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Economic Integration in Asia: The Case of ASEAN+3

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OUTLINE

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- II. Drivers of Post-WWII AEI
- III. State of Play: ASEAN+3
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- VI. Perception Survey of ASEAN+3
Opinion Leaders on CMIM and AMRO

I. Definitions and Thesis

Definitions

- REI: growing trade, financial, and labor linkages/interdependence within a region
- REI can be market-led (through economic reforms) or through regional cooperation policies of governments

I. Definitions and Thesis (cont)

Thesis

- Role of REI has been highly under-emphasized in Asia by academics and IEMs
- True both in economic history (Rana, *Renaissance of Asia*, forthcoming) and in post-WWII period
- REI is both a cause – complementarities and portfolio diversification – and effect of economic growth
- Virtuous circle between growth and REI

I. Definitions and Thesis (cont)

- Post-WWII Period
 - EADM: “sequential” not “interdependent” development
 - Akamatsu’s “flying geese” pattern - transfer of export markets from the more advanced to the less advanced countries: ML integration
 - What is new is that after the Asian Financial Crisis of 1997/98 ML REI being supported by regional cooperation policies as well
 - Paradigm shift in the Asian development model

II. Drivers of Post-WWII AEI

- **Driver 1:** (of market –led integration)
 - Outward-oriented policy reforms
 - Economic dynamism and complementarities
 - Development of vertical regional production networks: Factory Asia model
 - In East Asia there was a close nexus between trade and FDI; flying geese pattern
 - Production networks gained impetus after the 1985 Plaza Accord when the yen was revalued significantly

II. Drivers of Post-WWII AEI (cont)

- Traditional production networks were triangular – Japan and NIEs exported parts for electrical appliances, office and telecom equipment, and textiles and apparel industry to the ASEAN 4 which then processed them and exported to the US and EU
- Modern production networks are more complicated and involve product fragmentation and transshipment of parts (reason: technological development)
- Increasingly, China is emerging as the hub of regional production networks in Asia

II. Drivers of Post-WWII AEI (cont)

- **Driver 2:** Policy mistakes of the IMF in managing the capital account crisis in Asia, and need to supplement IMF resources by regional financing mechanisms
- **Driver 3:** Reaction to progress in regionalism elsewhere in the world (Europe, North America, Latin America)
- **Driver 4:** (For trade integration) Slow progress in multilateralism (Doha Round)

II. Drivers of Post-WWII AEI

(cont)

- **Driver 5:** The global economic crisis further strengthened the case for regional integration in Asia:
 - A “New Normal” - muted growth in industrial countries but more robust growth in emerging markets (mainly China and India): Asian countries need to find regional (and domestic) demand
- **Driver 6:** Global economic architecture is slowly decentralizing because of slow progress in reforming governance of international institutions such as IMF and World Bank, so need to develop regional institutions and regional voice (*RSIS WP 215 Rana*)
- **Driver 7:** As Asia re-emerges, its footprint in the global economy is increasing and its voice has to be heard

III. State of Play: ASEAN+3

Trends

- East Asian economic integration has so far focused in 3 areas - trade and, finance, and macroeconomic policies/monetary integration

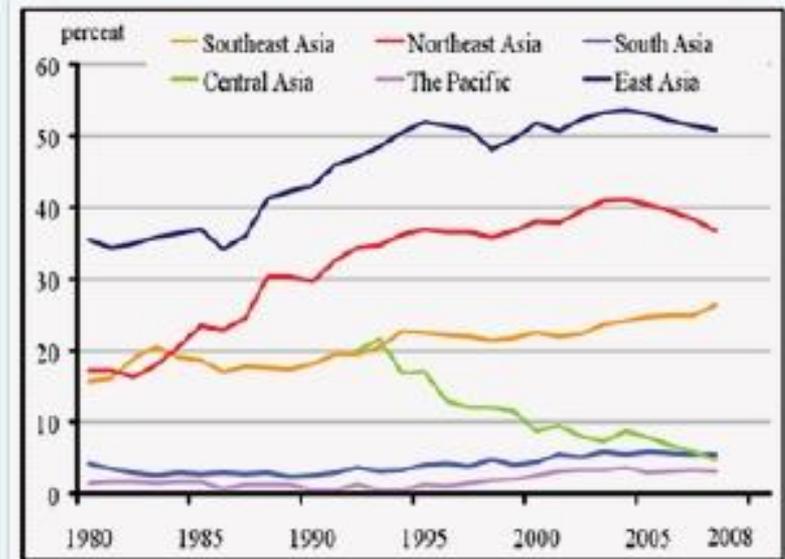
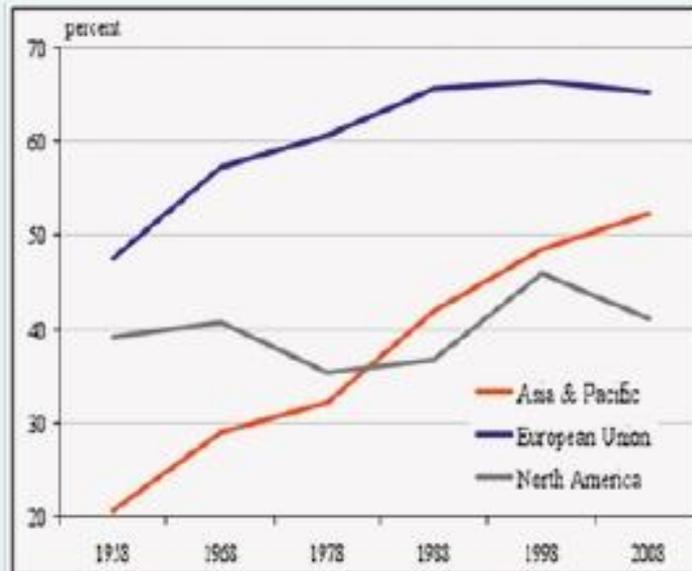
III. State of Play: ASEAN+3 (cont)

