

Chapter 8

The way forward

Asia's remarkable rise is reshaping the world economy—and especially relations among the region's economies. Outward-oriented development, once aimed primarily at export markets elsewhere, is now knitting Asia together. This has far-reaching implications—in the face of both adverse developments, such as the financial contagion of the 1997/98 crisis, and constructive ones, such as the rise of regional production networks and the growing role of Asian demand in smoothing global business cycles. Regional economic integration is proceeding rapidly, not only due to Asia's growing importance, but also because structural changes are helping to deepen the region's economic and social ties. This market-driven integration is also increasingly supported by cooperation among the region's governments.

Regional integration has not weakened Asia's global connections—rather, as this study details, Asia's trade with the rest of the world remains strong. For most Asian economies, macroeconomic interdependence has increased both within the region and with the world. The global reach of companies in the region continues to widen. Every other day, it seems, new products and services are joining established Asian brands to become household names across the world. Eye-catching Asian investments dominate the news in some of the world's wealthiest markets—and help to build infrastructure and accelerate development in some of its poorest. At the same time, Asia is welcoming an unprecedented wave of outside investment. As was noted at the outset, Asia is emerging as the center of the world economy, and is ever more strongly connected to it.

8.1. A new type of regionalism

As this study shows, Asian regionalism defies conventional expectations. In Asia, regional and global integration are not substitute—they complement each other. Asian economic integration is deliberately outward-looking—it enhances the productivity and competitiveness of the region as a whole, in a global context. Asia faces important challenges in preserving its dynamism, maintaining a favorable global environment for its growth, and making its development more inclusive and sustainable. Regional cooperation, this study argues, will help Asia address these challenges and build more stable and enduring foundations for growth. Overall, Asian regionalism will benefit both Asia and the world by helping to smoothen global business cycles, stimulating innovation and productivity, reducing poverty in the region and outside it, and complementing and supporting global economic institutions.

The form of Asian regionalism is also unique. It involves wide-ranging intergovernmental consultations, but relatively few formal institutions. Compared to Europe, Asia is “institution light.” However, measuring the development of Asian regionalism by non-Asian standards—as even regional observers sometimes do—can be misleading. Cooperation in Asia is based on deepening relationships, predominantly driven by markets rather than political agreements. Concerted unilateral action, even if only some countries in the region agree to it, has been remarkably effective in opening markets and facilitating trade; investment; financial deepening; cross-border capital flows; and, increasingly, labor flows too. Asia’s integration is market-friendly, multitrack and multispeed—and healthily pragmatic.

While national economic institutions and policies continue to play a key role in Asia’s economic success, regional initiatives increasingly complement them. ASEAN, the post-crisis ASEAN+3 framework, and the relatively new EAS reflect the broad regional dimensions of this process. At the same time, several of these institutions—among which there is some healthy competition—are beginning to get stronger. For example, ASEAN has recently made a major commitment to accelerate its integration and strengthen its secretariat, as it builds an ASEAN Economic Community. Overall, the approach is step-by-step and bottom-up, rather than a comprehensive project guided by a pan-Asian vision, or grand plan, for integration.

Subregional cooperation—a logical starting point, given the region’s diversity and wide gaps in economic development—is also increasing. Each subregion has different needs, so the scope and pace

of such cooperation varies. Some subregional bodies focus on a few areas; others pursue a more comprehensive agenda. As subregional cooperation develops, bridges naturally form, leading eventually to wider and more comprehensive cooperation and integration across Asia.

8.2. An agenda for cooperation

An important aim of this study has been to set out criteria for judging when collective action is needed. Some issues identified in public dialogue—such as the regional sourcing of production inputs in a competitive market—do not require regional cooperation, except of course the removal of impediments to business operations and the free flow of goods and services. Even among problems that require government involvement, relatively few require regional—rather than national or global—policy action.

