14. Deepening Asian integration and the architecture for regional cooperation

Peter Drysdale

The case for greater regional cooperation in Asia is clear. Less so is the form that it should take. Asia's huge diversity and complex politics argue for pragmatism and flexibility in the scope, speed, sequencing and style of economic cooperation. Different groups of countries may wish to collaborate in various policy areas to varying extents; overlapping subregional groups may coexist comfortably with broader regional ones. But Asia's growing integration and importance in the world economy also require more ambitious, comprehensive efforts in cooperation. An Asian single market is hugely preferable to a tangled web of preferential trade agreements, for instance. And if Asia is to play a role in global economic decision-making commensurate with its growing importance, it must increasingly act together – not just for its own sake, but also for the world's sake. The future of the system of open world markets on which regional and global prosperity rest may depend on it. This became more and more abundantly clear as the global financial crisis unfolded through 2008.

Global and regional institutions will need to accommodate the rise of the People's Republic of China (PRC) and India, while ensuring that smaller economies – notably those of ASEAN – have an important stake in both of them. The PRC is already Japan's largest merchandise export market, and in the next 20 years it will become the top export market for every East Asian economy. The rise of the PRC and India presents huge opportunities, as well as risks and challenges. Building a regional architecture that sustains growth and closer economic integration with the PRC and India while also managing any accompanying risks is a major priority. Regional institutions cannot be built independently of antecedents and context – ASEAN's role and history are central in both.

The rapid growth of the PRC and India – and that of Asia as a whole – will have a large impact on the structure of world and regional output as well as regional and world trade. Increased Asian incomes will raise

Figure 14.1 Projected world trade shares by region (%)

the region's share of world trade. Projections developed for this chapter suggest that Asia's share of world trade could rise to 36 percent in 2020, while North America's could drop to 15 percent.¹ East Asia's share of world trade could reach 34 percent, exceeding that of North America and even Europe (Figure 14.1). The PRC's could be nearly 15 percent – and even more if its trade is measured to include Hong Kong, China net of intra-Hong Kong, China–PRC trade. Clearly, Asia will have a significant stake in keeping global markets open – and if it acts together, it will have considerable leverage in global economic forums.

Certainly, the gains from regulatory reform could be substantial. Dee (see Chapter 4 of this volume) finds that the gains from wide-ranging national behind-the-border reforms would exceed those even from global trade reforms. If governments were able to substantially reform regulatory systems in Asia – a significant economic, technical and political challenge – the annual welfare gains (in 2001 US dollars) would amount to \$116.9 billion for ASEAN+3² and \$128.1 billion for ASEAN+6.³

Behind-the-border reform, of course, is closely linked to, and reinforces, trade and financial reform. Yet progress with behind-the-border regulatory reform cannot easily be negotiated within any current international or regional forum. It is seen as a task for action by national governments. But there are institutional settings at a national level in which progress is more likely to be made, and there is a key role for regional cooperation and capacity-building to strengthen policy-making institutions and encourage common purpose in the pursuit of regulatory reform. This is a major new

agenda for regional cooperation. Efforts on this and other fronts provide an incentive for institutional innovation in the strengthening of the East Asian regional cooperation architecture.

What shape might an Asian economic community that seeks to promote reform and growth, and to help manage growing regional interdependence in a global context eventually take? One possibility is focused on East Asia narrowly defined, such as ASEAN+3. Another encompasses a broader conception of regional interdependence that includes India and Australasia, such as the East Asian Summit (or ASEAN+6) process. The broadest is trans-regional in character, such as Asia Pacific Economic Cooperation (APEC), which includes North America and some Latin American countries, as well as Russia.⁴ This chapter assesses the merits of these arrangements in managing various dimensions of regional cooperation – trade, investment, infrastructure, finance and money, energy and environment, health and safety – and Asia's global role and responsibilities. It concludes that Asia's economic and political circumstances favor an eclectic approach to regional cooperation, employing the principle of 'flexible and variable geometry'. Different arrangements are likely to continue to make an important contribution to regional prosperity and stability in different areas, but the time is now right to commit to building a stronger East Asian Community, most importantly because closer coordination between East Asian economies is needed to effectively manage the region's role in global economic affairs.

14.1 REGIONAL ECONOMIC ARCHITECTURE

East Asia is already a key engine of global growth. It has contributed 43 percent of the world economy's growth since 2000 and is responsible for over a quarter of world trade growth since 2003. It is projected to account for 25 percent of global growth and 59 percent of world-trade growth from 2005 to 2020.⁵ These outcomes are likely, more so because of the impact of the global financial crisis on regional and world growth in the near term. These changes will put pressure on existing regional and global arrangements.

How can regional arrangements help develop trade and economic policies that promote Asia's economic growth? What regional structures are needed to promote financial development and cooperation, develop essential infrastructure, and cope with the energy and environmental issues associated with rapid industrialization? Does the nature of Asia's economy and its place in the global economy allow all these issues to be dealt with in a single comprehensive regional arrangement? How can

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regional architecture be strengthened in the face of the challenges presented by Asia's continuing rise?

The existing architecture includes a variety of institutions, mechanisms and frameworks for collective action, on several layers from the subregional – such as the Greater Mekong Sub-region programs – to the regional, such as ASEAN, ASEAN+3 and ASEAN+6, and the trans-regional, such as APEC and the Asia-Europe Meeting (ASEM), each with different roles and functions.

While Asia's institutions for economic cooperation remain underdeveloped, the region's policy dialogue arrangements are evolving rapidly. An expanding network of forums, groupings and informal contacts bring the region's leaders, officials, businesspeople, researchers and civil society together. The main established groupings are ASEAN, ASEAN+3, the East Asia Summit (EAS) and APEC. They are distinctive, mutually reinforcing elements of the wider regional economic architecture.