Trade integration

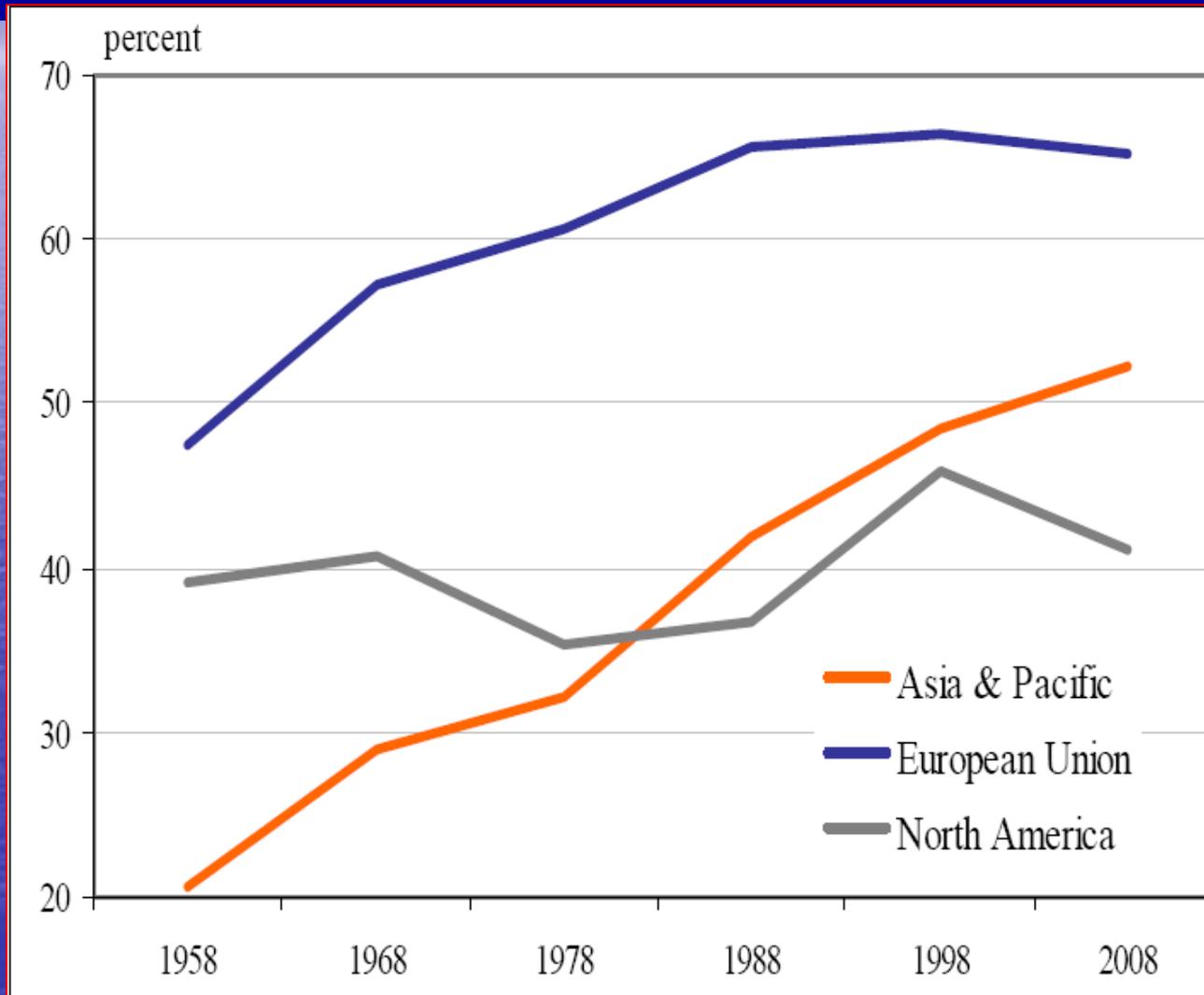
- Level of intra-regional trade is 52% of total trade – higher than NAFTA (42%) but only slightly lower than EU (67%)
- Intra-regional trade has been led by policy reforms, economic dynamism of the region, and the establishment of regional production networks