But given the rapid growth of Asian economic interdependence, opportunities for cooperation are rising, even when judged by the most rigorous economic standards. Some priorities for cooperation include:

- providing new regional public goods, such as mechanisms to head off epidemics; resources to address financial crises; and rules to enable countries to integrate financial, goods, and services markets;
- managing spillovers among economies resulting from closer macroeconomic relations, greater capital and labor flows, and environmental degradation;
- exercising Asia's influence in global economic forums to help sustain open and competitive global markets;
- liberalizing trade and investment beyond levels achievable through global negotiations; and
- adding value to national policy making, notably by sharing the best practices and highlighting priorities that may be opposed by domestic special interests—such as measures to enhance competition and regulatory oversight, reduce poverty and inequality, and control environmental externalities.

These criteria give rise to a substantial agenda for collective action (Table 8.1). Important findings emerge in each of the study's five principal areas of analysis—and these are reviewed in the following section.

Table 8.1. Enhancing Asian regionalism: An agenda for collective action

Themes	Building an Asian Economic Community: the way forward	
	Priorities	Policy solutions
Integrating production	<ul style="list-style-type: none"> • Enhance investment in and the productivity of regional economies • Strengthen comparative advantage derived from integrated regional production chains • Promote technological upgrading and development of a knowledge economy 	<ul style="list-style-type: none"> • Support the global trading system • Pursue regional cooperation as widely and deeply as possible • Develop guidelines for best practices in subregional trade agreements • Enhance regional connectivity
Integrating financial markets	<ul style="list-style-type: none"> • Increase resilience against financial crises • Develop larger, deeper regional financial markets • Improve returns for investors and reduce capital costs to firms by strengthening the regional intermediation of savings 	<ul style="list-style-type: none"> • Improve financial market surveillance and create an “Asian Financial Stability Dialogue” • Promote consistent standards and mutual recognition • Strengthen financial markets (especially including local currency bond markets) and their infrastructure • Liberalize capital accounts and cross-border financial services prudently
Managing macroeconomic interdependence	<ul style="list-style-type: none"> • Increase macroeconomic and exchange rate stability • Smoothen global economic adjustments, including reallocation of the region’s external savings to regional demand • Increase investment and growth in slower-growing economies 	<ul style="list-style-type: none"> • Make macroeconomic consultation and surveillance more effective by creating an Asian Secretariat for Economic Cooperation • Strengthen Asia’s short-term financing facility (Chiang Mai Initiative) • Cooperate in exchange rate and macroeconomic policy management
Making growth inclusive and sustainable	<ul style="list-style-type: none"> • Reduce poverty and income disparities • Improve social safety nets and provide support for the aged • Fight epidemics and mitigate the impact of disasters • Address environmental issues 	<ul style="list-style-type: none"> • Connect the poor to the thriving regional economy • Develop cost-effective social protection systems • Facilitate and manage labor migration • Protect regional health and safety • Make development sustainable

Source: Asian Development Bank.

Integrating production

Asia’s economic growth and the new economics of production networks are the principal driving forces behind regional integration, and make coherent regional policies especially important. The spread of subregional and bilateral trade negotiations reflects widespread

interest in regional cooperation, but such agreements are inevitably partial, and could even turn out to be counterproductive. This study argues that Asia has a vital stake in maintaining open markets that help to accommodate the global impact of its growth and that help to build truly integrated regional markets. Asia can achieve these goals with policies that:

- **Support the open global trading system.** Asia's continued success depends on an open, rules-based global system of trade and investment. The region should help lead the world in successfully concluding the Doha round and maintaining a framework strongly consistent with that of the WTO.
- **Pursue regional cooperation as widely and deeply as possible.** Asia's bilateral and subregional free trade agreements should be gradually absorbed into a deep, open, and region-wide trade and investment framework.
- **Provide guidelines for subregional trade policies and agreements.** Guidelines could help to ensure that subregional trade agreements recognize regional interests and prioritize sectors, such as agriculture, that have beneficial distributional effects.
- **Enhance regional connectivity.** The region needs world-class infrastructure—transport, communications, and energy systems—to connect its economies, and in particular to link its poorer economies and subregions to its economic centers.

