



ADB Working Paper Series

**Institutions for Economic and
Financial Integration in Asia:
Trends and Prospects**

Giovanni Capannelli

No. 308
September 2011

Asian Development Bank Institute

Giovanni Capannelli is principal economist and senior research fellow at the Asian Development Bank Institute, Tokyo.

The views expressed in this paper are the views of the authors and do not necessarily reflect the views or policies of ADBI, the Asian Development Bank (ADB), its Board of Directors, or the governments they represent. ADBI does not guarantee the accuracy of the data included in this paper and accepts no responsibility for any consequences of their use. Terminology used may not necessarily be consistent with ADB official terms.

The Working Paper series is a continuation of the formerly named Discussion Paper series; the numbering of the papers continued without interruption or change. ADBI's working papers reflect initial ideas on a topic and are posted online for discussion. ADBI encourages readers to post their comments on the main page for each working paper (given in the citation below). Some working papers may develop into other forms of publication.

Suggested citation:

Capannelli, G. 2011. Institutions for Economic and Financial Integration in Asia: Trends and Prospects. ADBI Working Paper 308. Tokyo: Asian Development Bank Institute. Available: <http://www.adbi.org/working-paper/2011/09/07/4689.economic.financial.integration.asia.trends.prospects/>

Please contact the authors for information about this paper.

Email: gcapannelli@adbi.org

Asian Development Bank Institute
Kasumigaseki Building 8F
3-2-5 Kasumigaseki, Chiyoda-ku
Tokyo 100-6008, Japan

Tel: +81-3-3593-5500
Fax: +81-3-3593-5571
URL: www.adbi.org
E-mail: info@adbi.org

© 2011 Asian Development Bank Institute

Abstract

Asian economic regionalism has emerged from a bottom-up process, driven by market forces in the absence of a grand plan for regional integration. While the financial crisis of 1997–98 triggered new regional cooperation initiatives, more recently several Asian political leaders have formulated proposals for the creation of a regional economic community, suggesting the possible start of a top-down approach. Based on the results of a survey of Asia's opinion leaders conducted by the Asian Development Bank (ADB) in 2010, this paper discusses how Asia's institutional architecture for economic and financial integration is taking shape, suggesting the need to strengthen existing institutions that promote Asian regionalism and to create new ones. While the focus of the paper is on monetary and financial integration, the analysis also covers other integration pillars such as trade and investment, connectivity and infrastructure, and regional public goods. It suggests the need to create new institutions in support of Asian regionalism and to adopt a broad perspective in moving towards the formation of a region-wide economic community based on strong political commitment and grassroots participation.

JEL Classification: F15, F36, F55, H87, O53

Contents

1.	Institutions for Regional Economic Integration: Analytical Framework.....	3
2.	Opinion Leaders' Survey.....	6
3.	Challenges to Strengthening Asia's Institutions for Regionalism	8
4.	Progress of Asia's Monetary and Financial Cooperation.....	14
4.1	The Chiang Mai Initiative and its multilateralization	15
4.2	Developing bonds markets in Asia	19
5.	Towards an Asia-wide Economic Community	21
	References	25

1. INSTITUTIONS FOR REGIONAL ECONOMIC INTEGRATION: ANALYTICAL FRAMEWORK

The well-known “Balassa” scheme describing the process of economic regionalism includes five stages of progressive integration: a free trade area, a customs union, a single market, a common currency, and a political union. While this sequencing is supposed to apply to any of the world’s regions, in practice it is a reflection of European ideas, reflecting not only Europe’s economic reality, but also its philosophical foundations and the underlying political debate (Balassa 1961).

Although the idea of economic regionalism in Asia has been—and to a certain extent still is—influenced by the theoretical and practical developments experienced in Europe, it has quite different origins. As recent studies have shown, the process of economic regionalism in Asia has been primarily induced by market forces. Coordinated intergovernmental initiatives for cooperation, including the creation of regional institutions, have lagged behind. Unlike Europe, economic integration in Asia has emerged without a grand plan for creating a united front across the countries in the region (ADB 2008; Drysdale 2006; Kawai 2005; Petri 2006; Soesastro 2006).