Intra-regional trade

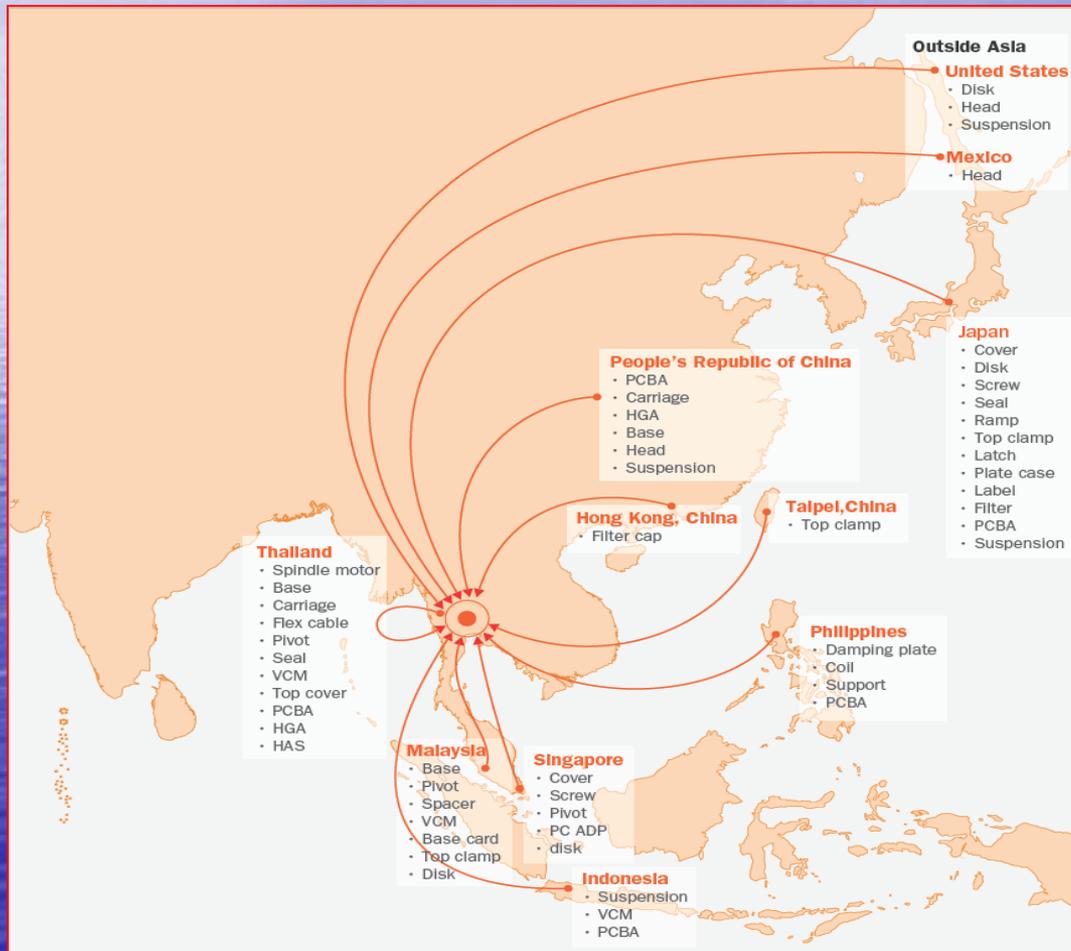
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Intra-regional Trade

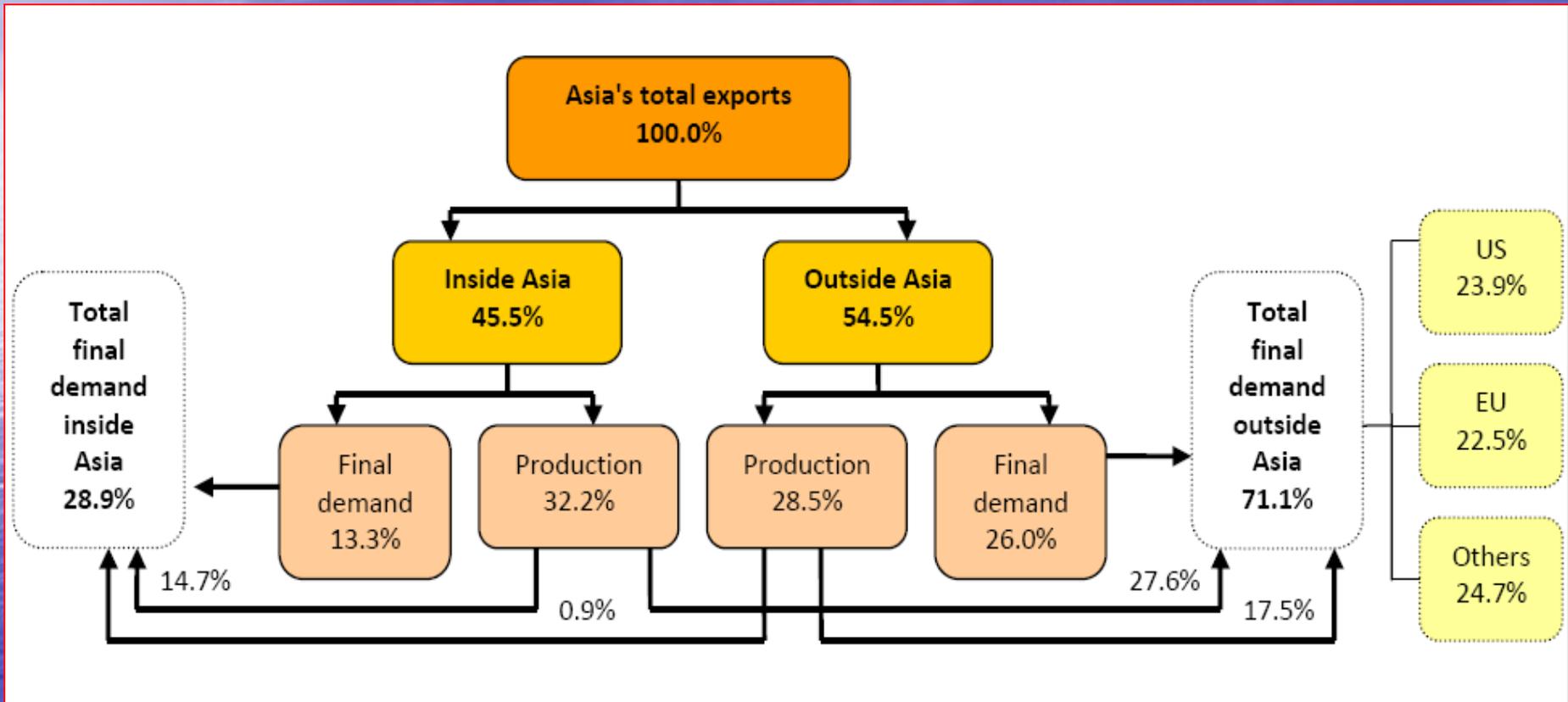


How Asia Makes a Disk-drive



- Assembly production of raw materials, parts, components
- Production and trade fragmentation: location is decided by the cost and availability of inputs, economic infrastructure, local environment
- Technology policy upgrading and transfer

