



Regional Cooperation and Integration – a Balanced View

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Regional Integration— Key Messages

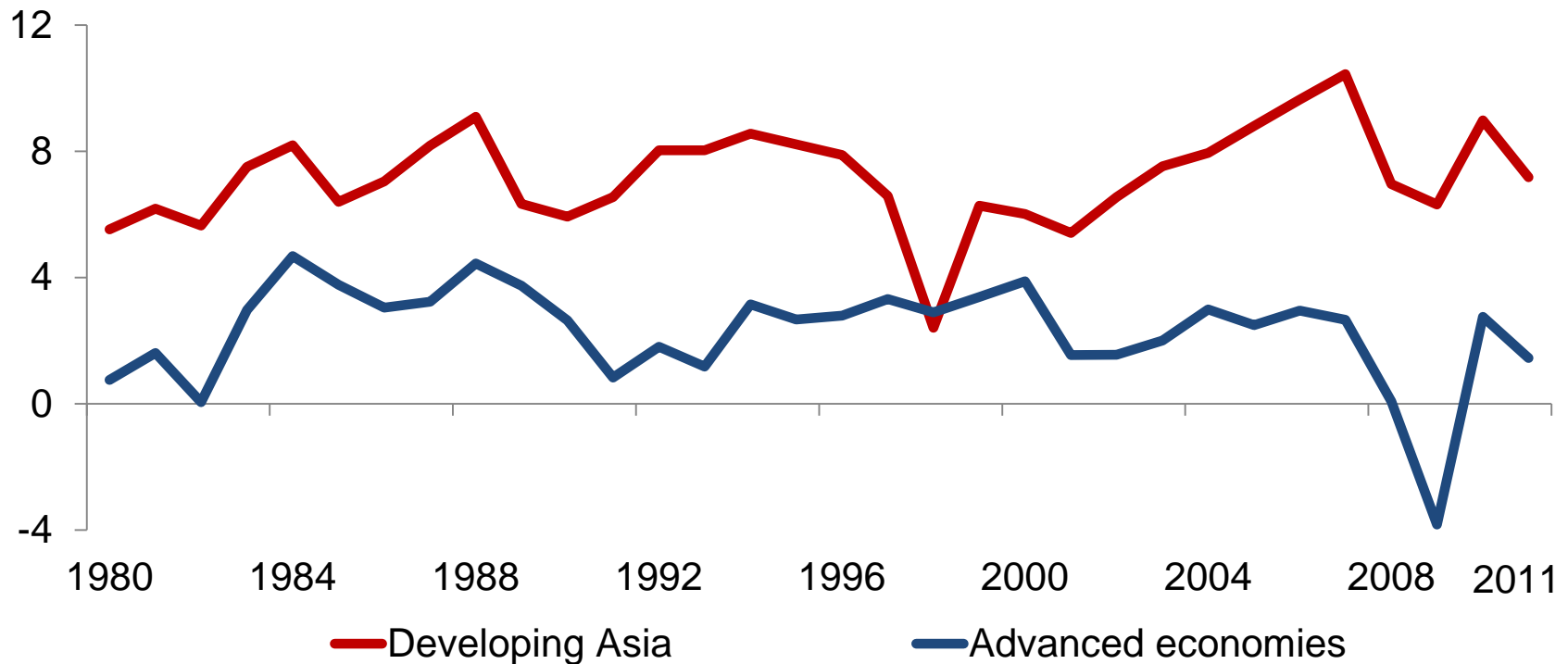


- Weak global growth will likely strengthen rebalancing from external to domestic and regional demand in Asia.
- A “Double-track” growth will continue with Asia forging ahead through flows of trade and finance; increased labor mobility and cross-border infrastructure, and increased cooperation efforts in several fronts.
- Greater regional integration will likely bring benefits as well as costs; such that greater cooperation efforts will be needed to mitigate adverse impacts, limit potential risks and maximize economic benefits.