Regional institutions have played an important role in bringing Asia, or at least parts of it, together. But the increased economic interdependence experienced over the last few decades has been determined by the logic of markets more than government policies. For example, the emergence of East Asian production networks in industries such as electronics and automobiles has largely been determined by firms’ relocation decisions, independent from intergovernmental plans for regional cooperation (ADB 2008; Ando and Kimura 2005; Athukorala 2005).

Unilateral initiatives by individual Asian countries—in favor of economic liberalization and aiming to create incentives to attract investment and promote exports—have facilitated this process. Based on the model provided by Japan and Asia’s newly industrializing economies,¹ during the 1980s members of the Association of Southeast Asian Nations (ASEAN) such as Indonesia, Malaysia, the Philippines, and Thailand, shifted from an economic policy in favor of import-substitution to one focusing on export-expansion. And since the 1990s, the People’s Republic of China (PRC) was also able to join the group of integrating regional economies. Following a “flying-geese” pattern, Asian countries have been able to establish a trade-investment nexus which has played an important role in fostering economic development and growth in the region (Yamazawa 1990; Urata 1991).

Intergovernmental initiatives for regional cooperation started playing a significant role in fostering economic integration only after the Asian financial crisis of 1997–98, when the Asian model of development underwent a major test. The crisis was important to realize the limits of an approach to regionalism primarily based on market forces and to reconsider the macroeconomic management pattern followed by Asian countries, which proved to be ineffective, too risky, and complacent. Asian policymakers realized the lack of regional mechanisms which could have helped avoid the crisis and used to prevent future crises. They also understood the intrinsic weaknesses of Asian financial systems and their poor state of development. And as a result of extensive dialogue among ASEAN countries, plus Japan, the PRC, and the Republic of Korea (ASEAN+3), they were able to create several new initiatives for regional cooperation.

Indeed, the financial crisis of 1997–98 was a watershed: it was the most significant triggering factor for regional economic and financial cooperation among Asian countries in the last few decades (ADB 2008). Prompted by regional dialogue, economic and monetary authorities

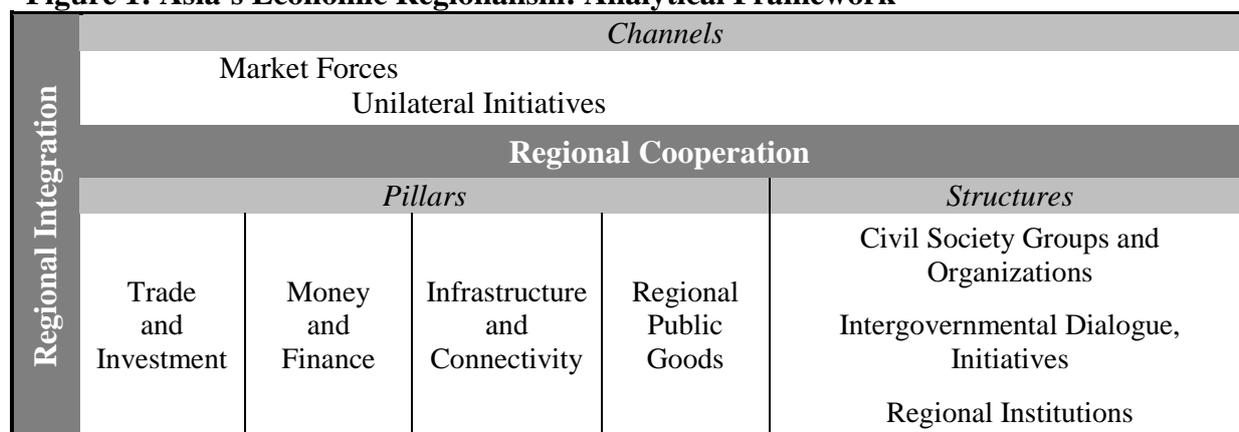
¹ Hong Kong, China; Republic of Korea; Singapore; and Taipei, China.

were able to undertake structural reforms and introduce regulations at national levels which strengthened financial markets and increased, in turn, the countries' economic resilience against the 2008–09 global financial crisis. As a matter of fact, the regional cooperation dialogue started after the 1997–98 crisis helped Asian economies perform the engine role for global economic growth they have been playing in the last few years (ADB 2010).