Final Demand for Asian Exports

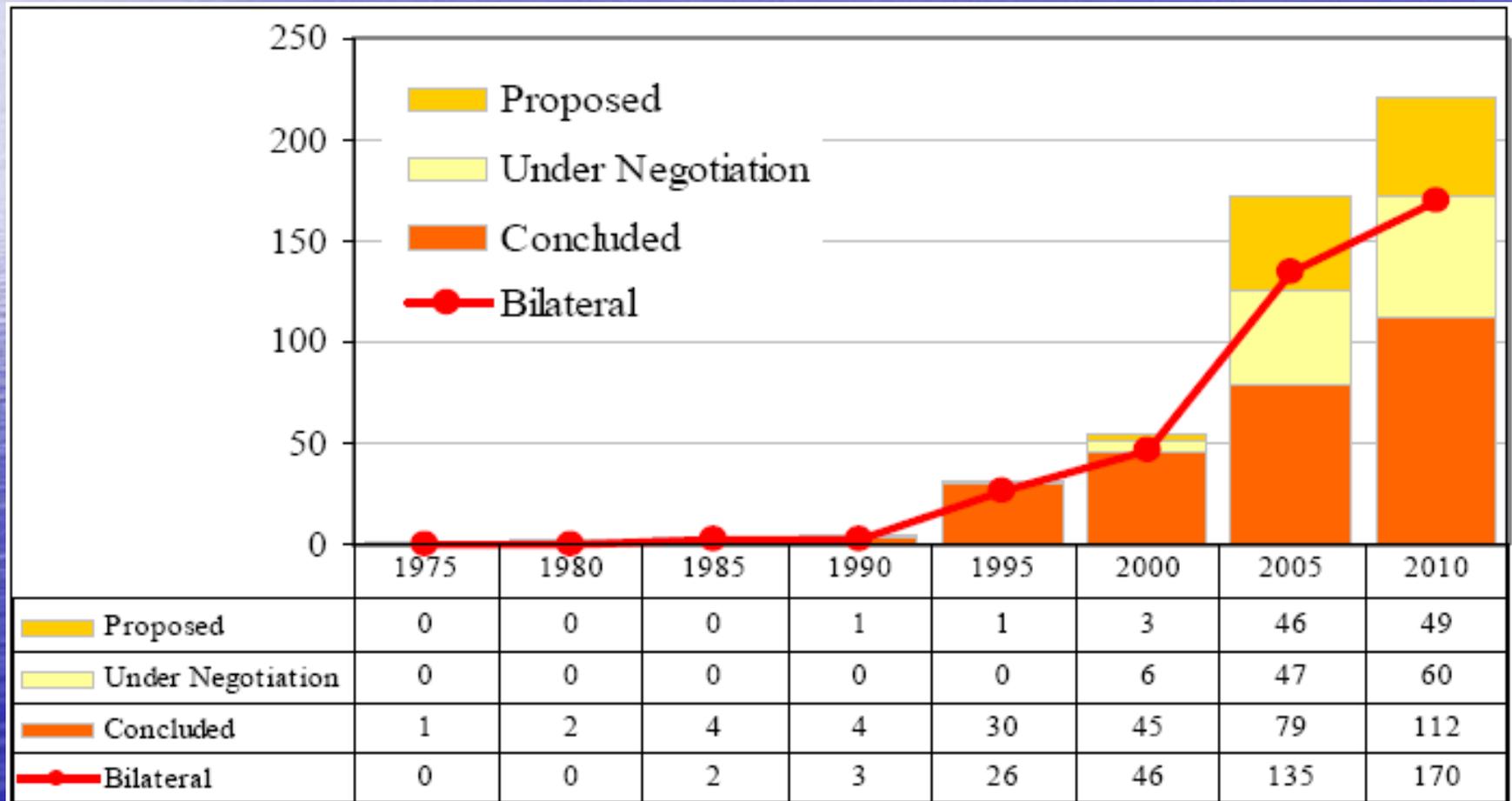


III. State of Play: ASEAN+3 (cont)

- Also since 2000, East Asia has witnessed a proliferation of FTAs (policy-led integration): 209 agreements are in existence or under negotiation
- These include the ASEAN Free Trade Area (of 1992) which is being deepened into the ASEAN Economic Community by 2015
- ASEAN-led architecture in the region

Growing FTAs in Asia

Free trade Agreements in Asia and the Pacific as of January 2010



III. State of Play: ASEAN+3 (cont)

- There are positive and negative implications of the proliferation of FTAs.
- An important negative is the high administrative and business costs of multiple rules of origin – the so-called “Asian spaghetti or noodle bowl” effects
- Recent evidence more sanguine: not much but increasing (Kawai and Wignaraja)

