

ADB

Asian Economic Integration Monitor

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Asian Development Bank
6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
Tel +63 2 632 4444
Fax +63 2 636 2444
www.adb.org

For orders, please contact:
Department of External Relations
Fax +63 2 636 2648
adbpub@adb.org

This inaugural issue of the *Asian Economic Integration Monitor* (AEIM) was prepared by a team from the Office of Regional Economic Integration (OREI), which falls under the purview of the Vice President for Knowledge Management and Sustainable Development Bindu N. Lohani. The AEIM team included Iwan J. Azis, Noritaka Akamatsu, Ramesh Subramaniam, Lei Lei Song, Thiam Hee Ng, Takaaki Nomoto, Biswanath Bhattacharyay, Jayant Menon, Sabyasachi Mitra, Alisa Di Caprio, Haruya Koide, Shintaro Hamanaka, Karen Lane (Department of External Relations), Mitzirose Legal, Damaris Yarcia, and Maria Criselda Lumba. OREI's *Asia Regional Integration Center*, led by James Villafuerte with support from Michael Alba,

contributed data, research, and analysis. Guy Sacerdoti provided editorial assistance. Ariel Paelmo and Erickson Mercado did the typesetting, layout, and cover design.

How to reach us: Asian Development Bank
Office of Regional Economic Integration
6 ADB Avenue Mandaluyong City
1550 Metro Manila, Philippines
Telephone: +63 2 632 6302
Facsimile: +63 2 636 2183
E-mail: aric_info@adb.org

Download AEIM at: <http://www.aric.adb.org/aeim>

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Foreword

The vision of an integrated, poverty-free, prosperous, and peaceful Asia and the Pacific motivates Asian Development Bank (ADB) support for regional cooperation and integration (RCI) initiatives. In the wake of the 2008/09 global financial crisis, a “new normal” has emerged, with both the US and eurozone facing a prolonged period of structural reform due to poor economic fundamentals. The new normal stresses the need for Asia to rebalance its sources of growth toward domestic and regional demand. Asia’s robust growth—despite the recession in the eurozone and anemic recovery in the US—is in part due to increased RCI. Asia’s increasing importance in the global economy and its need to respond to crises without disrupting its economic transformation underscores the importance of RCI for the region’s sustained economic prosperity.

Indeed, RCI holds huge potential benefits for Asia and the Pacific. Deeper trade, better developed and integrated financial markets, seamless logistics and infrastructure are the foundations for new, sustainable and more inclusive growth. Better coordinated macroeconomic, financial, and trade policies are the parameters that help drive a more efficient and welfare-oriented Asia. Yet, RCI initiatives also carry costs and risks, particularly for smaller countries.

Asia and the Pacific has been a leader in RCI. Many subregional groupings have emerged to collaborate in boosting development for shared prosperity. ADB has supported RCI initiatives since the late 1980s, initially through knowledge sharing and, beginning in the mid-1990s, through technical assistance and loans focused on regional integration in the Greater Mekong Subregion and subsequently in East Asia, Southeast Asia, Central Asia, and South Asia.

A comprehensive and coherent approach was needed. The Board of Directors approved the RCI strategy in July 2006, detailing ADB’s role as catalyst, coordinator, and knowledge leader of RCI in Asia and the Pacific. In April 2008, ADB unveiled *Strategy 2020*, which identified regional integration as one of its three development agendas (along with inclusive growth and environmentally sustainable growth), with RCI as a core specialization and operational area.

Paralleling these efforts, ADB established the Office of Regional Economic Integration (OREI) in April 2005, to coordinate and support RCI initiatives by serving as a knowledge center and raising ADB’s profile as a key player in policy consultation and institutional capacity building for developing member countries as well as regional and subregional groups.

Given the still evolving nature of ADB’s RCI work, the *Asian Economic Integration Monitor* (AEIM) represents a significant milestone. This new semiannual series combines two important elements of ADB’s knowledge portfolio—regional economic and financial monitoring and RCI assessment. Intended to keep track of the region’s progress, the AEIM reviews recent economic performance, assesses new RCI developments in Asia and the Pacific and its subregions, and—in a special section—analyzes initiatives or events that will affect the process of cooperation and integration.

The AEIM evolved from the *Asia Economic Monitor* (AEM), which—since December 2001—continued the work of the *Asia Recovery Report* in monitoring the impact of the 1997/98 Asian financial crisis and policy response. The AEIM expands its coverage to all of Asia and the Pacific.

The AEIM also continues the work of a trilogy of studies conducted jointly by the Asian Development Bank (ADB) and ADB Institute—*Emerging Asian Regionalism: A Partnership for Shared Prosperity* (2008); *Infrastructure for a Seamless Asia* (2009); and *Institutions for Regional Integration: Toward an Asian Economic Community* (2010). The trilogy analyzes the process and progress of integration in promoting the vision of an integrated Asian economic community. By monitoring the region’s progress and sharing knowledge on RCI, the AEIM will help the region reach that goal in a manner that balances the benefits and costs of integration.