Integrating financial markets

Asia has made impressive progress since the crisis in strengthening its national financial systems and building connections among them. Nevertheless, Asian financial markets remain relatively underdeveloped and are more closely linked to global markets than to each other. This study argues that effective regional financial cooperation could help Asia build larger, deeper, and more open financial markets. These goals can be achieved with policies that

- **Improve financial market surveillance.** A new, high-level “Asian Financial Stability Dialogue” is needed to bring together all authorities responsible for financial markets and regulation, to help support the development and stability of Asian financial markets.
- **Promote consistent standards and mutual recognition.** The region should identify best-practice policies to help countries improve prudential norms and financial supervision, as well

as minimum standards to facilitate mutual recognition, at least among subsets of economies.

- **Strengthen financial markets and infrastructure.** Official initiatives, such as the Asian Bond Markets Initiative and Asian Bond Fund, and a new regional infrastructure for credit enhancements, payments and settlements, and information exchange could promote deeper markets.
- **Liberalize capital accounts and cross-border financial-services flows prudently.** The integration of regional financial markets could be accelerated though measured and prudent liberalization of flows of capital and financial services.

Managing macroeconomic interdependence

The 1997/98 crisis highlighted the urgency of regional macroeconomic and financial cooperation. Since then, Asia's macroeconomic links have strengthened, although formal policy coordination has been limited. New mechanisms include currency swap agreements—the Chiang Mai Initiative (CMI)—and specialized forums for consultation on macroeconomic policy: ASEAN+3's economic review and policy dialogue (ERPD). At the same time, many Asian economies have been building large external reserves, and the region faces potentially large adjustments as the current global payments imbalances unwind. To meet these and other potential challenges, Asia's macroeconomic cooperation needs greater focus and a deeper institutional structure. These goals can be achieved with policies that:

- **Strengthen macroeconomic consultation and surveillance.** The region should consider establishing an “Asian Secretariat for Economic Cooperation” with qualified, permanent staff, to support the ERPD process, the CMI, and other mechanisms.
- **Enhance Asia's short-term financing facility.** The CMI would become more effective if its swaps were multilateral and its rules permitted more rapid activation. The Asian Secretariat could oversee CMI resources and manage the activation process.
- **Cooperate in exchange rate and macroeconomic policy management.** Cooperation could begin to intensify with understandings on the conduct of macroeconomic and exchange rate policy, and coordinated ad hoc actions in, for example, currency adjustments.

Making growth inclusive and sustainable

Economic policies that benefit a broad cross-section of the population need to be supplemented with policies that focus on opportunities for groups who fall behind. This study finds that poverty and exclusion can be reduced with labor market and infrastructure investment policies, with improved social safety nets, and with increased labor migration and better conditions for migrants. Concerted regional efforts are also needed to manage the negative side effects of development, including rising threats to health, safety, and the environment. These goals argue for initiatives that

- **Connect the poor to the thriving regional economy.** Relevant policies include eliminating regulatory, social, and geographical barriers in labor markets; promoting trade in sectors with a strong impact on poverty; and investing in infrastructure to link poor populations to economic centers.
- **Develop cost-effective social protection systems.** New technologies and policy instruments are making it increasingly affordable to provide cost-effective social insurance.
- **Facilitate and manage labor migration.** Labor migration can benefit both sending and receiving countries, and complementary policies can control its social side effects and ensure that migrants enjoy basic rights and are treated with dignity.
- **Protect regional health and safety.** Densely populated and closely integrated Asia needs world-class systems to monitor, prevent, and contain epidemics. Such regional “public goods” are critical for disease prevention and disaster management.
- **Make development sustainable.** Regional cooperation can help to mobilize Asian and non-Asian resources and technologies to limit environmental degradation and tackle cross-border environmental issues.