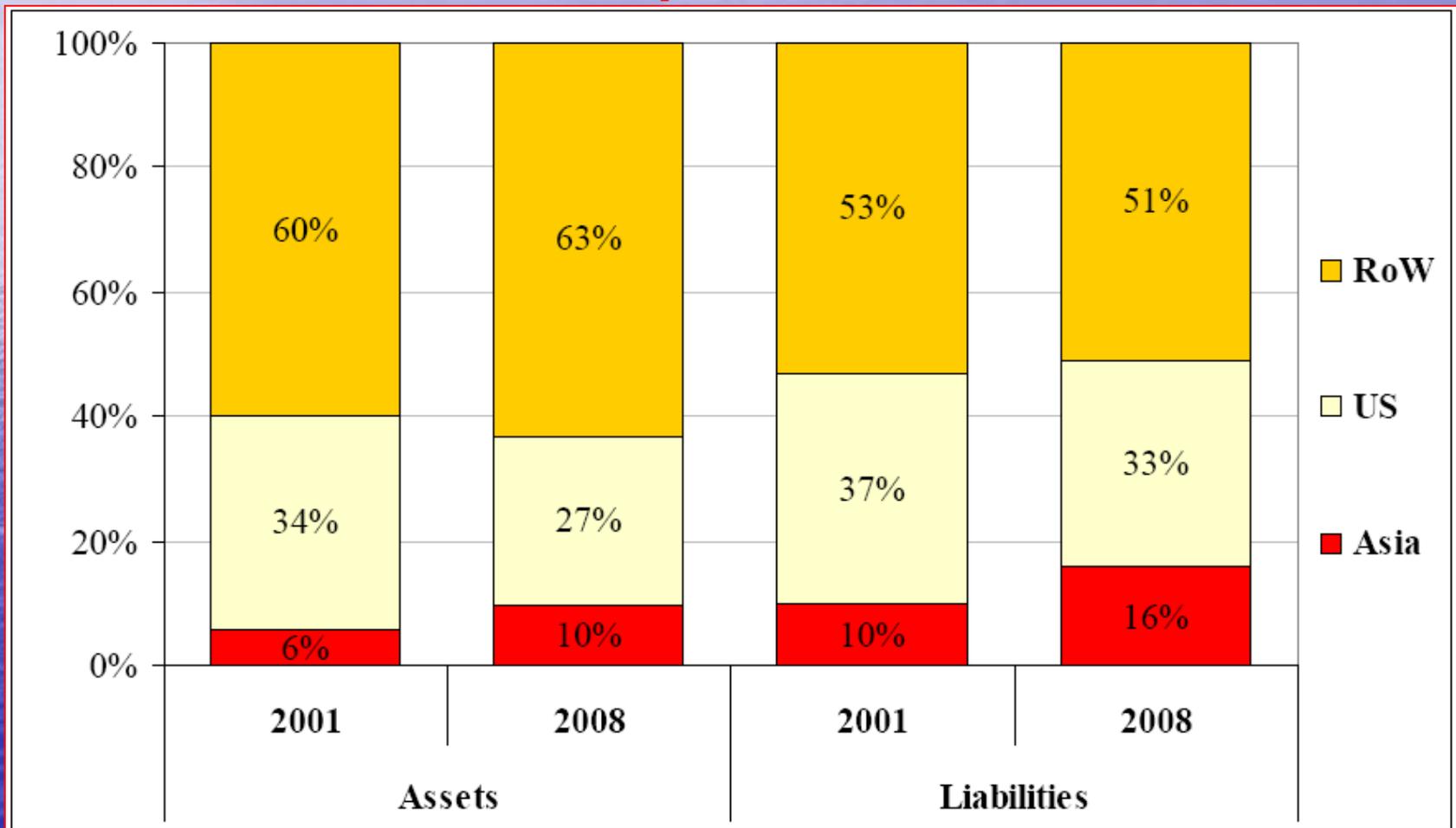
III. State of Play: ASEAN+3 (cont)

Financial Integration

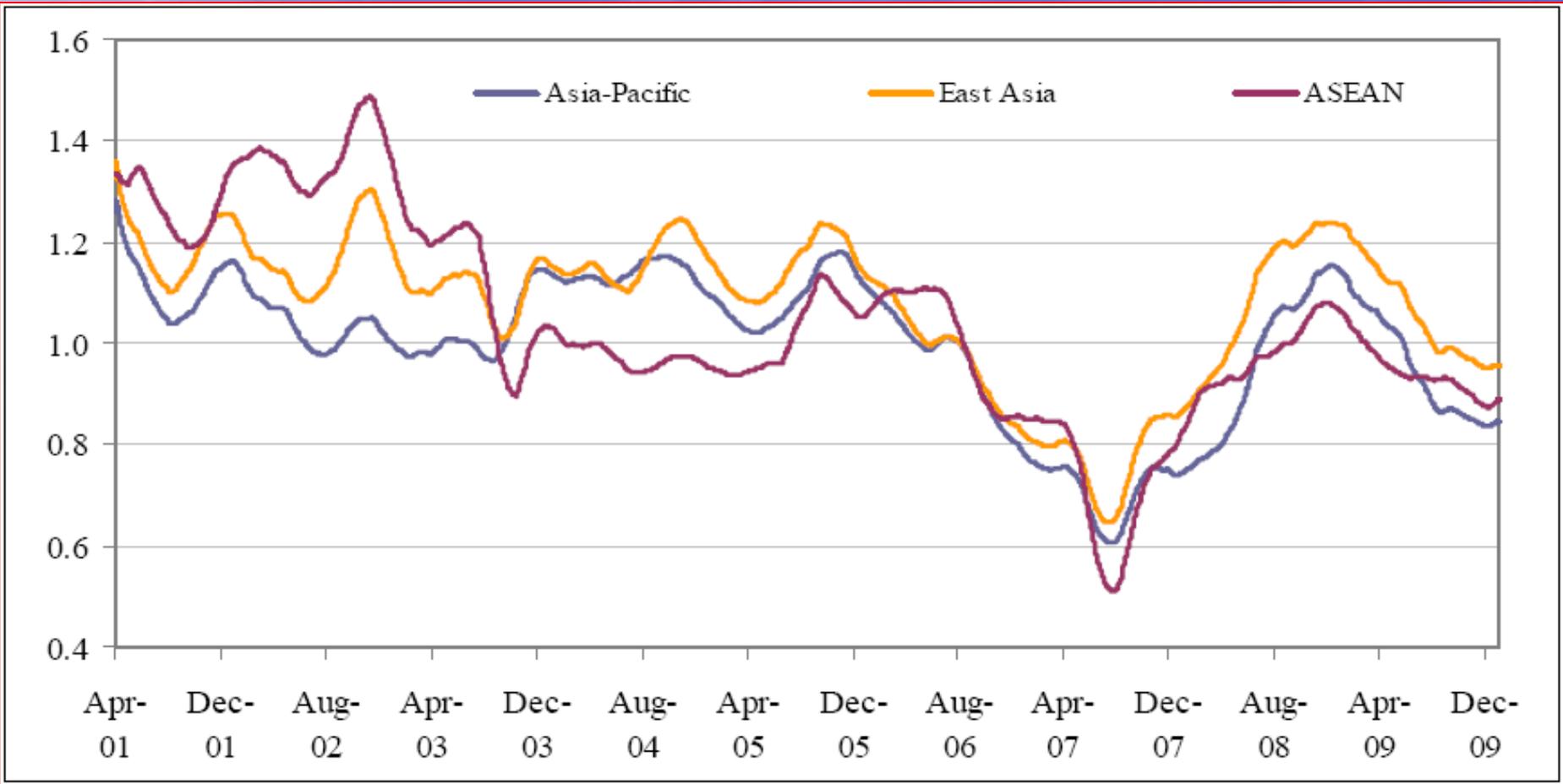
- Lack of data –but low and increasing
- Collective actions being taken to develop local currency bond markets to reduce “double mismatch” problem and the “original sin” problem
- APEC Bond Market Initiative, EMEAP ABF I and ABF II, ASEAN+3 Asian Bond Market Initiative
- Credit Guarantee and Investment Facility was established in 2010 to make it easier to issues LCB

