transport and trade links between South and Central Asia. Between South and Southeast Asia, BIMSTEC has emerged as an important cross-regional cooperation initiative. At the first BIMSTEC summit in July 2004, the member countries reaffirmed their commitment to cross-regional cooperation under the BIMSTEC framework. BIMSTEC and ADB initiated a process of dialogue in 2005, resulting in BIMSTEC's request for assistance to conduct a transport logistics study.

5. While a subregional approach will continue to accelerate project-based cooperation, given the changes in the environment and improved prospects for cooperation, ADB will significantly expand its cooperation programs by supporting region-wide and cross-regional cooperation to address broader and policy issues. Links among the ongoing cooperation initiatives such as SAARC and BIMSTEC will be strengthened to create synergies and avoid duplication. With its experience and comparative strengths, ADB's support will be focused on improving connectivity, facilitating trade and investment, developing regional tourism, supporting cooperation in energy, and promoting private sector cooperation.

B. East and Central Asia

6. Following the break up of the Soviet Union in 1991, the newly independent states of Central Asia experienced a severe economic decline and a sharp deterioration in social conditions. Nearly a third of Central Asia's population slipped into poverty. In the late 1990s, the new states began to find their feet, and economic recovery took root. This rebound coincided with an economic upturn in Russia, continued rapid growth in the PRC, and new opportunities in Afghanistan and South Asia.

7. Continued growth in Central Asia will require export expansion, growth of private enterprises, and an increase in investment in areas currently excluded from economic gains. To make this possible, the region will need to create efficient transport infrastructure, rehabilitate energy networks, restore and improve irrigation systems, and enable seamless transit across the region to external markets. All are contingent on improved regional economic cooperation. The region's geographical, economic, and historical contexts and asymmetrical distribution of natural

resources augur well for cooperation and for achieving inclusive economic growth. However, the main impediments to closer cooperation are (i) a perception of inequitable distribution of benefits from investments for regional projects, (ii) weak political will and absence of mutual trust and ownership by governments, (iii) weak government capacity for intraregional cooperation, and (iv) sensitivity to national sovereignty and the pursuit of national self-reliance. Conscious and concerted efforts are required to improve the incentives for cooperation.

8. The Central Asia Regional Economic Cooperation (CAREC) Program is an initiative supported by ADB to encourage economic cooperation in Central Asia. Begun in 1997, the program has focused on regional initiatives in transport, energy, trade facilitation, and trade policy critical to improving the region's economic performance and the livelihoods of all people, especially the poor.

9. Participating countries are Afghanistan, Azerbaijan, PRC (Xinjiang Uygur Autonomous Region), Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, and Uzbekistan. CAREC is also an alliance of multilateral institutions actively promoting economic cooperation in Central Asia. These institutions, besides ADB, are the European Bank for Reconstruction and Development (EBRD), International Monetary Fund (IMF), Islamic Development Bank (IsDB), United Nations Development Programme (UNDP), and World Bank. The CAREC Program operates in partnership with other key regional cooperation programs and institutions, particularly the Shanghai Cooperation Organization and the Eurasian Economic Community. CAREC is the only forum that brings together the countries of the region and the key multilateral and regional institutions cited above within a single institutional framework.

10. In January 2002, an overall institutional framework (OIF) was established for CAREC. The OIF's objectives are to (i) strengthen the overall planning and implementation of regional cooperation activities, (ii) ensure continued country ownership, and (iii) foster improved donor coordination. The OIF consists of (i) an annual ministerial conference to provide strategic and policy guidance; (ii) senior officials' meetings to support the ministerial conference; (iii) sector coordinating committees and working groups in priority sectors to oversee the identification, prioritization, and implementation of regional projects; and (iv) a national

focal point for each country to serve as a national coordinating mechanism for regional cooperation activities. ADB's CAREC Unit has served as the program secretariat since March 2000.

11. Awareness of the benefits of regional cooperation and the opportunity costs of noncooperation is increasing in CAREC countries. Based on the principles of consensus, pragmatism, and results-orientation, CAREC has made progress in identifying and mobilizing support for regional projects and expanding policy dialogue.

C. Southeast Asia

12. Southeast Asia is a subregion of East Asia. Its countries are linked by a distinct geography and economic history, including the severe financial crisis in 1997, which wiped out most of the miracle achievements of the newly industrialized economies. One of the greatest obstacles to competitiveness is the geographical separation of several countries, which raises the cost of doing business and deters foreign direct investment. The countries have to surmount a number of challenges, and one of these is the infrastructure obstacle caused by the subregion's archipelagic geography. This unusual landscape requires integrated planning of transport and energy infrastructure, as many areas are far more easily linked to other nations than they are to their own national centers. The lack of infrastructure poses serious barriers to development in the poorer, border islands of Indonesia and the Philippines, and in Sarawak and Sabah in Malaysia.