Creating an architecture for cooperation

The case for regional cooperation is compelling, but its agenda is complex and wide-ranging. Asia’s distinctive architecture of cooperation is gradual, flexible, multitrack, and multispeed—and is well-suited to the region’s diversity. Short of major new shocks, Asia’s architecture is likely to evolve step-by-step, with an emphasis on practical results. This evolution can be supported by policies that

- **Maintain a multitrack, multispeed architecture.** The region's cooperative efforts are best served by mechanisms that enable any group of countries, economies, or territories to join the integration process, while providing options for building deeper partnerships.
- **Strengthen institutional support.** An Asian Secretariat for Economic Cooperation (as proposed in Chapter 5), and other institutions should be established, as necessary, to provide consistent and highly professional support for regional integration.
- **Sharpen the focus and coherence of regional and global forums.** Asia needs to project a coherent voice in global institutions as well as regionally, and its cooperative forums need to work together to help implement regional objectives.

8.3. The challenge of leadership

Gradual, bottom-up cooperation has economic and political advantages; it also has risks, including possible inconsistencies among initiatives and slower progress than might be possible with a top-down approach. Which forces will generate momentum and pressure for deep and ambitious integration? Three groups of actors could: political leaders, regional institutions, and civil society. Ideally, all would play active roles in the “public diplomacy” of regional cooperation.

Political leaders are at the center of regional cooperation: they set its goals and implement its decisions. At the highest levels of government, the importance of regional cooperation is well accepted—Asian leaders have repeatedly and eloquently confirmed their commitment to work together. But they will need effective mechanisms to translate this intent into pragmatic results. The regional economy and regional cooperation initiatives are vital to most Asian economies. It is in each government's interest to prioritize national policy work that supports regional collective action, to appoint talented officials to lead it, and to empower them to use regional platforms creatively and wisely.

Institutions of regional cooperation are a second vital source of ideas and energy. The people who lead regional forums and manage nascent regional institutions are particularly knowledgeable about the challenges and opportunities of regional cooperation. With time and resources, they can provide insight into what should be done and how best to do it. But Asia's relatively undeveloped regional

institutions and cooperative mechanisms operate with very limited resources, often with staff members on short, temporary assignments from their governments. This makes it difficult to chart and pursue a well-defined, long-term strategy. Greater capabilities for planning and implementation could yield large benefits by helping to guide regional collaboration, as ASEAN has recently concluded. It has accordingly committed to strengthening the capacity of its Secretariat to oversee the implementation of the new ASEAN Blueprint.

Knowledge-generating institutions outside the official sphere can play an especially vital role. Ideas matter. Unlike governments, the region's think tanks and universities are ideally structured to conduct research and offer advice: they can focus on issues in depth, and over time. They are well-positioned to guide integration—provided they work closely with governments to ensure that their research addresses timely questions and receives high-level attention. The region greatly needs strong institutions and networks for policy analysis. It already has many (discussed in Box 8.1); they should be fully engaged in crafting the regional cooperation agenda. New institutions may also need to be established as gaps are identified

Last and most important, civil society needs to participate in and vigorously champion regional integration. Our survey suggests that opinion leaders throughout the region welcome international cooperation. All groups seem to share this perspective, including business executives; professionals in other fields; leaders of nongovernment organizations; experts in universities, laboratories, and research institutes; and political and economic analysts in the media. Their cross-border collaborations and friendships represent a key source of information and ideas on regional issues, and are vital to the future of regional cooperation. By fostering such contacts at all levels—through professional, academic, and cultural exchanges—countries can build powerful foundations for mutual understanding and cooperation.

Asian integration does not lack champions. Its energy comes from political leaders, business and other professionals, academic experts, and public intellectuals—representing many viewpoints and segments of society. The challenge for governments is to make space for the leadership of this broad coalition, to provide forums where its voice can be heard, and to make sure that its impact is felt in the pursuit of the integration agenda.

Box 8.1. Engaging the region's brain trust

Regional economic integration and cooperation is a knowledge-intensive process, requiring careful policy analysis. Asia has outstanding institutions to support this effort, including public, semi-public, and private organizations. To be sure, their contributions will need to be effectively focused, most likely by governments and intergovernmental forums. Large benefits can be reaped by drawing on these resources in the integration process, as regionalism requires the insights and support of Asia's economic and political leaders. Eventually, the work may need to be complemented by new organizations linked to specific regional policy institutions.