Financial Integration: Low but Increasing

Cross-border portfolio investment



Variation Coefficient of cross-market 10-year bond yield spread



III. State of Play: ASEAN+3 (cont)

Macro/Monetary Integration: 3 stages in terms of intensity

1. ASEAN+3 Economic Review and Policy Dialogue (ERPD)

- Ministers meet annually and their deputies semi-annually
- Steps have been taken to monitor short term capital flows and to develop early warning systems
- But still information exchange, no peer review or due diligence

III. State of Play: ASEAN+3 (cont)

2. Resource pooling arrangements under the Chiang Mia Initiative of May 2000

- Initially , a network of bilateral swaps: 16 amounting \$83 billion and the amount that could be disbursed without IMF-supported programs was 20% (increased from 10%)
20%
- In 2007, the ASEAN+3 Finance Ministers agreed in principle to establish a “self managed” reserve pool over the next few years

III. State of Play: ASEAN+3 (cont)

- In May 2010, CMI Multilateralization (CMIM) or a \$120 billion crisis was established
- In May this year, the ASEAN+3 Macroeconomic Research Office (AMRO) established in Singapore for (i) regional surveillance of macro and financial situation and (ii) activate the CMIM

III. State of Play: ASEAN+3 (cont)

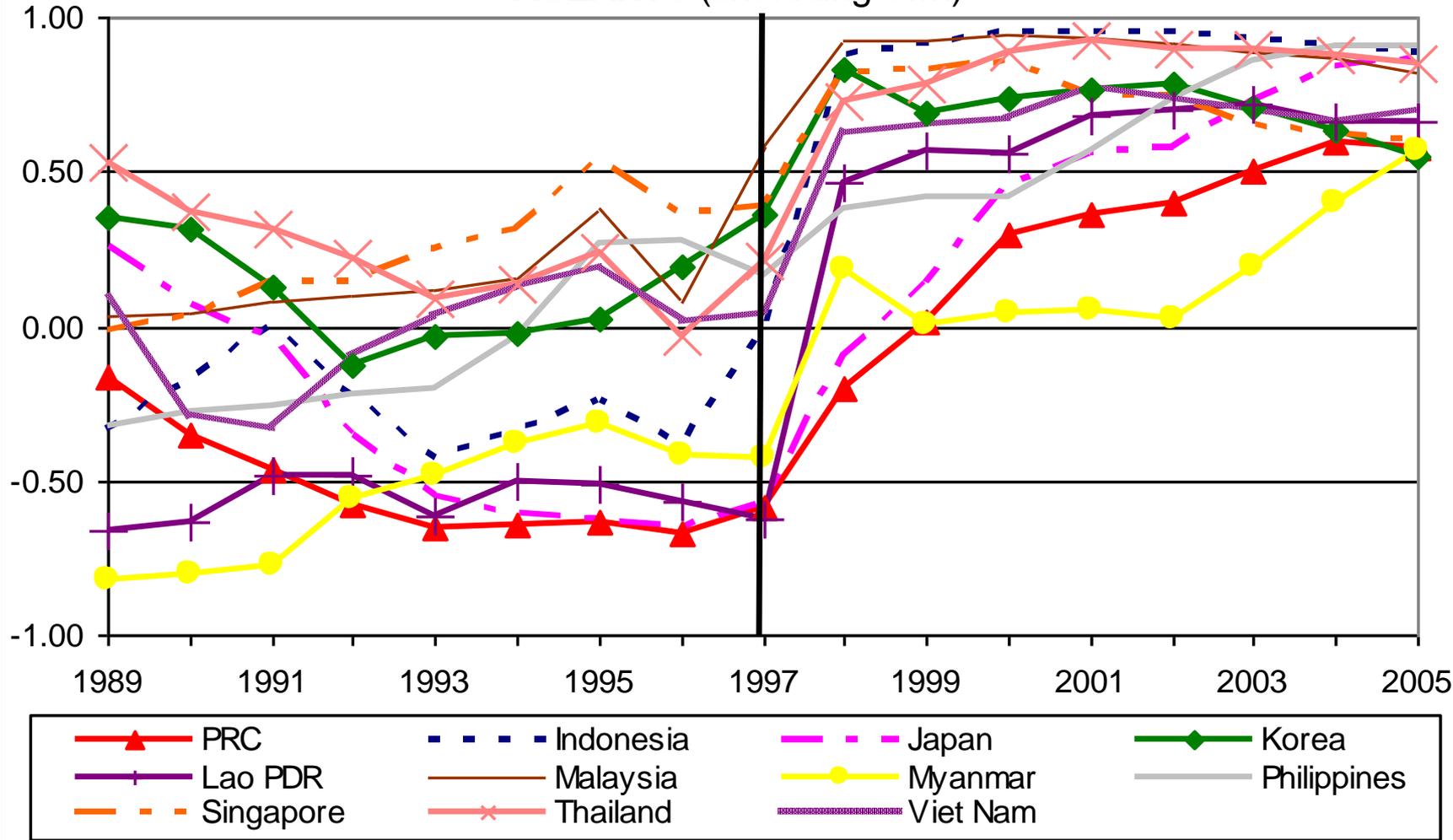
3. Exchange rate coordination