Given its history, scope and institutional development, ASEAN remains the core of broader regional arrangements. It is integral to all of them and has a denser network of cooperative institutions, including a formal commitment to building an ASEAN Community (Box 14.1). While the approaches of individual members differ – some are less committed to the disciplines of regional association than others – all want to secure a role for ASEAN in any regional architecture. ASEAN is distinguished by its outward orientation toward the rest of Asia and the global economy. The main ASEAN economies are not only the most open economies in East Asia but also among the most open economies in the world (Armstrong et al. 2008). ASEAN is also the linchpin of the security-focused ASEAN Regional Forum (ARF). Although not an alliance framework, ARF has a very broad membership and is a confidence-building arrangement based on consensus decision-making and minimal institutions.⁶

ASEAN+3 was formally established in 1999, after the financial crisis shook Asian confidence in global institutions, particularly the International Monetary Fund (IMF), but also the World Bank and the World Trade Organization (WTO). Its intellectual origins lie in earlier ideas, such as former Malaysian prime minister Mahathir Mohamad's proposals in 1990 for an East Asian Economic Group or Caucus. It has established a dense network of meetings across 16 broad-ranging areas of cooperation, including economic, monetary and financial matters, politics and security, tourism, agriculture, the environment, energy, and information and communications technology.

The Shanghai Cooperation Organization (which brings together the PRC, Russia and its central Asian neighbors), is a model, like ASEAN+3, to which the PRC was attracted. It provides Beijing with a sense of intimacy and

BOX 14.1 ASEAN'S CENTRAL ROLE IN THE INTEGRATION ARCHITECTURE

The Association of Southeast Asian Nations (ASEAN) has been at the hub of wider economic cooperation and integration within East Asia and across the Pacific. It is a central element in shaping economic cooperation throughout Asia. Although most of ASEAN's ten member economies are relatively small, together they are an economically significant bloc. Since its inception in 1967, ASEAN has grown in size and influence in the region and globally. In geopolitical terms, it plays the role of reliable and equal Southeast Asian partner, linking to many larger, more powerful economies and groups. ASEAN economies were the anchor in the establishment of Asia Pacific Economic Cooperation (APEC) and later in the launch of ASEAN+3. ASEAN is also the coordinating point for the East Asian Summit (EAS, or the ASEAN+6 process). ASEAN members have been the major focus in the rapid expansion of free trade agreements (FTAs) across Asia and the Pacific. If these arrangements are to be pulled together into an East Asian FTA, drawing together ASEAN, ASEAN+3 and potentially all EAS members, ASEAN is key to success. Given its experience in regional consultation and the principles that it has applied in addressing common issues and concerns, ASEAN is a natural vehicle for promoting the consolidation of regional cooperation in Asia more broadly. ASEAN itself stands to gain as a community by becoming a center for expanding regionalism. There is an evolving common agenda to guide it forward, based on a shared commitment to adaptation, reform and action.⁷

The signing of the ASEAN Charter in Singapore in November 2007 was a significant milestone in the evolution of the organization. Consensus remains an important principle in ASEAN-style cooperation. Pragmatism, and acknowledgement that national economic development and national priorities vary, particularly between the original ASEAN five and the newer, less-developed economies that joined in the past decade, are elements on which cooperation within the group have to continue to be based. However, the new Charter poses the challenge of shifting ASEAN's institutional framework toward a more rules-based approach.

The new Charter serves ASEAN in three interrelated ways: (i) it gives ASEAN a formal legal personality; (ii) it establishes greater

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institutional accountability and a system for compliance; and (iii) it commits ASEAN to a regional role in the future of Asia and the Pacific and toward East Asia integration. The Charter calls for a people-oriented ASEAN; the establishment of an ASEAN human-rights body; and gives an enhanced role to the ASEAN secretary general and secretariat. The new Charter also provides a way to 'sell' ASEAN to all of the region's 500 million people, to build the concept of 'ownership' across ASEAN borders.

ASEAN has identified priorities in building a single market and competitive production base that is fully integrated into the global economy by 2015. The plan is designed to increase the dynamism of the ASEAN economy with new measures for strengthening existing economic initiatives, accelerating regional integration in priority sectors and easing the movement of business personnel and skilled manpower. It aims for a level playing field within the community, applying international standards and best practices and respect for intellectual property rights. Integrated transportation, telecommunications and energy infrastructure are priorities. And growth with equity is to be enhanced, accelerating the integration of Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam through the 'Initiative for ASEAN Integration'.

engagement with its immediate regional neighbors, and gives it more sway over regional developments than is possible in the larger organizations.

The East Asia Summit – ASEAN+6 – includes India, Australia and New Zealand as well as the PRC, Japan and Korea. Although the core membership remains East Asian, the PRC's weight is balanced by the presence of other countries. India, the other emerging Asian power, is keen on this broader model, which gives it a seat at the East Asian table (see Chapter 12 in this volume).

Other bodies stretch beyond the East Asian region. APEC, which was established in 1989, initially focused on economic issues. But its agenda has broadened in recent years to include human security issues. It engages the United States, as well as the Latin American countries of the Pacific littoral, and Russia, giving them a stake in this growing area of the world. Its geographical compass was the Pacific – at least until recently, when discussions about admitting members such as India began. ASEM is a forum for trans-regional dialogue with Europe, that meets every two years for informal discussions on a range of economic and social issues.

Figure 14.2 maps the membership of the three main regional arrangements

Note: Not all individual members of the Association of Southeast Asian Nations (ASEAN) are members of Asia Pacific Economic Cooperation (APEC) but the core ASEAN membership, including the ASEAN five and Viet Nam, are included and ASEAN collectively plays a key role in APEC.

Figure 14.2 Regional architecture and membership

across Asia and the Pacific, with their overlapping boundaries centered on ASEAN. Figure 14.3 describes the issues on which each arrangement has primarily focused and provides a picture of how their cooperative activities complement each other.