Research institutes

Most Asian countries have significant relevant capabilities in their major research institutes (some public, some private, some in between), of which at least one is typically focused on international economic issues. These institutes have begun to organize through regional networks—such as the Asian Policy Forum, the East Asian Bureau of Economic Research, and the Network of East Asian Think Tanks—in order to share ideas and research.

Universities

Asia is now home to many of the world's leading research universities. They too are joining regional networks, such as the Association of East Asian Research Universities and the ASEAN University Network. Their faculties and students represent exceptional assets for analyzing and debating regionalism. Programs that involve

leading centers of learning can bring powerful intellectual resources to bear on the subject of regionalism, and can help mobilize future leaders for the long-term project of building a regional community.

Business and nongovernment organizations

Business organizations, such as the ASEAN Business Advisory Council (the business arm of ASEAN) and many other regional business groups and nongovernment organizations can provide connections with the companies and communities directly affected by regional initiatives. Their participation in shaping the regional agenda will help to ensure that policies reflect the priorities of civil society, and that regionalism is positively received by the people whom it is intended to serve.

International organizations

Several global organizations have significant resources committed to analyzing the region. These include the International Monetary Fund (IMF), the Organisation for Economic Cooperation and Development (OECD), the World Bank, the agencies of the United Nations, and regional institutions such as the Asian Development Bank (ADB) and the Economic and Social Commission for the Asia Pacific (ESCAP). ADB's new long-term strategic framework, for example, identifies regional integration as one of ADB's priority areas of research and lending. These institutions have substantial expertise for project-oriented efforts, but could also play a sustained professional role in supporting regional forums and institutions.

8.4. A partnership for shared prosperity

It is easier, in some ways, to envision an integrated Asia many decades from now than to describe the more pragmatic and limited goals that might be reached by 2020. In the longer run, Asia is likely to have a single market subject to common regulations, a common currency, and substantial freedom of movement for workers—in other words, an environment not so different from that of the EU today. Asia is well placed to reap enormous benefits from the great diversity of its economies and peoples; its deep cultural heritage; the vast scale of its financial, technical, and other resources; and its joint ability to manage economic, social, environmental, and other threats. It will offer unrivaled opportunities for innovation, entrepreneurship, and commerce. And it will help subdue the political rivalries that could otherwise threaten stability.

A long-term vision can provide inspiration and offer guidance on the direction of change. But to inform immediate policy, the vision must be translated into steps that can—and should—be achieved in the near and medium term. The vision that motivates these steps has to be pragmatic. It must consist of realistic initiatives that show early, step-by-step results. This report has identified important options. By pursuing some of these, by 2020 Asia could have

- an integrated market free of restrictions on regional flows of goods, services, and capital;
- deep and liquid financial markets open to cross-border financial flows and services, with high standards of oversight and strong protection for national and foreign investors;
- effective frameworks to coordinate macroeconomic and exchange rate policies, taking into account global challenges and differing national circumstances;
- collective efforts to address vital social issues, such as poverty, exclusion, income insecurity, migration, ageing, health, and environmental threats;
- a consistent voice to project the concerns of Asian economies in global policy forums and enhance responsible global governance; and
- vital institutions, adequately and highly professionally staffed, to provide first-rate analytical and logistical support for these efforts.

The goals are challenging but achievable. Some should receive earlier attention than others; cooperation to ensure financial stability and the smooth adjustment to global imbalances are especially urgent.

Each step toward regional integration will require innovation, leadership, and support from major economies. Asia is poised to take these steps: its economies are sound and enjoy good relations with each other and other global centers. Appropriately, it is becoming more confident about the potential of Asian regionalism to contribute to both Asian and global welfare. All of this favors the emergence of a strong, prosperous, outward-looking Asian economic community, regionally integrated yet connected with global markets, and with responsibility and influence to match its economic importance. In short, emerging Asian regionalism is a partnership that can ensure the region's continued, peaceful progress, and help power its shared prosperity and that of the global economy.