- Not much other than various research
- Exchange rate coordination will become an important activity of ASEAN+3 as the integration process moves forward and business cycles become more synchronized

III. State of Play: ASEAN+3 (cont)

- In fact, business cycles are starting to be more synchronized in East Asia suggesting that there is good potential for enhancing East Asian integration

Figure 1 - Correlations between Individual Countries and ASEAN+3 (excluding own)



IV. The Next Steps

- Multi-track multi-speed approach
- Bottom-up approach
- Linking East Asia with South Asia: Going back to history

IV. The Next Steps (cont)

- **Trade track** – harmonize and consolidate FTAs; expand membership of and deepen coverage of FTAs (Francois, Rana, Wignaraja) – EAFTA vs CEPEA; address connectivity issues including infrastructure development and trade facilitation

IV. The Next Steps (cont)

- **Finance Track** - set up an Asian Financial Stability Forum

IV. The Next Steps (cont)

Macro/Monetary Track

- Strengthen policy dialogue: beyond “information sharing” to “peer review” and ultimately “due diligence”
- CMIM + AMRO = AMF
- As business cycles synchronize further, enhance coordination of monetary policies and exchange rates

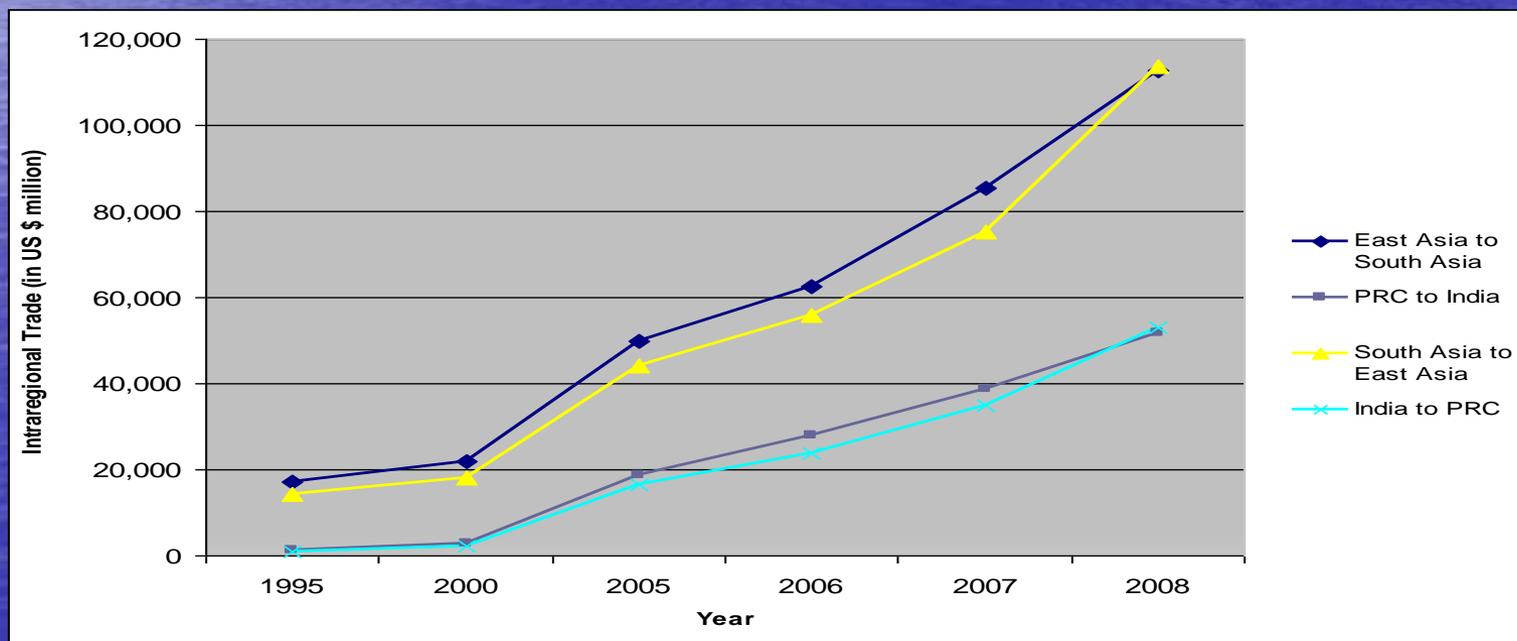
Further East-South Asia Economic Integration