We hope the AEIM will promote knowledge sharing throughout Asia and the Pacific and its subregions. It supports both our thematic and sector work, and provides new research and analysis to help build partnerships among policymakers, regional and global think tanks, and regional institutions.

A handwritten signature in black ink, appearing to read 'H. Kuroda', written in a cursive style.

Haruhiko Kuroda
President, Asian Development Bank

Abbreviations and Acronyms

ABF	Asian Bond Fund	CROP	Council of Regional Organisations in the Pacific
ABMF	ASEAN+3 Bond Markets Forum	DMC	developing member country
ABMI	Asian Bond Markets Initiative	EAS	East Asia Summit
ADB	Asian Development Bank	EMEAP	Executives' Meeting of East Asia Pacific Central Banks
AEC	ASEAN Economic Community	ERPD	Economic Review and Policy Dialogue
AEIM	Asian Economic Integration Monitor	ESM	European Stability Mechanism
AEM	Asia Economic Monitor	EU	European Union
AFC	1997/98 Asian financial crisis	EU-15	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom
AFDM+3	ASEAN+3 Finance and Central Bank Deputies' Meeting	FDI	foreign direct investment
AFMGM+3	ASEAN+3 Finance Ministers and Central Bank Governors' Meeting	FTA	free trade agreement
AFMM+3	ASEAN+3 Finance Ministers' Meeting	FY	fiscal year
AFTA	ASEAN Free Trade Area	GDP	gross domestic product
AH	Asian Highway	GMS	Greater Mekong Subregion
AIF	ASEAN Infrastructure Fund	GSP	Generalized System of Preferences
ALTID	Asian Land Transport Infrastructure Development	GSTP	Global System of Trade Preferences
AMRO	ASEAN+3 Macroeconomic Research Office	G7	Group of Seven (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States)
AMU	Asian monetary unit	G20	Group of Twenty (Argentina, Australia, Brazil, Canada, the People's Republic of China, France, Germany, India, Indonesia, Italy, Japan, the Republic of Korea, Mexico, Russian Federation, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States, and European Union)
APEC	Asia-Pacific Economic Cooperation	HKMA	Hong Kong Monetary Authority
ARIC	Asia Regional Integration Center	HP filter	Hodrick-Prescott filter
ASEAN	Association of Southeast Asian Nations	IMF	International Monetary Fund
ASEAN+3	ASEAN plus the People's Republic of China, Japan, and the Republic of Korea	IMT-GT	Indonesia-Malaysia-Thailand Growth Triangle
ASEAN-4	Indonesia, Malaysia, the Philippines, and Thailand	IRTI	intraregional trade intensity
ASEAN-5	Indonesia, Malaysia, the Philippines, Singapore, and Thailand	ISTS	inter-subregional trade share
ASEM	Asia-Europe Meeting	ITA	Information Technology Agreement
BCLMV	Brunei Darussalam, Cambodia, the Lao People's Democratic Republic, Myanmar, Viet Nam	Lao PDR	Lao People's Democratic Republic
BIMP-EAGA	Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area	LHS	left-hand scale
BIMSTEC	Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation	MDG	Millennium Development Goals
CAREC	Central Asia Regional Economic Cooperation	MERCOSUR	Mercado Común del Sur (Southern Common Market)
CBTA	Cross-Border Transport Agreement	MFN	most favored nation
CGIF	Credit Guarantee and Investment Facility	MoPs	margins of preference
CMI	Chiang Mai Initiative	NAFTA	North American Free Trade Agreement
CMIM	Chiang Mai Initiative Multilateralisation	North America	Canada, Mexico, and the United States
CMIM-PL	CMIM Precautionary Line		
CPI	consumer price index		
CPIS	Coordinated Portfolio Investment Survey		

OECD	Organisation for Economic Co-operation and Development	SAEU	South Asian Economic Union
OREI	Office of Regional Economic Integration	SAFTA	South Asian Free Trade Area
PBOC	People's Bank of China	SASEC	South Asia Subregional Economic Cooperation
PMI	purchasing managers' index	SEACEN	South East Asian Central Banks
PNG	Papua New Guinea	SEANZA	South East Asia, New Zealand, and Australia central banks
PPP	purchasing power parity	TAR	Trans-Asian Railway
PRC	People's Republic of China	TOT	terms-of-trade
PWT	Penn World Table	UN Comtrade	United Nations Commodity Trade
q-o-q	quarter-on-quarter	UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
RBI	Reserve Bank of India	UNICEF	United Nations Children's Fund
RCI	regional cooperation and integration	US	United States
RIETI	Research Institute of Economy, Trade, and Industry	WTO	World Trade Organization
RHS	right-hand scale	y-o-y	year-on-year
ROW	rest of the world		
RSI	Regional Settlement Intermediary		
saar	seasonally adjusted annualized rate		
SAARC	South Asian Association for Regional Cooperation		
SAARCFINANCE	Network of central bank governors and finance secretaries of the SAARC region		

Unless otherwise indicated, all percentage comparisons are y-o-y.