14.2 REGIONAL GOALS AND GLOBAL INTERESTS

Asia's growing weight and importance in the global economy requires that regional arrangements be shaped with global objectives and interests in mind. Asia's best choice remains a regional framework structured to help it deliver on its global interests. The major East Asian powers are already important global economic players. Their pursuit of trade and investment objectives, their impact on international financial developments, their role in the global macroeconomy and the effect of their growth on the environment all have global ramifications and need to be negotiated globally. Thus far, East Asia has lacked the coherence to pursue these global agendas. This is starkly obvious in the context of the 2008/09 global financial and economic crisis. East Asian economies are key players in the

Note: Free Trade Area of the Asia-Pacific Region (FTAAP) and the East Asia Free Trade Agreement (EA FTA) are policy strategies under consideration by Asia Pacific Economic Cooperation (APEC), the Association of Southeast Asian Nations plus People's Republic of China, Japan and Republic of Korea (ASEAN+3), and the East Asia Summit (EAS) respectively.

Figure 14.3 Regional architecture and agendas of cooperation

response to the crisis but, despite their representation in the Group of 20 (G-20)⁸ and related processes, none of East Asia's regional organizations has served to deliver an effective East Asian response to the crisis.

What of seeking regional integration through preferential trade arrangements (or FTAs) in Asia? The creation of a regional FTA along the lines of the North American Free Trade Agreement is sometimes seen as a necessary first step in effective Asian regionalism. In Europe, the common market preceded the Community, the Single Market and the Union.

In the most recent and comprehensive review of FTAs in East Asia, Kawai and Wignaraja (2007) make the case for extending existing bilateral and plurilateral arrangements to a regional one involving either the ASEAN+3 or the EAS economies. Either, they say, would strengthen regional integration and greatly improve on the tangled web of bilateral arrangements, the latter somewhat more so than the former. Meanwhile, they argue, measures to enhance the quality, WTO consistency, coverage and depth of regional FTAs are called for (ADB 2008: Chapter 3). Like

Lee et al. (2006) and others, Kawai and Wignaraja see ASEAN as the natural core of an East Asia-wide arrangement, and collaboration between the PRC and Japan as critical to progress toward such an arrangement. They conclude by noting that the USA, which has political as well as economic interests in the evolution of East Asian trade arrangements, has put forward a competing proposal for a trans-Pacific FTA (Free Trade Area of the Asia-Pacific Region, or FTAAP).

The negotiation of a tight arrangement exclusive to East Asian economies, in the form of an East Asian Free Trade Area, would present considerable economic and political challenges (Soesastro 2007a, 2007b). But if multilateral negotiations at the WTO were to offer no prospect of progress over the next decade or two, a regional trade bloc may begin to look like an attractive option, however preferable resisting that option and pressing ahead with unilateral trade liberalization might be.

Yet the evolution and success of East Asian cooperation need not stand or fall on early negotiation of a comprehensive preferential trade agreement. An outward-looking, open Asian regionalism can reconcile the twin aims of fostering closer regional integration while deepening connections to the global economy. Moreover, Asian regionalism is more likely to succeed if it is encompassed within a framework of international organizations that strengthens the region's capacity to exercise leverage globally and encourages continuing engagement with the USA – and globally in multilateral negotiations. The biggest economic relationship in East Asia – that between the PRC and Japan – has continued to prosper, despite the ups and downs in bilateral political relations between the two Asian economic giants, precisely because it is conducted within the framework of global commitments and arrangements (Drysdale 2008).

The PRC and Japan will have more comfortable relationships with each other, as well as with other powers in the region, large and small, the more open these relations are. An East Asian framework (founded on ASEAN+3 or ASEAN+6) is still important to these broader relationships. Indeed, such a framework is more important precisely because it can greatly strengthen both the PRC's and Japan's dealings with North America and Europe, providing leverage on trans-Pacific issues and in global forums that benefits both countries and their partners in the region.

14.3 FROM REGIONAL INTERDEPENDENCE TO REGIONALISM

Can existing East Asian arrangements foster deeper economic integration in Asia? ASEAN+3 and ASEAN+6 have considered proposals for an

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East Asian Free Trade Area. An East Asian Community has been mooted in the dialogues around ASEAN+3 and an Asian Economic Community has been set as an objective by Indian Prime Minister Manmohan Singh.⁹ What are the practical next steps in the evolution of an Asian regional architecture?

These are not purely economic or technical matters; they are also political ones. The future shape of regional economic cooperation will reflect political circumstances and choices as well as deepening economic interests and policy decisions. For economic as well as political reasons, Asia cannot avoid tough choices in the decade ahead about how to establish the institutional structures that will define its approach to regionalism – and its impact on global economics and politics – because of the way in which the rest of the world will perceive what is happening in Asia.

Economically, Asia is now very important to America, Europe and the rest of the world. Rapid resolution of the global financial crisis, for example, requires active play and leadership from East Asia. East Asian economies (certainly the PRC and Japan, and perhaps India) need to bring greater coherence to their economic dealings with the world, as well as with each other. High-level consultation and cooperation between them is a prerequisite for this. While the emergence of ASEAN+3 in the aftermath of the crisis gave East Asia a sense of common purpose, it has yet to acquire sufficient supporting substance and high policy impact. This is partly a consequence of caution and an absence of commitment to institutional strengthening, and partly because policy leaders talk regionally but still tend to act bilaterally (see Soesastro 2007a, 2007b). The platforms for the gradual process of generating, socializing and testing regional policy initiatives are being put in place. Now they need to be deeply embedded in regional structures.