13. To help meet these and other challenges, ADB is currently working with the stakeholders to formulate its first regional cooperation strategy program (RCSP) for Southeast Asia. ADB will review and selectively build on, streamline, and integrate past and ongoing assistance activities in the region, including investments in infrastructure development and TA activities in support of the Brunei Darussalam, Indonesia, Malaysia, and Philippines–East ASEAN Growth Area (BIMP–EAGA).

D. The Pacific

14. Pacific DMCs (PDMCs) within the ADB context are widely dispersed over a large area and differ significantly in size, population, endowments, opportunities, and development constraints. The total population of the PDMCs is 8.2 million. The economic performance of the

Pacific since 1995 has been mixed but generally disappointing, despite generous aid flows. As a result, poverty has been increasing. Each PDMC is unique, but they also face common challenges related to high transport and other transaction costs, limited human resources and weak institutional capacities, governance challenges, and narrowly-based economies vulnerable to natural disasters and external shocks.

15. Because of the low level of economic integration and high geographical dispersion, the nature and scope of regional cooperation and integration in the Pacific differs greatly from that elsewhere. The scope for cooperation among PDMCs in physical investment or infrastructure is limited. However, there is a strong rationale for regional efforts on the "software" to improve connectivity and minimize the cost and constraints of isolation, by creating more efficient and effective regional aviation, shipping, and communications markets. Perhaps most critically needed in the Pacific are regional public goods that enhance skills, knowledge, and technology transfer related to the specialized but common needs of these countries. Specifically, it is important to build regional institutional capacity as a complement to necessarily limited national capacity.

16. Regional cooperation and integration received renewed attention within the Pacific in 2005. A Pacific Plan for Strengthening Regional Cooperation and Integration was approved by Heads of Government of the Pacific Islands Forum. The plan has a strong analytical rationale, supported by an ADB–Commonwealth Secretariat study, *Toward a New Pacific Regionalism*, but further progress needs to be made in implementation—prioritizing the elements of a regional trade and development agreement that includes more scope for integration of labor and capital markets and which is supported by the large forum members—Australia and New Zealand.

17. ADB's focus on RCI for the Pacific will be to support priority programs under the Pacific Plan, with emphasis on providing regional public goods and services. Enhancing connectivity through improved regional aviation arrangements is a related objective. ADB's support for the creation of the Pacific Aviation Safety Office demonstrates its ability to support Pacific regionalism that helps PDMCs deliver essential services efficiently and responsively. Regional provision of services that strengthen governance in the PDMCs will be a priority, including an initiative on regional public sector audit services.

E. Mekong

18. Mekong is another subregion of East Asia. A combination of rich natural and human resources gives it enormous economic potential, yet many of its inhabitants remain poor. Of its 255 million people, about three fourths live in rural areas and survive on subsistence or semi-subsistence agriculture. About 35 million people—one in every seven—are undernourished. Many Mekong countries are in transition from centrally-planned to market economies, with Thailand at the other end of the spectrum as a functioning market economy.

19. One of the most serious impediments was a severe mistrust attributed to deep political and ideological divide among the Mekong countries since the Cold War. Thus, perhaps the greatest accomplishment of the GMS program has been building trust among countries and confidence in the countries, as well as a stronger community, all of which has driven the program and brought it to where it is today.

20. With ADB assistance, the process of regional cooperation among divided countries in Mekong started in 1992 with the establishment of the GMS program. Mekong's emergence as a regional entity has been a good lesson to promote regional cooperation by demonstrating how countries can leave aside political differences and tension to work to better their peoples' lives. Within a decade, the subregion has witnessed the rapid evolution of an integrated regional market, the growth of regional

institutions, the development of a sense of shared experience and community, and a growing capacity for collective action for the common good and common purposes.

21. ADB has played a key role in these developments. The financial and intellectual resources and leadership wielded by ADB have helped economically transform the subregion, created new opportunities for its members to compete more effectively in a global economy, and fostered a sense of community among like-minded countries.

22. The approach to promote subregional cooperation in Mekong is also one of the best practices of ADB that can be replicated elsewhere in Asia the Pacific. The GMS's initial focus was on overcoming inadequate transport and communication links. Overcoming geographical barriers and integrating subregional markets and promoting new economic opportunities have been key dimensions through which subregional projects have complemented national assistance programs. Thereafter, the need to harmonize the legal and regulatory frameworks and facilitate cross-border transactions to allow the integration of markets for production and services has become another focus of the GMS Program. Subsequently, greater recognition of environmental and social issues has widened the GMS's scope over the last five years. The RCSP for 2004–2008 in Mekong takes the GMS program to its next stage, one that recognizes in equal measure the public benefits of managing the GMS commons.