Asia's economy will surge due to regional cooperation and integration



Double-track growth: Real GDP growth (%)



Note: Developing Asia refers to ADB member countries. Advanced economies includes Australia, Canada, European Union, Japan, Israel, New Zealand, Norway, Switzerland, and United States. Weighted using gross domestic product (current international dollar, PPP). Source: *Asian Development Outlook 2012*, ADB, for GDP growth of developing Asian economies; and *World Economic Outlook April 2012 Database*, IMF.

Progress of regional cooperation and integration in Asia



- Market driven, bottoms-up, multi-speed and multi-track.
- In contrast to European model which is institution heavy, based on political and legal integration, and a grand scheme to create a single market for the region.
- Given the differences in RCI model, the Eurozone crisis should not detract Asian policymakers from cooperating closely.

Progress of regional integration in Asia (2008–11 from 2000–07)



	Production Network and Trade		Capital Markets		Macro-economic Links	Transmigration	
	Intra-regional FDI (%)	Intra-regional Trade (%)	Intra-regional Equity Holdings (%)	Intra-regional Bond Holdings (%)	Intra-regional Output Correlations	Intra-regional Tourism (%)	Migrant to Population Ratio ¹ (%)
Asia	50.08 ▲	55.02 ▲	24.98 ▲	6.36 ▲	0.36 ▲	81.07 ▲	0.51 ▼
Central Asia	0.02 ▼	5.33 ▼	---	---	0.35 ▲	32.20 ▲	1.56-
East Asia	41.81 ▲	36.17 ▼	17.65 ▲	2.84 ▲	0.59 ▲	75.32 ▲	0.26 ▲
Southeast Asia	6.32 ▼	24.61 ▲	9.54 ▼	9.49 ▼	0.70 ▲	69.69 ▲	0.66 ▲
South Asia	0.03 ▲	4.61 ▼	---	---	0.04 ▼	13.17 ▼	0.47 ▼
The Pacific and Oceania	1.91 ▼	8.05 ▼	---	---	0.46 ▲	2.43 ▼	0.09 ▼

▲ = increase from 2000-2007 average; ▼ = decrease from 2000-2007 average; -- = data unavailable.

¹ Data are insufficient to conclude progress of intraregional migration in Central Asia and inter-regional migration from Central Asia to other Asian regions due to unavailability of similar data for 2010.