The political rationale for institutionalizing Asian regional arrangements is even more compelling. Cementing the region's strengthening economic ties requires a secure political framework. The PRC faces the challenge of coming to terms with its new status in international affairs. The Chinese leadership clearly understands that the current international system is of enormous benefit to the PRC economically. Moreover, modernization in the PRC is not merely an economic goal, but a political and social one. A key question for the PRC, therefore, is how it manages its partnerships in regional and global political and economic affairs. Asian economic arrangements will need to be greatly reinforced if they are to mitigate the political tensions with the rest of the world surrounding the PRC's continuing rise. These endeavors are central to an outward-looking East Asian regionalism.

14.4 TOWARDS AN EAST ASIAN ECONOMIC COMMUNITY

The financial crisis of 1997/98 gave a new impetus to regional cooperation in Asia. ASEAN+3 was launched and the idea of an East Asian economic community gained traction. The initial agenda was regional financial cooperation, but the broader aim was promoting high-level dialogue and projecting broader East Asian interests. The ambition was to build a sense of community among East Asian countries and assert a distinct Asian identity internationally as a basis for closer regional cooperation.

This ambition continues to evolve, and much has already been achieved. The East Asia Study Group (ADB 2008: Chapter 2, p. 51) called for an East Asian Free Trade Area, an East Asian Investment Area, the establishment of an East Asian financial facility and exchange rate coordination. Its recommendation that ASEAN+3 host an East Asia Summit is already in place. Consistent with this ambition, the ADB has initiated work that aims to make existing FTAs more multilaterally friendly by promoting trade and investment facilitation, simplifying restrictive rules that discriminate against outside partners, and adding more WTO-plus elements to these agreements. The objective is to broaden these arrangements into the negotiation of an East Asian Free Trade Area. On monetary and financial cooperation, there is progress toward multilateralization of the Chiang Mai Initiative swap arrangements and growing acceptance of the need to elevate the information-sharing and review mechanisms that will be needed to bed these arrangements down. The ambition is for these developments to lead to the establishment of what in effect would be an Asian Monetary Fund.

But are these the main issues that should propel East Asian regionalism today? The global financial crisis of 2008/09 has caught the region on the back foot, at least partly because regional endeavors have been focused on issues that are not central to the problems that now confront East Asia in the international economy. East Asia was not prepared for the collective action needed to deal with the crisis. Nor has the crisis yet stimulated the elevation of regional cooperation that is needed to deal with it. The crisis has projected East Asia to center stage in the global economic theater, but East Asia is still to define the role and how it needs to play it.

Whatever the contest of visions for the shape of an East Asian Community, it is an idea whose time has come. The vision has broadened with the inauguration of the EAS and its incorporation of trans-regional dialogue with Australia, India and New Zealand. The formation of EAS has encouraged the idea that the intensification of regional cooperation in East Asia might gradually expand to include South Asia, and ultimately

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BOX 14.2 EAST ASIAN LESSONS FOR SOUTH AND CENTRAL ASIA

Measured by a number of yardsticks, East Asia is an already quite deeply integrated regional economy. And East Asian experience with deepening integration is of interest to other regions, such as South Asia, Central Asia and the South Pacific, which are also pursuing closer economic integration.

The South Asian Association for Regional Cooperation has so far focused principally on cooperation in agriculture, rural development and health. The Central Asia Regional Cooperation Program, created in 1997, promotes shared infrastructure projects and the improvement of the policy environment in priority areas, such as transport, energy and trade. The Pacific Islands Forum has developed a Pacific Plan, updated in late 2006, which covers areas ranging from fisheries to air transport safety.

What can South Asia, Central Asia or the South Pacific learn from East Asia? In the Association of Southeast Asian Nations (ASEAN) and East Asia, economic development was a common and dominant political goal; and periods of significant political difference between member countries – between Malaysia and Singapore, Thailand and Myanmar and the PRC and Japan, for instance – were suppressed by common commitment to that goal through economic cooperation. Governments in these regions need to give primacy to economic development goals and not allow political differences to stand in the way of regional cooperation.

East Asia pursued an open regional approach (not only open trade but also open investment strategies) based on the priority of competing in global markets. The inward-looking mindset of earlier times is still reflected in South Asia's approach to regionalism. The South Asian Free Trade Area accord is characterized by large negative lists, limited number of products for tariff concessions, restrictive rules of origin and the exclusion of services and issues such as border charges, fees and other non-tariff barriers.

the formation of an Asian Economic Community as Prime Minister Singh (2005) has advocated. If this is to occur, it will need to be a gradual process. It will ultimately depend on South Asia's commitment to the policy strategies and economic reforms that are quite deeply entrenched in East Asia (Box 14.2)

Consistent with East Asia's global role and interests, the principal objective of an East Asian Community should be to maintain open policies globally and to develop an active role in global economic diplomacy. It should complement and reinforce other regional arrangements, such as the trans-Pacific APEC process. A challenge will be to develop a policy infrastructure for regional cooperation that is accessible across these regional structures and facilitates the conduct of cross-cutting high-level political dialogue. The development of an East Asian Community that is competitive with – or not engaged in – trans-regional dialogues with America or South Asia is not likely to serve East Asian economic integration and economic interests well.

14.5 ELEMENTS OF AN EAST ASIAN COMMUNITY

Most economic cooperation in East Asia consists of discussions of international economic policy issues and national policy responses to them. ASEAN, ASEAN+3, the EAS and APEC all engage in dialogues of this kind. The Executive Meeting of East Asia-Pacific Central Banks (EMEAP) is another vehicle for regional policy dialogue and capacity-building. It sits alongside these other arrangements but is not yet an integral part of them.

These forums overlap somewhat, but they can be characterized loosely as concentric circles, all of which include ASEAN, most of which include East Asia, and some of which embrace countries that have close economic ties to the region. Streamlining such regional exchanges is an ongoing agenda.¹⁰

Despite the proliferation of cooperative arrangements, their policy coverage remains patchy. Table 14.1 displays the issues handled by these forums and the form of regional cooperation that surrounds each issue. The blank cells represent areas in which there is no substantial regional cooperation.