Appendix 2

Greater Mekong Subregion: Fostering Socioeconomic Development through Regional Cooperation and Integration

1. The Greater Mekong Subregion (GMS) is a good example of ADB's support for regional cooperation and integration (RCI). Since 1992, the countries of the GMS—Cambodia, People's Republic of China (PRC), Lao People's Democratic Republic, Myanmar, Thailand, and Viet Nam—have participated in a comprehensive program of economic cooperation covering transport, energy, telecommunications, human resource development, environment and natural resources management, trade facilitation, private investment, tourism, and agriculture. With the support of the Asian Development Bank (ADB) and other development partners, the GMS program has been assisting the participating countries to achieve the Millennium Development Goals (MDGs) through increased connectivity, improved competitiveness, and a greater sense of community.

2. Increased connectivity through the development of subregional transport infrastructure has accelerated market-driven economic integration and improved access to basic social services, especially for the poor in border areas. Greater connectivity is particularly significant for the GMS given its strategic location at the crossroads of South and Southeast Asia. Total exports of GMS countries grew by more than 300% from 1992 to 2005. Intraregional trade increased even more dramatically; in 2004, it was 12 times the 1992 level. Annual tourist arrivals doubled from 10 million in 1995 to an estimated 20 million in 2005. Net foreign direct investment inflows to the GMS increased from about \$3 billion in 1992 to about \$5.5 billion in 2005 (excluding inflows to the PRC and Myanmar).

3. Improved competitiveness arising from greater connectivity, simplification of rules and processes governing the cross-border movement of goods and people,

development of trade logistics systems, establishment of a regional power market to rationalize energy supply, and the harnessing of information and communication technology links are providing the foundations for sustainable and accelerated economic growth in the GMS.

4. Over a decade of close cooperation and considerable economic progress has engendered a greater sense of community among the Mekong countries and a groundswell of goodwill. This, in turn, has given them the impetus to mutually recognize and jointly address shared environmental and social concerns. The GMS Core Environment Program, a systematic and integrated program to sustainably manage shared resources in the GMS. It began in April 2006 with the opening of the GMS Environment Operations Center in Bangkok.

5. The "peace dividend" of the GMS program has contributed to regional stability and better understanding among neighboring countries. The leaders of the six Mekong countries have met twice, first in Phnom Penh, Cambodia in November 2002 and more recently in Kunming, the PRC, in July 2005, to guide the future direction of the GMS Program. GMS Leaders have recognized and appreciated the unique and dynamic role that ADB has played in catalyzing and supporting the Mekong countries and the GMS Program.

6. As of the end of 2005, ADB has provided loans for the GMS program totaling almost \$1.8 billion for 26 investment projects estimated to cost \$6.5 billion. GMS governments and development partners have provided about \$2.1 billion and \$2.6 billion, respectively. In addition, 119 technical assistance projects with a total cost of \$143 million have been completed or are underway.

Appendix 3

Social Impact of the 1997–1998 Asian Financial Crisis*

When a macroeconomic and financial crisis hits an economy, there are several channels through which the impacts are felt by poor households. The effects can be grouped into five (overlapping) channels:

- **Relative price changes:** External shocks such as exchange rate depreciation or commodity price changes affect relative prices of tradable and nontradable goods, and the terms of trade the economy faces. These price changes alter the profitability of key sectors in the economy, and affect relative wages and employment levels. The relative prices of consumer goods also change, with a further effect on real incomes. In East Asia, the prices of imported goods increased dramatically following exchange rate devaluations. Food price increases hurt households that are net consumers of food, especially the urban poor and even poor farmers.
- **Decline in labor demand:** An important short-run impact on the poor is reduced labor demand. This follows economic contraction, which reduces aggregate demand for goods and services, thus reducing labor demand. The adjustment can be through quantities (reduced working hours, increased unemployment and informal self-employment) or through prices (lower wages for wage earners and lower earnings). These shocks have different impacts on workers with different skills and different levels of job security. Lowly-skilled workers and women are often more likely to lose formal-sector jobs and move into the informal sector, where earnings are likely to be lower. In East Asia, unemployment increased significantly after the financial crisis: in Thailand from 2% in February 1997 to 5% in May 1998; and in the Republic of Korea from 2% in July 1997 to about 8% in February 1999. In Indonesia and Malaysia, for example, most of the adjustment appears to have taken place through falling wages and the movement of workers into low-paying informal sector jobs.
- **Lower returns on physical assets and inflation tax:** Hikes in interest rates, declines in bond prices, stock market crashes, falling real estate prices, and inflation all affect the incomes of people who own various types of assets. While changes in the relative short-term returns to investors holding bonds rather than stocks may redistribute income only among the non-poor, there is one major impact on assets which affects the poor: inflation. The rate of inflation is a tax on money holdings. Because the poor often do not hold non-money financial assets, they are unable to adjust their portfolio to increases in inflation. Typically, they will hold a greater proportion of their wealth in cash even during inflationary periods than do the non-poor.
- **Cuts in public transfers:** Public expenditure cuts, beyond causing declines in labor demand and price effects (for example when subsidies are removed), affect cash transfers and the provision of in-kind social services. These cuts tend to harm people who rely on public services, usually including the poor (especially if they take place across the board or are ad hoc).
- **Reduced community services:** Impacts are felt not just by individuals, but by entire communities, as traditional ties and networks and other forms of social capital are disrupted because of economic hardship, migration, and the emergence of fault lines between different ethnic, religious, or radical groups. There is evidence from several countries that social