Asia's initiatives in support of regional cooperation and integration can be classified into four pillars: (i) trade and investment; (ii) money and finance; (iii) infrastructure and connectivity; and (iv) regional public goods (ADB 2006). In trade and investment, Asian economies have been experiencing a proliferation of free trade (and investment) agreements (FTAs) involving regional members. In money and finance, significant developments were recently achieved with the multilateralization of the Chiang Mai Initiative (CMI) and the establishment of the ASEAN+3 Macroeconomic Research Office (AMRO). In infrastructure and connectivity, a growing number of initiatives were started under the Great Mekong Subregion (GMS) and the Central Asia Regional Economic Cooperation (CAREC) programs, in addition to the ASEAN Infrastructure Fund and region-wide projects such as the Asian Highway and the Trans-Asian Railway, under the United Nations' Economic and Social Commission for Asia and the Pacific (ESCAP). Finally, in the regional public goods' pillar, Asian countries have been strengthening dialogue in areas such as natural disasters' management, environment and climate change, energy security, prevention and management of communicable diseases, and drugs and human trafficking (ADB 2010).

Figure 1 provides a schematic view of the analytical framework applied in this paper to the analysis of the channels, pillars, and structures used to promote regional economic integration in Asia, including initiatives for regional cooperation.

Figure 1: Asia's Economic Regionalism: Analytical Framework



Source: Author's compilation.

A recent ADB study took stock of Asia's institutions for regionalism and suggested the need to strengthen such institutions to promote regional economic and social development (ADB 2010). The study identified 40 intergovernmental institutions for regional integration (IRI), including transregional (7); pan-Asian (2); intraregional (10); and subregional (21) ones, classified as overarching, functional, and facilitating institutions.² Overarching IRIs such as the Asia-Pacific Economic Cooperation (APEC); ASEAN+3, ASEAN, the South Asian Association for Regional Cooperation (SAARC) or the Pacific Islands Forum (PIF) are seen as umbrella arrangements based on the vision of an integrated region, while functional IRIs such as AMRO or GMS, are specialized organizations with a specific range of activities and

² The study did not include non-intergovernmental organizations and other regional cooperation initiatives, programs, and groups which support Asian regionalism from broad perspectives and involve the knowledge community (such as local think tanks) and the civil society at large. By adding these organizations, the study suggested there may be more than one hundred IRIs currently active in Asia.

a technical agenda. In addition, Asia's facilitating IRI (ADB and ESCAP) are seen as international entities bolstering regional cooperation and integration through advisory, technical, and financial support.

While the existing network of IRIs has served Asia well, the institutional architecture for regionalism is facing a pressuring need to undertake structural reforms, as more Asian countries intensify their regional and global economic interdependence. As a matter of fact, Asian economic integration remains uneven across subregions as well as functional areas, having mostly focused on trade in intermediate goods within East Asia: South Asia, Central Asia, and the Pacific are de facto not involved in regional production networks. While trade between South and East Asia—notably between India and the PRC—is growing, only few industries are part of this development. Although East Asia's intraregional trade shares are close to 55%, similar figures remain very low for the other Asia's subregions. At the same time, as Asian economies are rapidly strengthening their ties with the rest of the world, it is of utmost importance to ensure that regional and global integration remain compatible: any measure aiming to cement Asia's integration should complement rather than compete with global initiatives (ADB 2010).

Reforms of Asia's institutional architecture for regionalism are also needed to cement the gains that have been so far achieved by regional members and to deepen integration in sectors which are still lagging behind. While regional cooperation initiatives are important to avoid the recurrence of economic and financial crises by limiting vulnerability to external shocks, Asia's integration needs to move beyond production networks and expand into services, skilled labor, financial markets, monetary and exchange rate arrangements, initiatives to narrow the income gap, and the provision of other regional public goods.

High-level political leadership is required to shape Asia's new institutional architecture for economic and financial integration. While the process of Asian regionalism is often seen as mostly coming from the bottom up, recently key political leaders have formulated visions for a more closely integrated Asia aiming to establish a regional community. Yukio Hatoyama and Kevin Rudd, the former Prime Ministers of Japan and Australia, respectively, called for the creation of an "East Asian Community" and an "Asia-Pacific Community", respectively. The PRC's President, Hu Jintao, articulated the vision for a "Harmonious Asia"; Korean President Lee Myung-bak suggested a "New Asia Initiative", and the Indian Prime Minister, Manmohan Singh, proposed to establish an "Asian Economic Community".