The issues covered by East Asian cooperative arrangements are wide-ranging but focus on macroeconomic policy, trade and finance. Microeconomic issues are an important and recent addition to the agenda, with ASEAN and APEC the only forums that examine them systematically. APEC does this primarily through its economic committee, which has been asked by APEC's economic leaders to focus on structural issues.

East Asian regional cooperation on all of these issues takes a range of forms, involving a progressively higher level of shared commitment and decision-making. More specifically, Table 14.1 sets out five incremental levels of cooperation listed by row:

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Table 14.1 Taxonomy of current regional economic cooperation in East Asia

	Macroeconomic			Trade and investment		Financial		Microeconomic		Energy and environment	Human security
	Monetary	Exchange rate	Fiscal			Markets, institutions, and systems	Crisis prevention and management	Regulation, competition, and governance			
Discuss issues	EMEAP* ASEAN ASEAN+3 APEC	EMEAP ASEAN ASEAN+3 APEC	ASEAN ASEAN+3 APEC	ASEAN ASEAN+3 EAS APEC	ASEAN ASEAN+3 EAS APEC	EMEAP* ASEAN ASEAN+3 APEC	ASEAN ASEAN+3 APEC	ASEAN APEC	ASEAN ASEAN+3 EAS APEC	ASEAN EAS APEC	ASEAN EAS APEC
Discuss policies	EMEAP* ASEAN ASEAN+3 APEC	EMEAP* ASEAN ASEAN+3 APEC	ASEAN ASEAN+3 APEC	ASEAN ASEAN+3 EAS APEC	ASEAN ASEAN+3 EAS APEC	EMEAP* ASEAN ASEAN+3 APEC	ASEAN ASEAN+3 APEC	ASEAN APEC	ASEAN ASEAN+3 EAS APEC	ASEAN EAS APEC	ASEAN EAS APEC
Informal ad hoc national policy action				ASEAN APEC	ASEAN APEC	EMEAP* ASEAN ASEAN+3 APEC	ASEAN ASEAN+3 APEC	ASEAN			
Formal national policy action				ASEAN			ASEAN ASEAN+3	ASEAN			

Table 14.1 (continued)

	Macroeconomic		Trade and investment	Financial		Microeconomic	Energy and environment	Human security
	Monetary	Exchange rate		Markets, institutions, and systems	Crisis prevention and management			
Formal supra-national policy action			ASEAN +					

Notes: * Indicates official level only. The Executives Meeting of Asia-Pacific Central Banks (EMEAP) includes the monetary authorities of Australia; People's Republic of China (PRC); Hong Kong, China; Indonesia; Japan; Republic of Korea (Korea); Malaysia; New Zealand; Philippines; Singapore; and Thailand. The Association of Southeast Asian Nations (ASEAN) includes Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam. ASEAN + 3 includes ASEAN plus PRC, Japan and Korea. The East Asia Summit (EAS) includes ASEAN + 3, Australia, India and New Zealand. Asia-Pacific Economic Cooperation (APEC) includes Australia; Brunei Darussalam; Canada; Chile; PRC; Hong Kong, China; Indonesia; Japan; Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; Philippines; Russia; Singapore; Taipei, China; Thailand; United States; and Viet Nam.

Source: Updated from de Brouwer et al. (2006).

- discussion at the official or political level on domestic, regional, and global economic issues
- discussion on national policies in response to a changing national, regional or global economic and strategic environment
- informal or ad hoc cooperative action on national economic policies to ensure regional or global consistency
- formal, binding or contractual cooperative setting of national economic policies at the regional level, and
- formal setting of economic policy at a regional supranational level to determine policy outcomes at the national level (de Brouwer et al. 2006)

There is no broad regional cooperation in East Asia that calls upon supranational authority, and the elements of regional cooperation that call for either formal or informal policy action remain limited.

Policy cooperation has focused primarily on specific functional areas, such as trade and finance. The principal vehicles for this stronger form of regional cooperation are ASEAN and ASEAN+3. Informal policy action on trade and investment is a key APEC activity, given the Bogor goals of an open trade and investment regime in the Asia-Pacific region. The primary regional forums for policy cooperation in finance are ASEAN+3, EMEAP and APEC. Both EMEAP and ASEAN+3 have systems for informal policy development of financial, especially bond, markets in the form of the Asian Bond Funds 1 and 2 and the Asian Bond Markets Initiative (ABMI).

The only regional forums that involve formal policy cooperation are ASEAN – the free-trade agreement between ASEAN countries (AFTA) and the commitments to building an ASEAN Community – and ASEAN+3, and the Chang Mai Initiative on the prevention and resolution of financial crises among the ASEAN+3 countries, which incorporates a relatively modest formal ASEAN agreement for cooperation during financial crises. This is a signed agreement with specific terms and conditions made between some ASEAN+3 countries to lend foreign-exchange reserves in the event of a financial crisis. The ASEAN Charter takes the first steps in committing member economies to a modest form of supra-national authority in economic and social affairs (see Box 14.1).

While macroeconomic issues and policies are extensively discussed at regional forums, there has been no informal or formal cooperation in this domain.¹¹ This is a glaring gap in regional cooperation arrangements in the context of East Asia's response to the global financial and economic crisis.

East Asian governments prefer institutional structures that allow them

Notes: * Indicates official level only. The Executives Meeting of Asia-Pacific Central Banks (EMEAP) includes the monetary authorities of Australia; People's Republic of China (PRC); Hong Kong, China; Indonesia; Japan; Republic of Korea (Korea); Malaysia; New Zealand; Philippines; Singapore; and Thailand. The Association of Southeast Asian Nations (ASEAN) includes Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam. ASEAN+3 includes ASEAN plus PRC, Japan and Korea. The East Asia Summit (EAS) includes ASEAN+3, Australia, India and New Zealand. Asia-Pacific Economic Cooperation (APEC) includes Australia; Brunei Darussalam; Canada; Chile; PRC; Hong Kong, China; Indonesia; Japan; Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; Philippines; Russia; Singapore; Taipei, China; Thailand; United States; and Viet Nam.