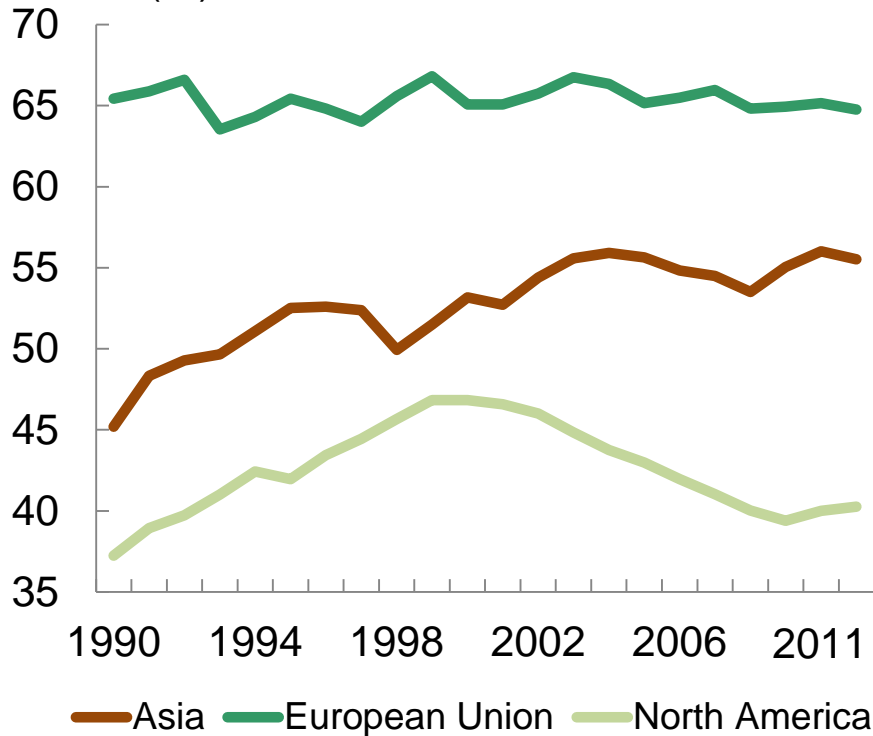
Trade Integration

- Has progressed in Asia through market forces and unilateral actions rather than coordinated regional efforts
- Reflects the growth of regional production networks with PRC as manufacturing hub.
- Strengthened after 2008 in part due to macroeconomic stimulus which helped income and demand to rise in the region.
- Role of FTAs unclear as take up remains low and costs of noodle bowl effects still a concern

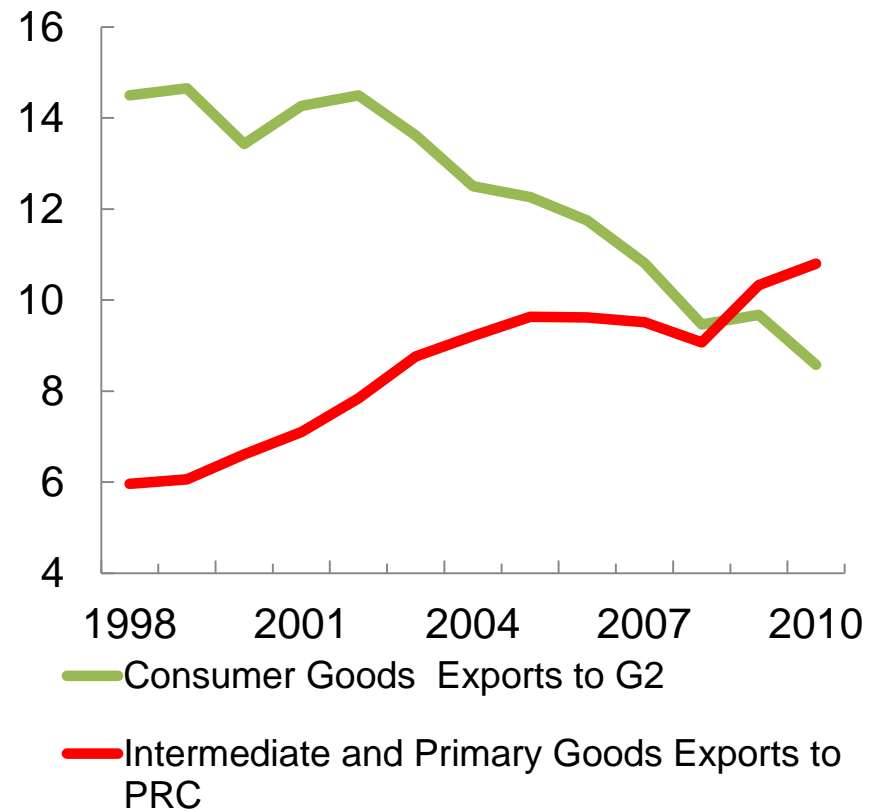
Rising trade integration reflects expanding regional production networks



Intra-regional Trade Share—World Panel (%)



Exports to G2 and PRC—Asia (% of total exports)