* This appendix is excerpted from Ferreira, Francisco, Giovanna Prennushi, and Martin Ravallion. 1999. *Protecting the Poor from Macroeconomic Shocks: An Agenda for Action in a Crisis and Beyond*. Washington, DC: World Bank.

capital can be damaged during financial crises. Evidence from rapid social assessments conducted in Cambodia, Indonesia, Philippines, and Thailand, and surveys in Indonesia, Republic of Korea, and Thailand confirmed that the poor were indeed responding in ways which would

affect their long-term well-being. Youngsters were taken out of secondary school and sent to work and health care was delayed or forgone. Productive assets were sold. There was also anecdotal evidence of reverse migration from the cities to the countryside.

Chart 2. ADB’s Mission and the Role of Regional Cooperation and Integration

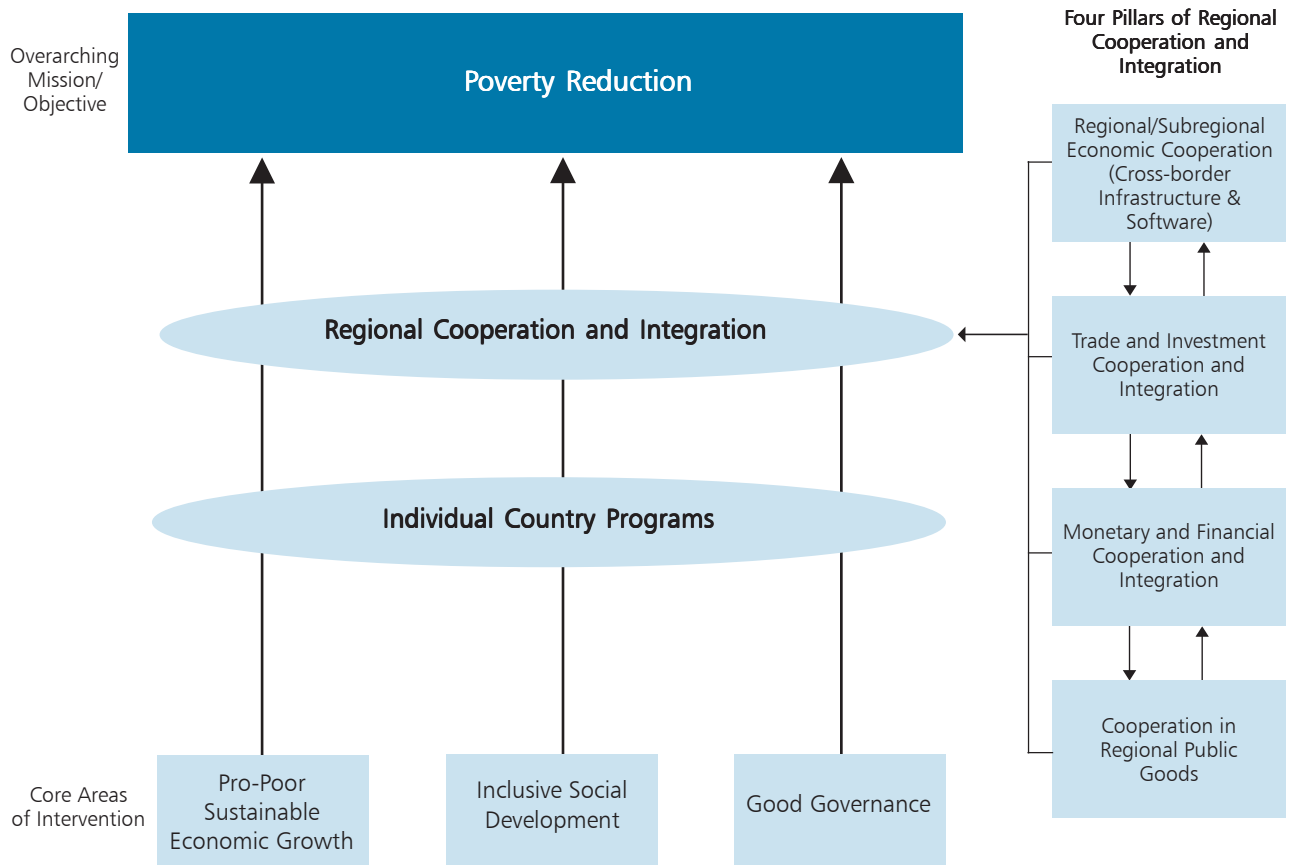
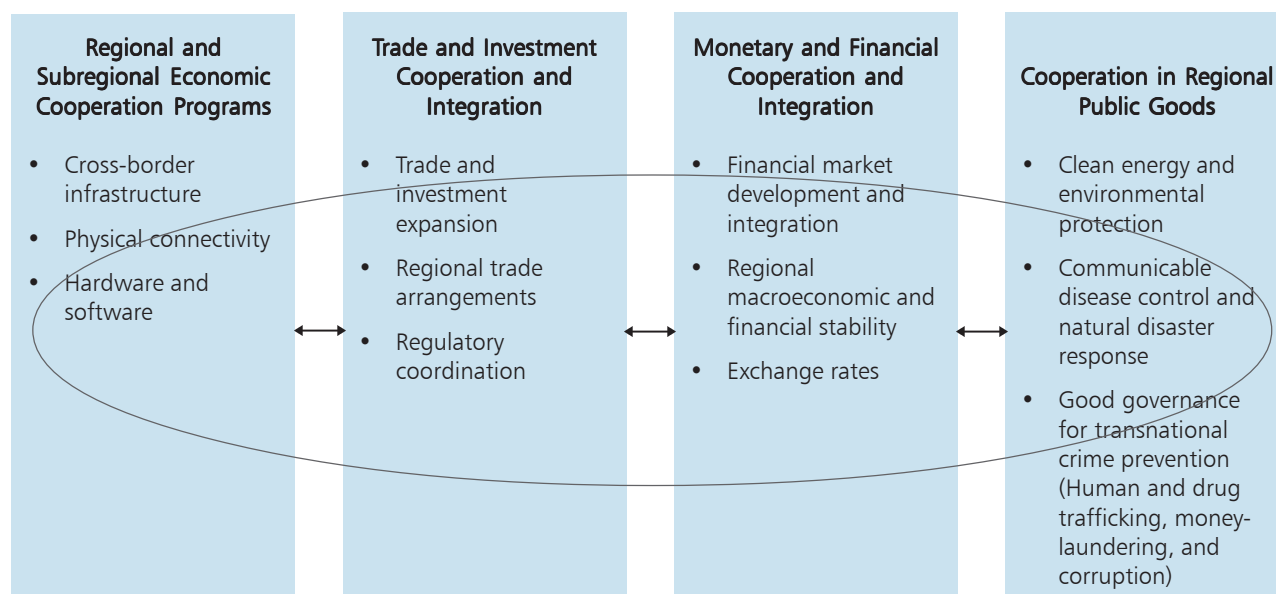


Chart 3. Four Pillars of Regional Cooperation and Integration

Table 1. ADB's Realigned Regional Departments and Coverage of Countries and Economies (effective 1 May 2006)*

Operations Group 1		Operations Group 2		
South Asia Department (SARD)	Central and West Asia Department (CWRD)	East Asia Department (EARD)	Southeast Asia Department (SERD)	Pacific Department (PARD)
<ol style="list-style-type: none"> Bangladesh Bhutan India Maldives Nepal Sri Lanka 	<ol style="list-style-type: none"> Afghanistan Armenia Azerbaijan Kazakhstan Kyrgyz Republic Pakistan Tajikistan Turkmenistan Uzbekistan 	<ol style="list-style-type: none"> People's Republic of China Mongolia <p>Non-Borrowing members</p> <ol style="list-style-type: none"> Hong Kong, China Republic of Korea Taipei, China 	<ol style="list-style-type: none"> Brunei Darussalam Cambodia Indonesia Lao People's Democratic Republic Malaysia Myanmar Philippines Thailand Viet Nam <p>Non-Borrowing members</p> <ol style="list-style-type: none"> Singapore 	<ol style="list-style-type: none"> Cook Islands Fiji Islands Kiribati Marshall Islands Federated States of Micronesia Nauru Palau Papua New Guinea Samoa Solomon Islands Timor-Leste Tonga Tuvalu Vanuatu

* ADB. 2006. *Realignment of Regional Departments*. Manila.