Political leaders seem keen to support closer regionalism through enhanced dialogue and projects on economic and security matters. They are showing stronger commitment to closer regional integration. But where do this new top-down approach and the traditional bottom-up approach meet? What is the desirable structure of a new institutional architecture for regional economic and financial integration? To what extent is it possible to convert the visions of political leaders into the process of institution building? Will Asia's IRIs become more effective in delivering their mandates?

This paper analyzes the results of a recently conducted ADB survey of 1,000 opinion leaders from Asian countries, which shed some light on the above questions (ADB 2010). It also discusses the need to strengthen existing regional institutions and to create new ones. Chapter 2 presents the survey's methodological approach and provides some basic statistics on the sample composition. Chapter 3 discusses main challenges Asia is facing to strengthen its IRIs. The progress towards closer regional monetary and financial cooperation is presented in Chapter 4, while Chapter 5 concludes with a discussion on the creation of an Asia-wide economic community and the needed new institutions.

2. OPINION LEADERS' SURVEY

In early 2010 the ADB surveyed opinion leaders in Asia and the Pacific about their views on the institutional architecture for regional integration. The survey findings suggest that Asia's opinion leaders are increasingly in favor of creating an economically integrated region (ADB 2010). They feel that while cooperation on trade and finance is progressing, more needs to be done to provide economic infrastructure and regional public goods in areas such as natural disasters' management, environmental preservation, communicable diseases, and energy and food security. They believe that, to promote closer cooperation and deeper economic integration, Asia needs new and stronger institutions for regionalism. They are confident that in the long run Asia will be able to create a region-wide economic community.

The ADB survey used a stratified sample of 3,027 opinion leaders from 19 countries in the Asia and the Pacific region. The sample was organized into five subregions³ and four categories of opinion leaders (academics, business leaders, government officials, members of media and/or civil society organizations). The sample distribution by country and category was based on a weighted average of the population size and its gross domestic product, as shown in Table 1.

³ Central Asia, South Asia, Southeast Asia, Northeast Asia, Oceania and the Pacific.

Table 1: Breakdown of Responses

Subregion	Country	Category				TOTAL
		Academia	Business	Government	Media/NGO	
Central Asia	Kazakhstan	2	4	4	2	12
	Kyrgyz Republic	1	2	2	1	6
	Uzbekistan	1	2	2	1	6
	Total	4	8	8	4	24
South Asia	India	16	36	36	16	104
	Pakistan	4	12	14	8	38
	Sri Lanka	3	10	10	3	26
	Total	23	58	60	27	168
Northeast Asia	PRC	36	70	43	8	157
	Japan	20	79	48	6	153
	Republic of Korea	11	43	12	2	68
	Total	67	192	103	16	378
Southeast Asia	Indonesia	7	42	23	10	82
	Malaysia	15	10	12	5	42
	Philippines	14	52	52	6	124
	Singapore	23	6	11	1	41
	Thailand	9	20	34	4	67
	Viet Nam	5	2	26	3	36
	Total	73	132	158	29	392
Pacific and Oceania	Australia	6	6	6	4	22
	Fiji Islands	1	2	2	1	6
	PNG	1	2	2	1	6
	Vanuatu	1	1	1	1	4
	Total	9	11	11	7	38
GRAND TOTAL		176	401	340	83	1,000

NGO = Nongovernment Organization; PNG = Papua New Guinea; PRC = People's Republic of China.

Source: ADB (2010).

Around 77% of respondents were based in either Southeast or Northeast Asia, followed by South Asia (16.8%), the Pacific and Oceania (3.8%), and Central Asia (2.4%). Business leaders accounted for 40% of respondents, government officials for 34%, academics for 18%, and opinion leaders from the media and nongovernmental organizations for 8%. The profile of total respondents was made up of 71% males and 29% females. The average education level of opinion leaders interviewed was very high: on average 61% of them had a post-graduate degree, 38% a graduate degree, and a mere 1% had only completed secondary education. In terms of age composition, the largest share (60%) was aged between 30 and 49, followed by those aged between 50 and 69 (31%), while only 6% were below 30 and 3% above 70.