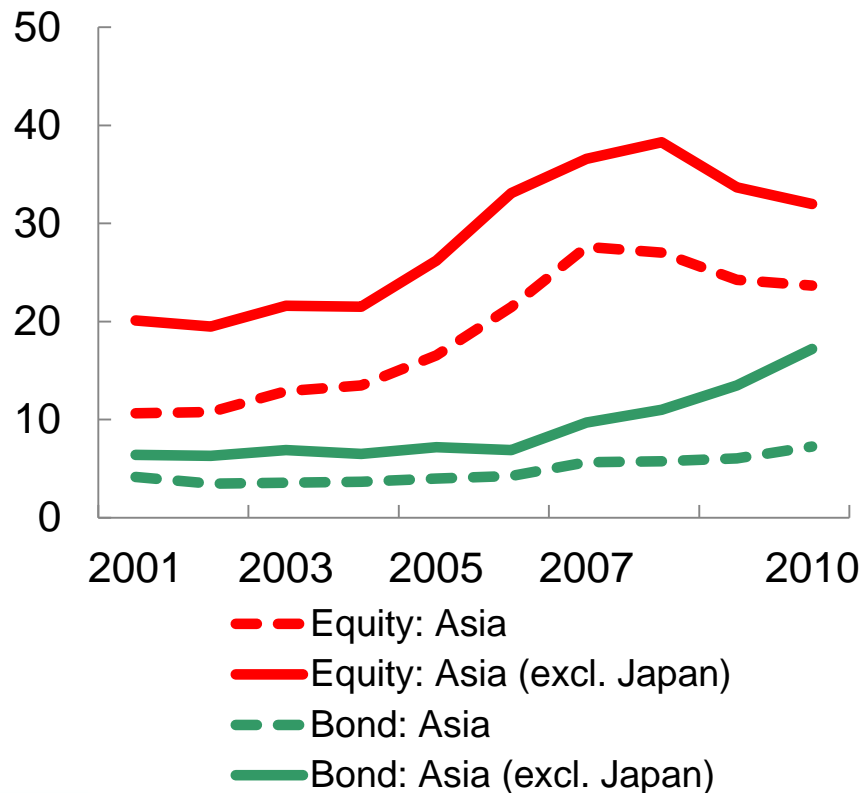
Financial integration

- Financial integration lags behind trade...
 - Financial markets remain more integrated with global markets;
 - sub-regional variations are significant
- but likely to increase with double-track growth, uncertain and volatile global capital market, and greater cooperation to ease cross-border flows
- Higher regional lending from Japanese banks after the global financial crisis counter European bank deleveraging and cushioned the region from adverse impact
- Greater financial integration raises risk of contagion
 - Should be managed through regional cooperation to strengthen regional financial safety nets and infrastructure

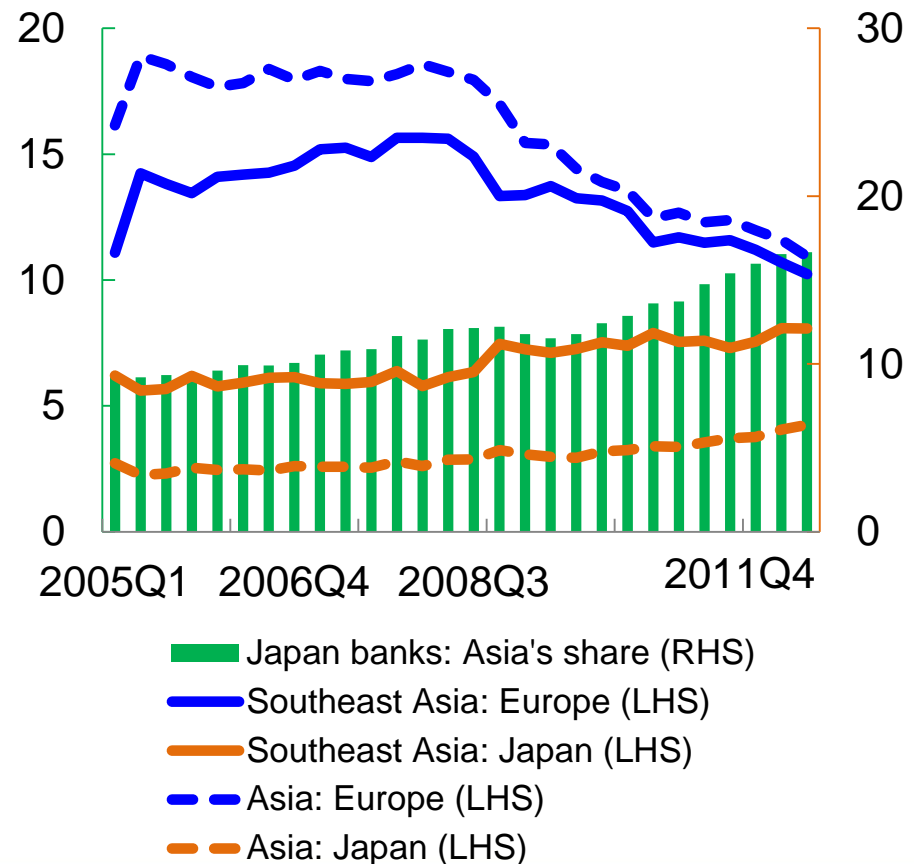
Intraregional equity and bond holdings increases — and Japan substitutes for deleveraging Europe