Table 2. Membership of Countries and Economies in Regional Groupings

	ACD	ACMECS	APEC	ASEAN	ASEAN + 3	ASEM	BIMP-EAGA
Central and West Asia							
Afghanistan							
Armenia							
Azerbaijan							
Kazakhstan	•						
Kyrgyz Republic							
Pakistan	•						
Tajikistan							
Turkmenistan							
Uzbekistan							
East Asia							
People's Republic of China	•		•		•	•	
Mongolia	•						
Hong Kong, China			•				
Japan	•		•		•	•	
Republic of Korea	•		•		•	•	
Taipei, China			•				
Southeast Asia							
Brunei Darussalam	•		•	•	•	•	•
Cambodia	•	•		•	•	•	
Indonesia	•		•	•	•	•	•
Lao PDR	•	•		•	•	•	
Malaysia	•		•	•	•	•	•
Myanmar	•	•		•	•	•	
Philippines	•		•	•	•	•	•
Singapore	•		•	•	•	•	
Thailand	•	•	•	•	•	•	
Viet Nam	•	•	•	•	•	•	
South Asia							
Bangladesh	•						
Bhutan	•						
India	•						
Maldives							
Nepal							
Sri Lanka	•						
The Pacific							
Australia			•				
Cook Islands							
Fiji Islands							
Kiribati							
Marshall Islands							
Micronesia, Federated States of							
Nauru							
New Zealand			•				
Palau							
Papua New Guinea			•				
Samoa							
Solomon Islands							
Timor-Leste							
Tonga							
Tuvalu							
Vanuatu							

Table 3. Intraregional Trade Share, 1980–2004 (%)*

REGIONS	1980	1985	1990	1995	2000	2001	2002	2003	2004
East Asia-15, including Japan	35	37	43	52	52	52	54	55	55
Emerging East Asia-14	22	28	33	39	41	41	43	44	44
ASEAN+3	30	30	29	38	37	37	38	38	39
NIEs-4	6	7	12	16	16	15	15	15	14
ASEAN-10	18	20	19	24	25	24	24	24	24
SAARC	4	3	3	4	4	4	5	6	5
Central Asia					7	7	6	6	5
NAFTA	34	39	38	43	49	49	48	47	46
MERCOSUR	11	7	11	19	20	18	14	15	15
Old European Union-15	61	60	66	64	62	62	63	63	62
New European Union-25	61	60	67	67	67	67	68	69	68

Note: (a) Intraregional trade share is defined as: $X_{ii}/\{(X_{i.} + X_{.i})/2\}$ where X_{ii} is exports of region i to region i , $X_{i.}$ is total exports of region i to the world, and $X_{.i}$ is exports of the world to region i .

(b) East Asia-15 includes Emerging East Asia-14 and Japan. Emerging East Asia-14 includes ASEAN+3 countries; Hong Kong, China; and Taipei, China.

* Computed from International Monetary Fund, *Direction of Trade Statistics, CD-ROM and CEIC database*.

Table 4. Results Framework for the Regional Cooperation and Integration Strategy (2006–2010)

Outcomes	Performance Monitoring Indicators*	Key Activities and Initiatives Contributing to Outcomes	Risks and Assumptions
Pillar 1: Regional and Subregional Economic Cooperation Programs			
<i>Long-term impact:</i> Improved cross-border physical connectivity			
Primary responsibility: Regional Departments and Private Sector Operations Department			
1.1 Improved physical connectivity through cross-border infrastructure	<ul style="list-style-type: none"> Projects/programs to improve regional and subregional transport corridors** 	Lending activities <ul style="list-style-type: none"> Development of corridors and other projects across regional and subregions within Asia and the Pacific 	<ul style="list-style-type: none"> Adequate resources will be available for subregional projects
1.2 Improved software; harmonized cross-border regulations, procedures, and standards	<ul style="list-style-type: none"> Average travel time across the region/subregions Projects and programs to improve digital connectivity, and facilitate regional and subregional energy trade Cross-border transport agreements Regional agreements, or policies, strategies prepared and adopted Training programs for customs, immigration, and quarantine personnel 	<ul style="list-style-type: none"> Regional and subregional infrastructure projects and programs, including cross-border projects and programs involving only two countries National infrastructure projects/programs that include significant regional and subregional dimensions Harmonization of sector regulatory standards, and evaluation and monitoring of cross-border infrastructure projects and programs Facilitation of private sector investment in cross-border infrastructure projects 	<ul style="list-style-type: none"> Close coordination with other development partners Stable economic growth in the region