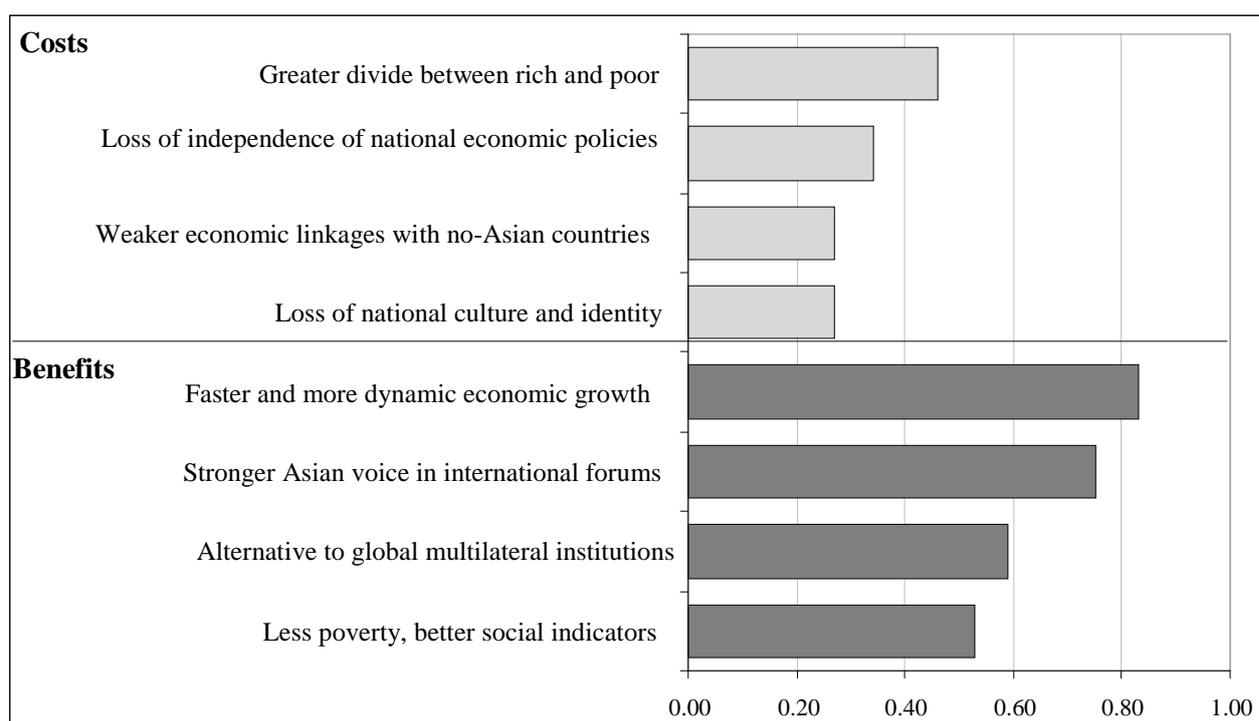
The names and contact details of opinion leaders interviewed were gathered from ADB's lists obtained from its headquarters and resident missions. To increase the likelihood of response, the survey questionnaire was designed to take no more than 10–15 minutes to complete. To facilitate understanding by a broad spectrum of respondents, the English questionnaire was translated into six languages (Bahasa Indonesian, Japanese, Korean, Mandarin, Russian, and Vietnamese). All interviews were conducted online with the help of

an independent surveying firm. The survey was closed once 1,000 responses were collected.

3. CHALLENGES TO STRENGTHENING ASIA'S INSTITUTIONS FOR REGIONALISM

The largest majority of Asian opinion leaders believe the benefits of strengthening regional economic interdependence outweigh its costs (Figure 2). Regional integration is seen as a positive force for Asian countries as it speeds up their economic growth and gives them a stronger voice in international forums. Closer regional integration is also perceived as helping reduce poverty and improve social indicators, as well as offering an alternative to global multilateral institutions. Among the costs associated with regionalism, opinion leaders are most concerned about a potential widening of the divide between the rich and the poor, which may happen because the benefits from closer regional economic ties are unevenly distributed within and across countries. However, regional initiatives such as improvements in infrastructure and connectivity may help narrowing the development gap. Perceived costs of regionalism include also a loss of independence over national economic policies and an erosion of competitive advantages over neighboring countries, as national standards are harmonized or mutually recognized. Other costs of closer regional integration are related to the weakening of economic links with non-Asian countries and the feared erosion of national culture and identity.