Source: Updated from de Brouwer et al. (2006).

to retain national and political control and avoid supranational and excessive bureaucratic decision-making (de Brouwer et al. 2006). Although the benefits of regional cooperation driven by mutual commitment to regional action are significant, differences within East Asia constrain its nature and define its boundaries. Yet rapidly changing economic, political and institutional circumstances are expanding the possibilities for regional – but not strong forms of supranational – economic cooperation, informal and formal. While Europe is often the point of comparison for East Asian cooperation, it does not provide a useful benchmark for evaluating it.

Eichengreen (see Chapter 11 in this volume) correctly observes that Asia is not Europe, and that the circumstances in which Asian cooperation is developing are very different to those pertaining in Europe in 1957. The diversity of Asia's history, politics and economies is stark, but East Asia is already much more deeply integrated through trade, investment and finance with the regional and world economy – which is also much more globalized than when the European project began 50 years ago.

While national institutions and policies will continue to play a key role in driving Asia's economic success, regional initiatives will increasingly complement them. Common issues, external and internal, tend to become topics of discussion in regional forums, formally or informally. The result is cooperation in forging responses.

The practical approach for integrating Asia that is evolving is one that promotes a market-friendly and market-strengthening, multi-track and multi-speed integration process. Economies that have developed close ties through market-driven integration have gravitated toward policy cooperation under the auspices of one or more of the region's principal established groupings. They have also built cooperation through sub-regional initiatives (ADB 2008, Chapter 2). This Asian variable geometry relies on a step-by-step, bottom-up approach, rather than on conceiving and implementing any comprehensive pan-Asian vision or grand plan for integration,

14.6 WHAT ARE THE NEXT STEPS IN REGIONAL COMMUNITY BUILDING?

Asia's regional arrangements remain patchy and inward-looking, and fail to give due weight to the growing economic and political importance of the region. There is still no effective regional caucus on the major global policy issues of critical importance to maintaining Asia's economic success despite the palpable current need. A comprehensive initiative is called for in four main areas.

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14.6.1 Trade and Investment

Without a credible commitment to the goal of free and open regional trade and investment, and the development of practical strategies to deliver it by, say, 2020, East Asia's rise will be fraught with economic and political risk. Common cause and regional institutional commitment to this goal is needed. Developing the capacity to negotiate it multilaterally is also necessary. This process is more likely to be successful and beneficial if the region commits to global liberalization from the base of strong regional commitments to trade and investment liberalization.

The first generation of reforms, in which East Asian economies committed to trade liberalization and related reforms to generate rapid trade-oriented growth, delivered remarkable economic success. East Asian trade diplomacy led to the region increasing its influence in the General Agreement on Tariffs and Trade (GATT) during the Uruguay Round. The rise of the East Asian economy was significantly assisted by an open, non-discriminatory international economic order.

The bilateralist trade policy strategies, detailed in *Emerging Asian Regionalism* (ADB 2008, Chapters 2 and 3), that have emerged in Asia over the past decade have so far had little impact on regional trade growth. Rather, there is concern now about the damage they might do to deepening regional integration unless there is a broader approach to trade liberalization (ADB 2006). The prospect of significant benefits to the regional economy from the proliferation of these bilateral arrangements is problematic because of their bilateral character, limited coverage and restrictive rules of origin (ADB 2008, Chapter 3). The ambition to forge free trade on a broader front within an East Asian Free Trade Area is in part a response to this danger. But it is also represented as an alternative strategy to multilateral negotiation of trade and border issues – including issues such as investment access that are only incompletely covered at this point in multilateral negotiations – and as the next important step in regional institution-building (Lee et al. 2006; Soesastro 2007c).

East Asia's reliance upon an open global order and multilateral frameworks such as the WTO is likely to be even more critical if the massive adjustment to its role in the world economy projected in this study is to succeed. A key message here is that the scale of the economic change that is happening in Asia is so large that it is bound to cause significant reaction in other parts of the world. The PRC and India will only succeed in the trajectory of development on which they are now firmly set so long as the rest of the world is prepared to adjust to their growing economic strength. That will require global negotiation and settlement of trade (and other) issues and cannot ultimately be resolved only within the region.

Hence, East Asian economies have a large stake in global institutions and agreements. In this next critical phase of their development, they will need not only to support, but increasingly to lead, these global arrangements. Despite its inexperience in this role, the PRC will have to assume a more prominent role in global economic affairs. And despite the advantage of its remarkable openness and engagement with North America and Europe, it is less likely to succeed in negotiating these adjustments alone than it is in close strategic cooperation with its East Asian partners, including and especially Japan, in the period of economic transition to 2020.

Continuing economic growth and deepening integration of the East Asian economy also requires reform of domestic institutions and regulatory systems beyond border restrictions on trade. The biggest impediments to trade and integration, as noted above, are behind-the-border domestic institutions and regulations. They are now a policy priority throughout the region, whatever each economy's starting point or stage of economic development. Of their nature, these regulatory and institutional reform issues are not susceptible to negotiation through traditional processes of trade negotiation, either through the WTO or through FTAs or economic partnership arrangements. They are better dealt with through regional policy cooperation and initiative at the national level supported by regional efforts.

14.6.2 Monetary and Financial Cooperation

The agenda for monetary cooperation and financial development also needs to be vastly strengthened. While there have been useful steps focused on addressing the financial vulnerabilities of the past, as the global financial crisis underscores, the problems of the future are of a totally different order. They include (i) the management of the relentless economic and political pressure for exchange-rate appreciation that will accompany the rise of Asia's economic power; (ii) the large accumulation of foreign-exchange reserves (ADB 2008: Chapter 5); (iii) active participation in macroeconomic policy coordination through the G-20 and other forums; and (iv) the wholesale reform of financial systems that will both facilitate these adjustments and channel regional savings to more productive investments inside and outside the regional economies (ADB 2008: Chapter 4). The need is for a stronger, deeper and more formal framework of cooperation between central banks and finance ministries that incorporates monetary policy dialogue, the development of multilateral reserve-pooling arrangements, exchange rate management, and an articulate response to developments in international financial and currency markets that engages the USA and makes an effective input into global dialogues possible.