Outcomes	Performance Monitoring Indicators*	Key Activities and Initiatives Contributing to Outcomes	Risks and Assumptions
<p>Non-lending activities</p> <p><i>Strengthening regional policy dialogue</i></p> <ul style="list-style-type: none"> Facilitation of and support for formulation of regional agreements, policies and strategies on harmonization of sector regulatory and legislations Development of coordinated approaches for the creation of regional and subregional infrastructure networks Support for reforms to the policy environment to facilitate private sector investment in cross-border infrastructure projects, particularly cross-border logistics systems that support physical infrastructure <p><i>Supporting studies and information dissemination</i></p> <ul style="list-style-type: none"> Preparatory and feasibility studies for the above cross-border infrastructure projects and programs and development corridors Books, briefs, updates, journals, research, working papers, reports. Press conferences and interviews and similar events, ADB seminar series, and ADB working papers <p><i>Supporting capacity building and institutional strengthening</i></p> <ul style="list-style-type: none"> Support for training programs for government officials, institutions, and agencies on issues related to physical connectivity and related software <p><i>Strengthening partnership with regional institutions</i></p> <ul style="list-style-type: none"> Implementation of joint activities with stakeholders 			
<p>Pillar 2: Trade and Investment Cooperation and Integration</p> <p><i>Long-term impact: Increased international trade and investment with regional and nonregional economies</i></p> <p>Primary responsibility: OREI</p>			
<p>2.1 Greater volume of trade and investment intraregionally and extraregionally</p> <p>2.2 Harmonized cross-border regulations, procedures, and standards for regional trade and investment</p>	<ul style="list-style-type: none"> Growth of total intraregional trade Growth of total and investment intraregional investment Best practices FTAs that are mutually coherent and consistent with WTO 	<p>Non-lending activities</p> <p><i>Strengthening regional policy dialogue on trade and investment</i></p> <ul style="list-style-type: none"> Support for promoting policy dialogue among regional and subregional forums <p><i>Supporting studies and information dissemination</i></p> <ul style="list-style-type: none"> Research on issues related to FTAs Support for the design of model frameworks of FTA negotiations to help DMCs in these negotiations 	<p>Adequate resources will be available</p> <p>Close coordination with other international institutions</p> <p>Stable global economy</p> <p>Strong commitment and willingness of governments</p>

Outcomes	Performance Monitoring Indicators*	Key Activities and Initiatives Contributing to Outcomes	Risks and Assumptions
		<ul style="list-style-type: none"> Books, briefs, updates, journals, research, working papers, and reports on issues related to RCI Press conferences and interviews and similar events, ADB seminar series on RCI, including at ADB annual meetings, and ADB working papers on trade and investment issues Development and maintenance of the ARIC website <p><i>Supporting capacity building and institutional strengthening</i></p> <ul style="list-style-type: none"> Support for training programs for government officials, institutions, and agencies on issues related to FTAs Capacity building through exchange of experience among government officials, institutions, and agencies on FTAs related issues <p><i>Strengthening partnership with regional institutions</i></p> <ul style="list-style-type: none"> MOUs with international and regional organizations as appropriate Implementation of joint activities with stakeholders, presentation of papers on issues related to trade and investment at regional and subregional forums 	
<p>Pillar 3: Monetary and financial cooperation and integration <i>Long-term impact: Regional macroeconomic and financial stability and financial market development</i> Primary responsibility: OREI</p>			
3.1 Development, deepening, and harmonization of regional financial markets	<ul style="list-style-type: none"> Effective regional economic surveillance Regional swap arrangements 	<p>Non-lending activities <i>Strengthening regional policy dialogue on monetary and financial cooperation</i></p> <ul style="list-style-type: none"> Support for regional policy dialogue among the various regional bodies/forums/initiatives 	<p>Adequate resources will be available</p> <p>Close coordination with other international institutions</p>
3.2 Maintenance of regional macroeconomic and financial stability	<ul style="list-style-type: none"> Development and establishment of early warning systems for DMCs Development of Asian bond markets,*** including the size and liquidity of bond markets, and market infrastructure 	<ul style="list-style-type: none"> Support for Asian Bond Markets Initiative (ABMI); the Chiang Mai Initiative (CMI); semiannual <i>Asia Economic Monitor</i> and <i>Asia Bond Monitor</i> <p><i>Supporting studies and information dissemination</i></p> <ul style="list-style-type: none"> Studies on Asian currency indexes Studies on issues related to monetary and financial cooperation Development and strengthening of the AsianBondsOnline website 	<p>Strong commitment and willingness of governments</p>