Intra-Asia holdings of equity and bonds
(investment source,% share)



Japanese and European Banks' foreign claims in Asia (% share)



Macroeconomic and financial cooperation efforts in Asia are up



- The global financial crisis ignited more dialogue, enlarged regional financial safety nets, and deepened bond markets
 - Economic Review and Policy Dialogue
 - ASEAN+3 Macroeconomic Research Office
 - CMIM
 - ABMI
- Internationalizing the renminbi will likely boost regional cooperation and integration in East and Southeast Asia
- Emerging cooperation in South Asia: SAARC swap facility

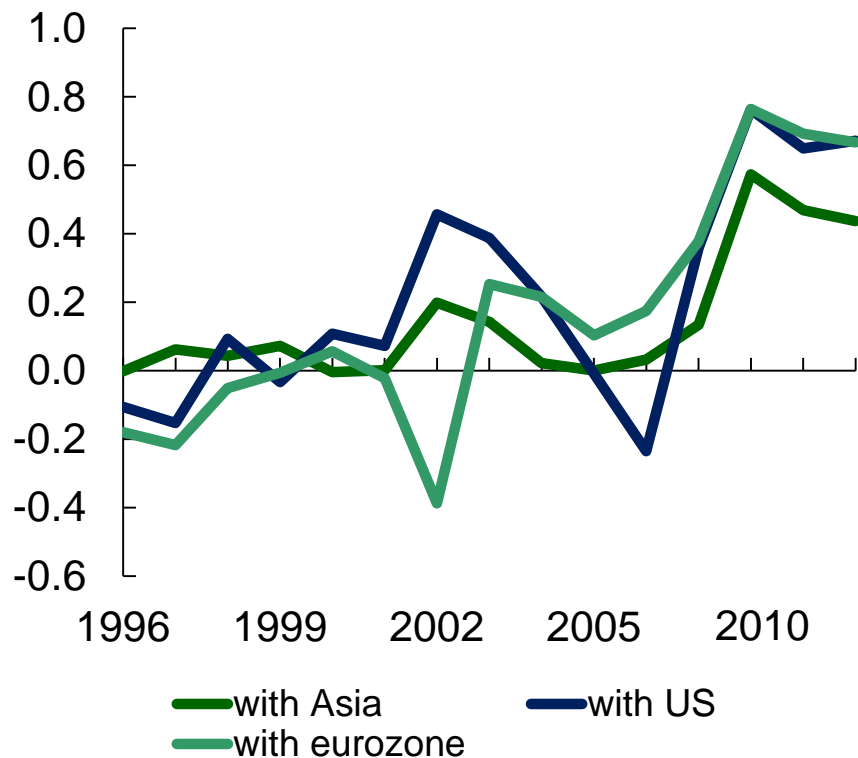
Macroeconomic interdependence

- Output correlations have gone up sharply during 2008/09 global financial crisis broadly reflecting the impact of global shocks
- Convergence and Polarization:
 - Income disparities narrow between countries, especially with strong growth in PRC and India
 - But within countries inequality increases within countries (polarization)
- Closer trade, investment, and financial ties will likely increase interdependence