Intraregional Trade in US\$ million

	1995	2000	2005	2006	2007	2008
East Asia 15 to South Asia	25,833	35,091	77,654	97,720	129,634	171,406
PRC to India	1,163	2,911	18,717	28,058	38,695	51,858
South Asia to East Asia 15	21,074	28,205	68,800	89,164	117,616	173,766
India to PRC	1,094	2,207	16,399	23,723	34,887	53,160

Note: Total trade is the sum of the value of exports and imports

Source: ADB Asia Regional Center (ARIC) Database



V. Role of Singapore

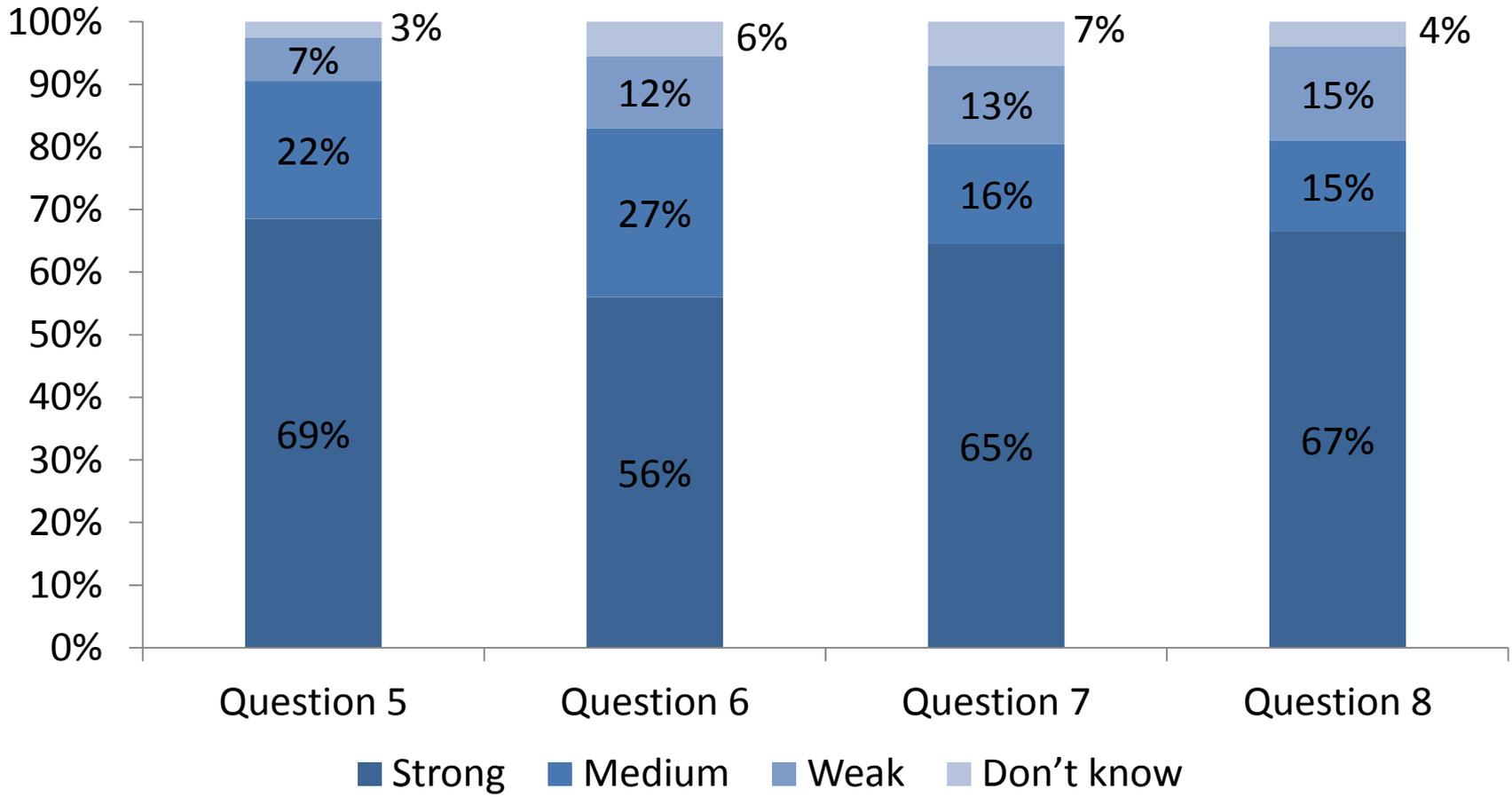
- Singapore is the Malacca and Macassar of the bygone era – cities/states energized by trading diaporas
- Singapore's pragmatic two-pronged approach: multilateralism is the first-best, but regionalism is also fine if it complements multilateralism
- Most prolific in signing FTAs
- Singapore has an important role in strengthening CMIM and AMRO

VI. Perception Survey of ASEAN+3 Opinion Leaders on CMIM and AMRO: RSIS Study

Future of AMRO and CMIM

- Question 5
In your opinion, is the establishment of AMRO a significant step towards strengthening regional surveillance in the region?
- Question 6
So far, CMIM, whose size at present is \$120 billion, has not been used. Do you think that this will change as the capacity of AMRO is strengthened?
- Question 7
In your opinion should the CMIM and AMRO be merged to create an institution like the Asian Monetary Fund sometime in the future?
- Question 8
If the Asian Monetary Fund is established, sometime in the future, it should work in a complementary manner with the IMF.

Future of AMRO and CMIM





Thank you