HIGHLIGHTS

Regional Economic Update

- The external environment for Asia has worsened given Europe's continuing sovereign debt and banking crisis, and the weak United States (US) economic recovery.
- The weak external environment plus slower growth in the People's Republic of China (PRC) and India have lowered growth projections for developing Asia; GDP growth now forecast at 6.6% in 2012 and 7.1% in 2013.
- The economic outlook for developing Asia is subject to three major risks: (i) a deepening eurozone recession and slower growth in the US; (ii) destabilizing capital flows; and (iii) a larger-than-expected slowdown in the PRC.
- Asian countries should stand ready to take fiscal and monetary measures in case the eurozone financial crisis spreads more globally.
- Asia needs to continue its economic transformation in a "new normal" environment where advanced economies are undergoing long-term restructuring—and thus slower growth.

Progress in Regional Cooperation and Integration

- With the global economy immersed in double-track growth—emerging economies expanding faster than advanced countries—Asia is forging ahead in part due to increased regional integration.
- Asia is leading growth in global trade through increased openness, with intraregional and "South-South" trade growing faster than trade with traditional markets in the US and Europe.
- The depth of trade integration varies across subregions, with the emphasis on intermediate goods trade reflecting expanding regional production networks.
- Cooperation in trade policy has developed most effectively in Asia through a combination of unilateral actions. But some regional free trade agreements (FTAs) also help foster intraregional trade flows, with the number of FTAs involving at least one Asian country dramatically increasing over the past decade. The degree of trade integration will likely increase.
- Asia's financial integration lags behind trade integration. The region's financial markets remain more integrated through global markets than among themselves, but signs since the 2008/09 global crisis show financial integration has accelerated; yet subregional variations remain significant.
- With double-track growth and greater cooperation to ease cross-border flows within the region, the degree of financial integration in Asia is likely to increase.
- As financial integration can also raise the risk of contagion in the event of a shock, regional cooperation is needed to manage the process. Given the uncertainty in global financial conditions—and the growing risks of a contagion-driven crisis, even for Asia—existing cooperation on financial safety nets needs to be strengthened.
- The 2008/09 global financial crisis provided further impetus to regional macroeconomic and financial cooperation in Asia—through dialogue processes, regional financial safety nets, and developing bond markets.
- Internationalizing the renminbi is likely to boost regional cooperation and integration, particularly in East and Southeast Asia.
- Together with national financial market deepening, greater financial integration can support the need to better intermediate Asia's vast savings within the region to help close the infrastructure gap.
- Indeed, Asia's infrastructure gap is huge, requiring more cross-border connectivity to strengthen intraregional trade and regional demand.

- In addition to physical infrastructure, for effective connectivity Asia needs to strengthen its soft infrastructure—policy, legal, regulatory and institutional frameworks, along with systems and procedures.
- International transmigration—including labor mobility within Asia—is increasingly important as migrants contribute to growth both in host economies and via remittances back home.
- Migrant stock data show that, while increasing between 2000 and 2010, intraregional migration remains low; Asian migrants increasingly move to countries outside Asia.

Regional Integration: A Balanced View

- Like any policy and strategy, the goal of integration must be an improvement in welfare and quality-of-life—both within and across countries.
- Regional integration can expand markets and input sources, better allocating resources across the region, thus accelerating economic growth. It can also improve risk-sharing. But there are also downside risks, ranging from potential contagion to growing income inequality and polarization.
- While the level of Asia’s financial integration may have increased, its benefits in terms of consumption and investment risk sharing have been limited. Closer economic links helped reduce income disparities across Asia, but inequality within countries has risen. Large portions of Asia’s population do not benefit from increased prosperity.
- The cascading effect of the ongoing eurozone crisis is a vivid reminder of the contagion risk of systems overly integrated, where some pre-conditions are not in place.
- While collective regional policies have their merit, unilateral policies can benefit individual countries and the region; it remains important to use national policies to maintain the integrity of domestic institutions.

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The Asian Economic Integration Monitor is a semiannual review of Asia's regional economic cooperation and integration. It covers the 48 regional members of the Asian Development Bank. This issue includes a special section—Regional Integration: A Balanced View.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.8 billion people who live on less than \$2 a day, with 903 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

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