Outcomes	Performance Monitoring Indicators*	Key Activities and Initiatives Contributing to Outcomes	Risks and Assumptions
		<ul style="list-style-type: none"> Books, briefs, updates, journals, research, working papers, and reports on issues related to monetary and financial cooperation and integration <p><i>Supporting capacity building and institutional strengthening</i></p> <ul style="list-style-type: none"> Capacity building programs in regional economic and financial monitoring, including financial vulnerability assessments and early warning systems for National Surveillance Units established in various ASEAN+3 countries Capacity building support to the Association of Credit Rating Agencies in Asia, and APEC financial regulators and eventually to other interested countries as well <ul style="list-style-type: none"> Establishment of a network among bank and security market regulators in DMCS <p><i>Strengthening partnership with regional institutions</i></p> <ul style="list-style-type: none"> MOUs with international and regional organizations as appropriate Implementation of joint activities with stakeholders, such as projects/programs, research, regional conferences/ seminars/ workshops, training, and other appropriate events to promote RCI 	
<p>Pillar 4: Cooperation in Regional Public Goods (RPGs) <i>Long-term impact: Improved regional environments, health, and social conditions</i> Primary responsibility: RSDD</p>			
4.1 Improved cross-border environments, health, and social conditions 4.2 Coordinated cross-border strategies and activities	<ul style="list-style-type: none"> Regional frameworks and strategies for managing cross-border issues developed Programs and projects supported or undertaken Coordinated actions with international institutions Establishment of donors trust funds used/ established Knowledge products, and other related papers prepared and presented at various regional and subregional forums 	<p>Non-lending activities **** <i>Strengthening regional policy dialogue</i></p> <ul style="list-style-type: none"> Support for promoting regional dialogue and coordination among governments on environment, clean energy and energy efficiency, natural disaster responses, communicable disease, governance and anti-corruption activities, and human trafficking Promotion of regional initiatives to encourage private sector participation in responding to cross-border issues, such as the development of regional energy markets, regional energy trade, setting up of the Carbon Market Initiative to establish a cofinancing facility to provide finance and marketing support for developers and sponsors of projects with carbon credit content 	<p>Adequate resources will be available</p> <p>Close coordination with other international institutions</p> <p>Strong commitment and willingness of governments</p> <p>Strong commitment and willingness of international institutions</p>

Outcomes	Performance Monitoring Indicators*	Key Activities and Initiatives Contributing to Outcomes	Risks and Assumptions
	<ul style="list-style-type: none"> • Regional networks used for information sharing • Training programs 	<p><i>Supporting studies and information dissemination</i></p> <ul style="list-style-type: none"> • Publication of books, briefs, updates, journals, working papers, reports and publications on the above issues • Technical support for research on environment, clean energy and energy efficiency, natural disaster responses, communicable disease, governance and anti-corruption activities, and human trafficking • Technical support for knowledge and awareness raising campaigns on cross-border issues such as HIV/AIDS, avian influenza, and human trafficking • Development and maintenance of website on these issues • Press conferences and interviews and similar events, ADB seminar series, and ADB working papers. <p><i>Supporting capacity building and institutional strengthening</i></p> <ul style="list-style-type: none"> • Technical support to develop relevant regional frameworks for managing cross-border issues • Support for training programs for government officials, institutions, and agencies on RPG issues • Support to establishment of regional networks of early warning and monitoring system of major environmental incidents <p><i>Strengthening partnership with regional institutions</i></p> <ul style="list-style-type: none"> • Development of close partnership with other international institutions such as UNESCAP, UNEP, WHO, ILO to strengthen cooperation in addressing cross-border issues • Formulation and implementation of joint programs with international organizations 	

* The indicators are only a broad approximation and each regional department will need to fine-tune the indicators to suit the specific features of their regions and subregions. Baseline data to measure these indicators will be established in 2006.

** These can be land, air, and sea corridors, including highways, railway networks, ports, shipping, and airports.

*** Specific indicators can include number of bonds issued, size (amount) of new bonds issued, liquidity as indicated by trading volumes and turnover, diversification of bond products (products innovation), and diversification of issuers and investors.

**** Until now, ADB has not provided any loans under pillar 4, although in March 2006 it approved a \$38 million grant project for prevention and control of avian flu in Asia and the Pacific. This, however, may not preclude future lending activities under this pillar if the need arises.

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