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Most East Asian economies have taken a second-best approach to crisis prevention by building up external reserves (ADB 2008: Chapter 5). Along with flexible exchange rates and inflation targeting, this combination of policies has been called the new East Asian consensus on monetary and financial management (Huang 2007). Real exchange rate stability is desirable in a highly interdependent regional economy, although the stability witnessed in East Asia in recent times is an artifact of circumstance, not a product of underlying policy regimes that are in place. As the yen begins to strengthen against the US dollar, the nominal exchange stability we have witnessed in recent years is unlikely to be sustained. In the longer run, the divergent growth of Asian economies noted before will require substantial and continuing exchange rate re-alignment between economies both within and outside the region for many years to come. The need for cooperation in managing exchange rates – or monetary policy – in the face of the impact of the massive growth in regional foreign exchange reserves and the pressure for exchange rate realignment is palpable. The first step in such policy cooperation is the development of arrangements for effective consultation on macroeconomic and exchange rate issues within the region and the development of the tools for monitoring exchange rate developments. More urgent need now is for coordination of East Asian efforts in the G-20 response to the global financial and economic crisis.

Exchange rate pooling will also reduce the need for holding excessive reserves (ADB 2008: Chapter 5). This can be achieved through multilateralizing and extending the Chiang Mai Initiative for bilateral currency swaps in conjunction with the establishment of an adequate mechanism for regional surveillance of macroeconomic and exchange rate developments, incorporating the support of an appropriate professional secretariat.

14.6.3 Structural Reform and Strengthening Policy Institutions

A third requirement is the development of institutions to support the structural and microeconomic reforms necessary to realize the potential of deeper regional economic integration. The need is for formal frameworks for closer policy dialogue, evaluation and development between the region's national regulatory agencies and institutions, covering both real and financial markets.

The development of robust institutions for independent policy analysis and review is important for developing more efficient policies; it is also important in curbing the corruption of policymaking processes. In the longer term, more representative political systems, stronger legal and judicial systems, and greater freedom for commentary through independent agents such as think-tanks and the press will expose and curb

inefficiency in, and the corruption of, policy processes (World Bank 2007). Progress toward establishing institutions for economic policymaking that increase transparency, independence and economy-wide consideration of the impacts of economic policies is an important step in this direction. It is also likely to enhance equity as well as efficiency and better policy outcomes. And it is an important area in which there can be practical regional cooperation.

14.6.4 Human Security and the Environment

A fourth requirement involves the need to formulate responses to transnational issues such as climate change, pandemics, social protection and energy security. Dealing with these issues will require the engagement of as many Asian economies as possible.

The core goal of economic development is to raise human welfare, and regional economic integration advances this goal by raising incomes, especially in low-income countries. But even in the course of successful economic growth there will be problems such as income disparities and economic dislocation. Effective social policies can address these problems as well as increase economic flexibility, an essential characteristic of a dynamic economy. The perception, backed by actual experience, that regional integration delivers inclusive progress is essential for maintaining political support for regional initiatives.

Inequality across countries in Asia is declining with successful growth, but wide disparities in incomes remain within and between them (ADB 2008: Chapter 6). This is a challenge for regional integration. Successful regional integration in Europe, for example, began when disparities were lower between the integrating economies. In addition, inequalities *within* countries in Asia today are on the rise, even in the most successful economies in the region. Growing inequalities undermine long-term growth and political stability, and weaken the base for integration.

Regional cooperation across each of these areas would demand a very large increase in regional policy infrastructure and policy dialogue. In ASEAN, the Bali Concord, with its enunciation of common security goals and its ambitions for an ASEAN economic and socio-cultural community, has begun a process similar to that which East Asia might aspire to in building an East Asian Community. The target for the ASEAN Community has been brought forward to 2015. Sequencing a move toward an East Asian Community in concert with ASEAN's progress might recommend sign-on in 2015. But the first steps can, and should, be taken sooner.

Whether functional integration within an East Asian Community is better initiated through ASEAN+3 or ASEAN+6 is another question. A

single East Asian platform is unlikely to be sufficient to handle the many aspects of cooperation that are important to the region. It is not impossible that India would want, or be able, to sign on to the commitments of membership soon. Whatever the case, the East Asian Community could be structured so as to allow EAS economies to participate in areas of functional cooperation where they can make a useful contribution and are prepared to undertake the relevant obligations. For example, EMEAP is a pre-existing vehicle for consultation and cooperation between monetary authorities. It would be sensible to embed the EMEAP forum into the structures of an East Asian Community and to add to closer monetary and financial cooperation through that process. The principle of 'variable geometry' can productively be built into East Asian regional cooperation in this and other ways (Soesastro 2007b). In time, the East Asian Community could evolve through effective functional cooperation into a broader Asian Economic Community.

14.7 EAST ASIAN AND TRANS-REGIONAL ARCHITECTURE

Must an East Asian Community compete with trans-regional cooperation in APEC or the growth of trans-regional cooperation with South Asia? Or can it be sensibly structured so as to incorporate and strengthen trans-regional cooperation across Asia and the Pacific? An open and inclusive strategy is likely to serve East Asian objectives best.

First, there will be practical ways to capture the synergies between political and ministerial level meetings in the schedule of East Asian and APEC-wide meetings. Second, the functional areas of cooperation between APEC and an East Asian Community are strongly complementary. In some areas, APEC brings capacities that will enhance regional cooperative outcomes. In such areas as human security, the environment and strengthening the policy institutions for structural and microeconomic policymaking, for example, APEC's wider membership means that it is likely to provide a better platform for cooperative initiatives and policy action.