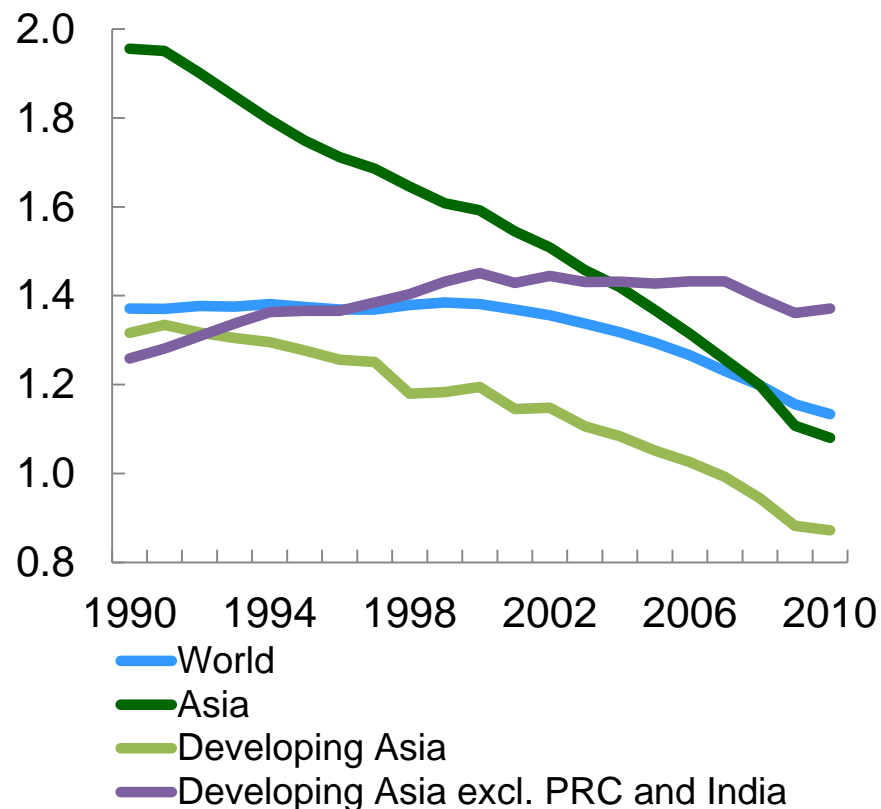
Rising correlations suggest greater interdependence and declining income dispersion



Output Correlations—Asia



Income Dispersion—World, Asia, and Asia Sub-regions (coefficient of variation)