Third, in most economies within East Asia and APEC, the same agencies and policy units have responsibility for regional cooperation. The coordination of approaches and activities across regional institutions is part of their remit. The extension of national policy infrastructure to support regional cooperation – a more prominent feature of the formal and informal policy action and activity that will be set in train with the establishment of an East Asian Community and the further institutionalization of

APEC – can be shared where possible across both regional arrangements. Analytic capacities, for example, that are instigated within one regional arrangement to assist the development of policy institutions and improve structural and microeconomic policymaking performance can be directed to the appropriate regional sphere. Sharing policy information and developing shared regional policy infrastructure would both economize on policy resources and maximize the complementarities between overlapping regional arrangements.

Fourth, talk of an Asia Pacific Community that might incorporate dialogues on political and security affairs must inevitably straddle and engage all the East Asian and Pacific arrangements.

Connecting the structures of an East Asian Community to other trans-regional cooperation arrangements in the way suggested above would secure East Asia's continuing engagement with the USA. The logic is the same as that which saw the formation of ASEAN+3. It is a strategy that East Asia alone can articulate. This implies that regional cooperation will be driven from within East Asia in a way that includes structured interaction with trans-regional processes across the Pacific and South Asia¹² and with Europe. East Asia has a powerful interest in leading regional cooperation in this way. It would strengthen the presence and cohesiveness of East Asia and reinforce institutionally the process of regional community-building at the heart of East Asian aspirations and interests.

Despite the locus of regional community-building interests in ASEAN, ASEAN+3 and the EAS, many of the challenges these economies confront can only be met – or at least can be met better – by regional institutions that comprehend trans-regional and global interests. The systemic stresses associated with the rise of the PRC and India and Japan's adjustment to the new regional environment are already evident. Although there is no reason to believe that this process cannot be managed successfully, it is not an easy task. It will certainly be easier and smoother if the broad environment into which the PRC and India emerge is one in which all regional voices have an opportunity to be heard. Inclusive regional institutions provide an obvious and effective way of facilitating this. The shifts in Asia's power structure have political, social and security dimensions as well as economic ones, and regional institutions need to address them. This is the logic on which APEC was built, and the logic for India's engagement in the EAS. ASEAN and ASEAN+3 are key players in these broader arrangements as well as the locus for East Asia's regional cooperation efforts.

'Regional community-building' is not likely, therefore, to take place within any single institutional framework. Indeed, it could not readily do so, because of the way in which the functions of each regional framework intersect with, impact on and complement the others (see Figure 13.1 and

Table 13.1) – and more fundamentally because of the region's nature and its role in the world.

A comprehensive European Union-like arrangement is unlikely in Asia soon; its history and geography do not recommend that. In 30 or 40 years, when the regional economy is more homogeneous and mature, the European model may be more relevant – or perhaps not. The pressures of globalization and the rise of ad hoc economic and political bilateralism have taken Asia further than ever from the EU model and toward a new model of Asian integration.

Asia's economic rise requires a coherent and decisive response to these changes. This must be built on a carefully negotiated and agreed political commitment to regional institution-building to serve the objectives outlined here. The scale and structure of regional economic interdependence in Asia and its impact on the rest of the world now demands a comprehensive strategy that can only come readily through the construction of an East Asian Community. Asian regionalism can no longer afford to be passive and reactive; this would entail significant risks to the success of the regional economy and the stability of its relationships with the rest of the world.

Asian regionalism has the potential to bolster Asian and global welfare through an East Asian Community that is internally integrated, closely connected with North America, Europe and other international markets, and that has a responsibility and influence in global economic arrangements more commensurate with its new economic weight.

NOTES

1. These are based on conservative Asian GDP and trade growth rates, and incorporate a contraction of the US current-account deficit and the effects of a tax on trade in carbon-generating products (Drysdale et al. 2007).
2. ASEAN+3 includes the ten members of the Association of Southeast Asian Nations (ASEAN) – Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic (Lao PDR), Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam – plus the PRC, Japan and the Republic of Korea (Korea).
3. ASEAN+6, also known as the East Asia Summit (EAS), includes ASEAN+3 plus Australia, India and New Zealand.
4. APEC includes all ASEAN+6 economies except Cambodia, India the Lao PDR and Myanmar.
5. Drysdale et al. (2007).
6. The ARF first met in 1994. Its membership includes the ten ASEAN countries, ASEAN's dialogue partners (Australia, Canada, the PRC, the European Union, India, Japan, New Zealand, Korea, Russia and the United States), Papua New Guinea, North Korea, Mongolia, Pakistan and Timor Leste. It meets at the (foreign) ministerial level once a year under ASEAN's chairmanship.
7. Pushpanathan (2007).

8. The G-20 (currently with 23 members) includes Argentina, Bolivia, Brazil, Chile, the PRC, Cuba, Ecuador, Egypt, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Peru, the Philippines, South Africa, Tanzania, Thailand, Uruguay, Venezuela and Zimbabwe
9. Manmohan Singh (2005).
10. For example, the Manila Framework Group, formed under the aegis of APEC after the 1997/98 financial crisis, was disbanded in December 2004 because it duplicated ASEAN+3 processes.
11. There are, however, pockets of monetary policy cooperation involving particular countries. An example is the common currency area between Brunei Darussalam and Singapore in which Brunei Darussalam uses the Singapore dollar (de Brouwer et al. 2006).
12. Some suggest (Kawai and Wignaraja 2007) that the USA might be drawn into the EAS process. But even were that desirable, it is not politically practical because of the substantial and enduring differences in political and security interests across the Pacific that would ultimately bedevil America in signing onto even the most minimal collective political-security undertaking.

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