International and regional transmigration

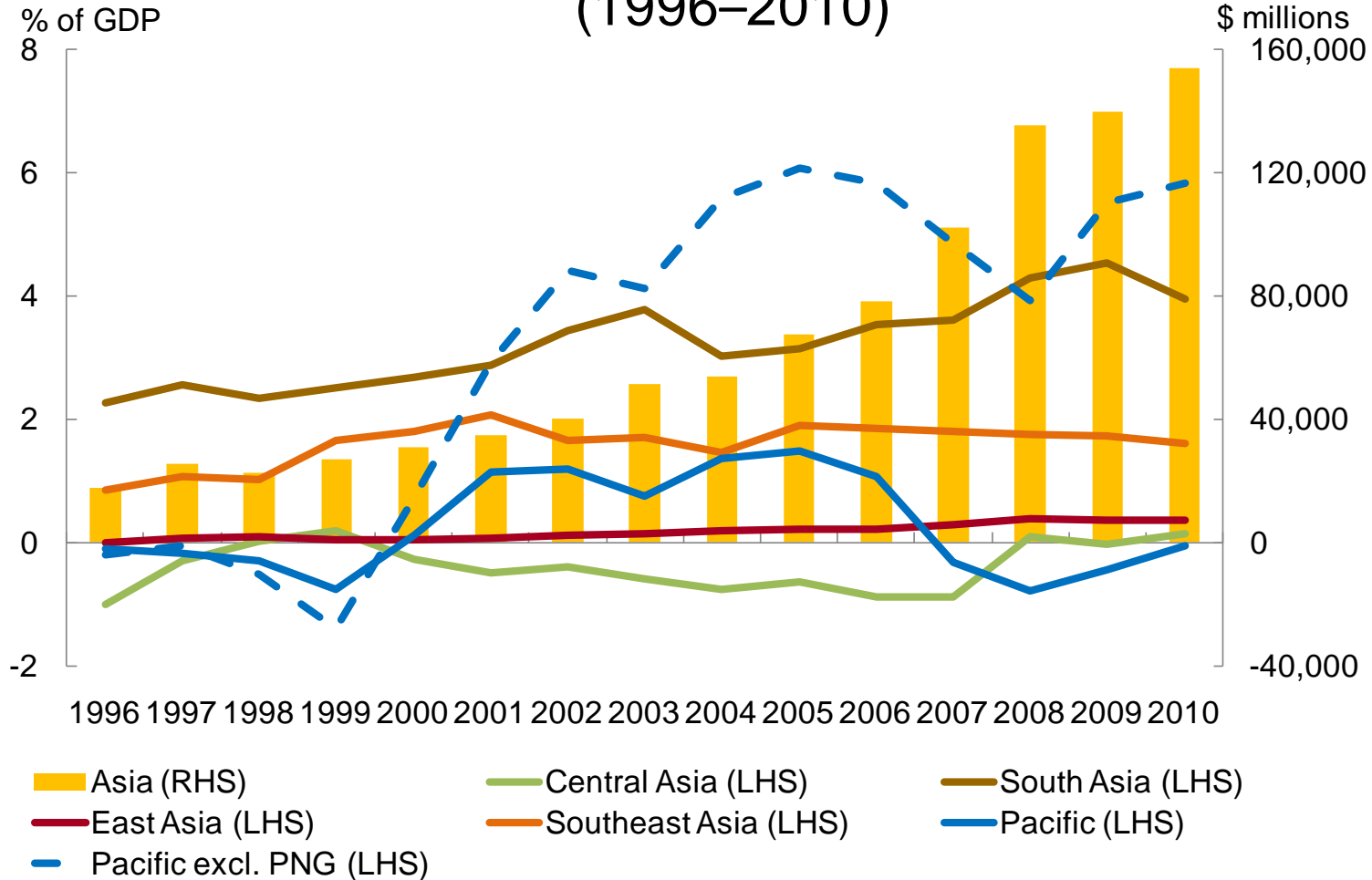


- Migrants contribute to growth both through host-country productivity and remittances back home.
- Regional transmigration still low; migrants increasingly favor markets outside Asia.
- If one looks at remittances and tourism flows, however, labor mobility has progressed strongly.
- Largest remittance inflows go to large countries but dependence is highest among landlocked and small island economies

Remittance flows increasing



Net Remittance Inflows to and from Asia (1996–2010)



Infrastructure connectivity

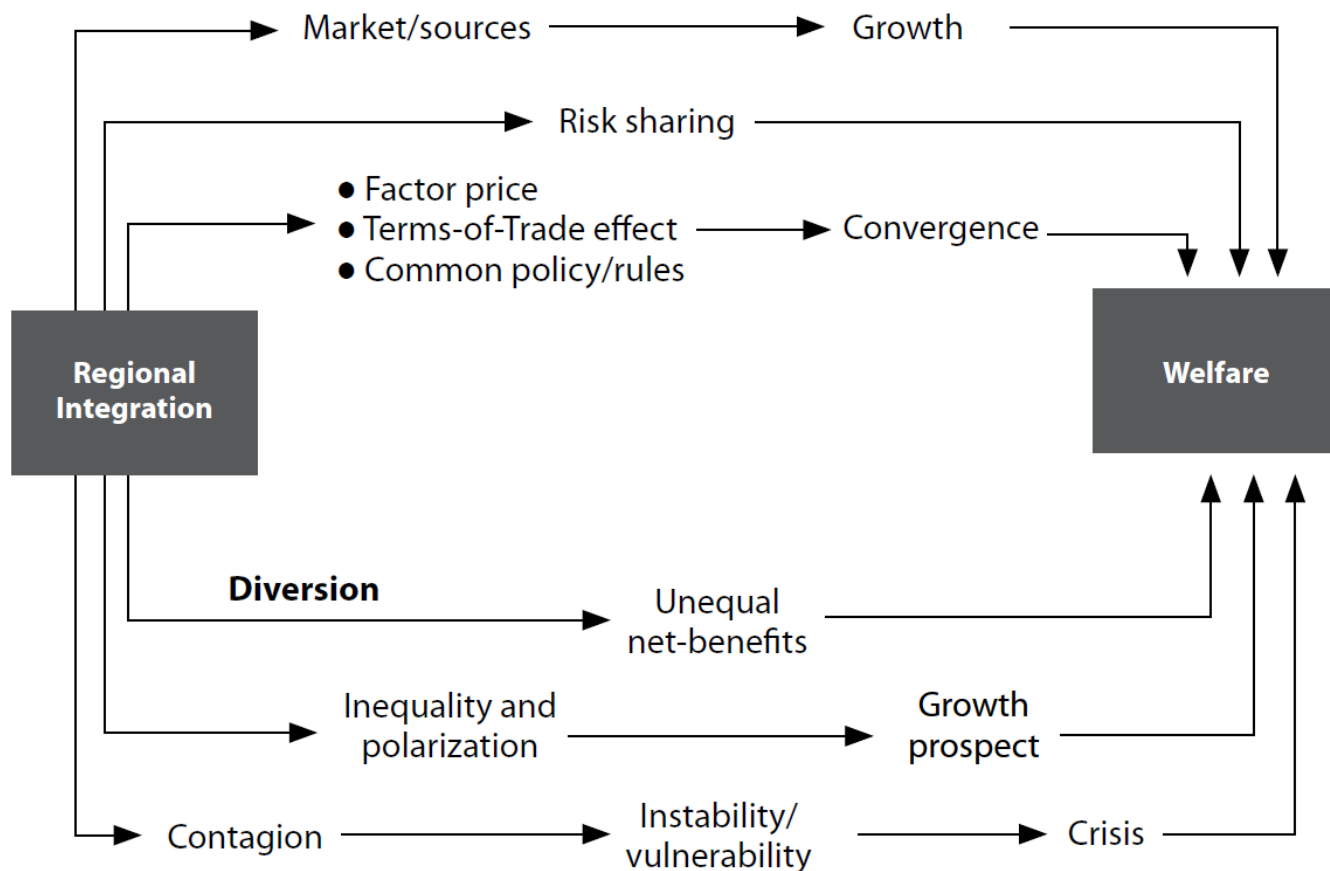
- Infrastructure connectivity provides the backbone for economic integration and sustained economic growth.
- Infrastructure investment in Asia has not kept pace with growth and the infra gap is huge.
- While some existing infrastructure in Asia is world class, most of it remains below average
 - Asia is poorly connected with few links between national and regional roads
- Asia also needs to strengthen its soft infrastructure—policy, legal, regulatory and institutional frameworks along with systems and procedures.
- Asia's excess savings can help close the infra gap
 - Development of local currency bond market is important

Cooperation and Integration: A Typology



	Cooperation	Non-Cooperation
Integration	Infrastructure/ connectivity (e.g. GMS, CAREC)	Unilateral trade liberalization (regional production network)
Non- Integration	ABMI and regional financial safety net (CMIM)	Unilateral financial sector liberalization

Impact of Integration



Source: Office of Regional Economic Integration, ADB.

How can integration work for Asia?



Regional integration has costs and benefits

– **Benefits:**

- Expands markets for goods and inputs thereby improving resource allocation and productivity
- Improves risk-sharing
- Reduces income disparities between countries

– **Costs:**

- Contagion-driven crisis
- Trade diversion
- Rising domestic inequality and polarization

How will integration work?

- Better and effective regional cooperation
- Managing risks and minimizing costs

Some Caveats:

- The goal of integration should be improvement in welfare and quality of
- Welfare system can help lower inequality
- Unilateral policies can benefit both individual countries and the region
 - National policies are important to maintain integrity of domestic institutions