Figure 2: Perceived Costs and Benefits of Regional Economic Integration



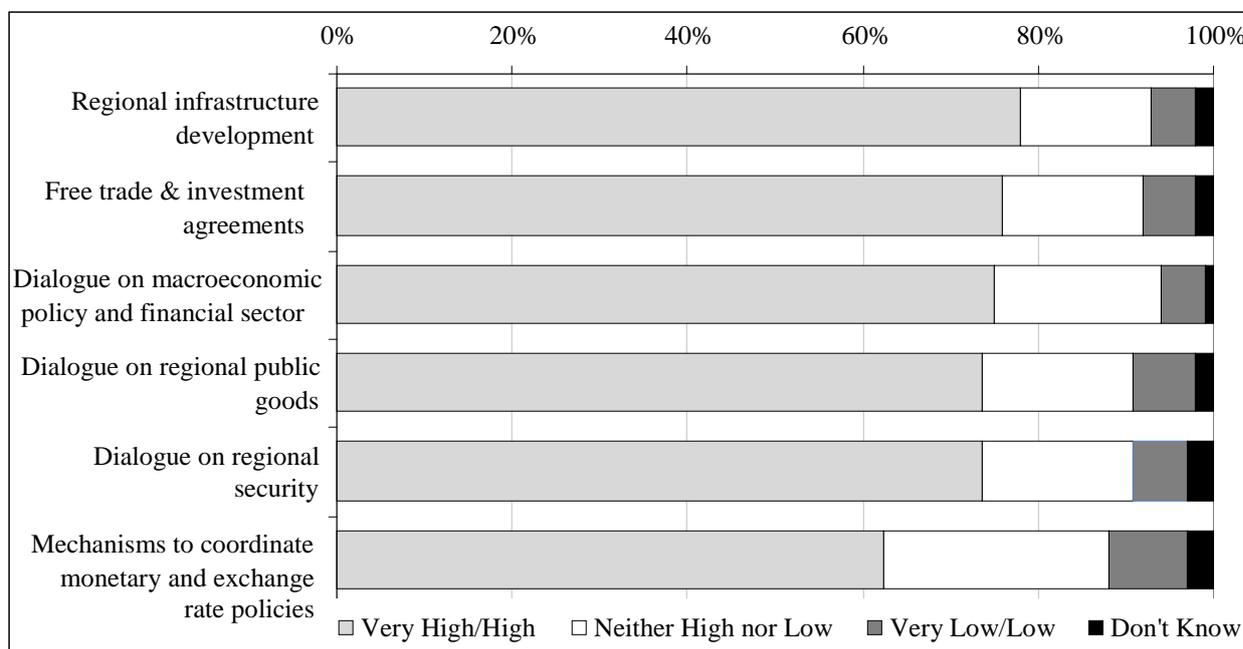
Note: Values are based on total response (1,000). The question was: Rate the costs and benefits for your country of strengthening economic relations with other countries in Asia and the Pacific.

Source: ADB (2010).

Concerning the effects of regional cooperation, opinion leaders believe that infrastructure projects to improve connectivity and establish energy links offer the biggest benefits, followed by the creation of a region-wide free trade and investment area. Regional dialogues on macroeconomic policy, financial-sector development, the provision of regional public goods, and security issues are also perceived as highly beneficial, followed by mechanisms to coordinate monetary and exchange-rate policies. Figure 3 lists such functional areas in

order of importance, as suggested by opinion leaders. These findings are consistent with those of a previous similar ADB survey conducted in 2007 to a relatively smaller group of opinion leaders (ADB 2008; Capannelli 2010).⁴

Figure 3: Advantages of Regional Cooperation



Note: Values are based on total responses (1,000). The question was: Rate the advantages for your country from participating in different initiatives for regional cooperation.

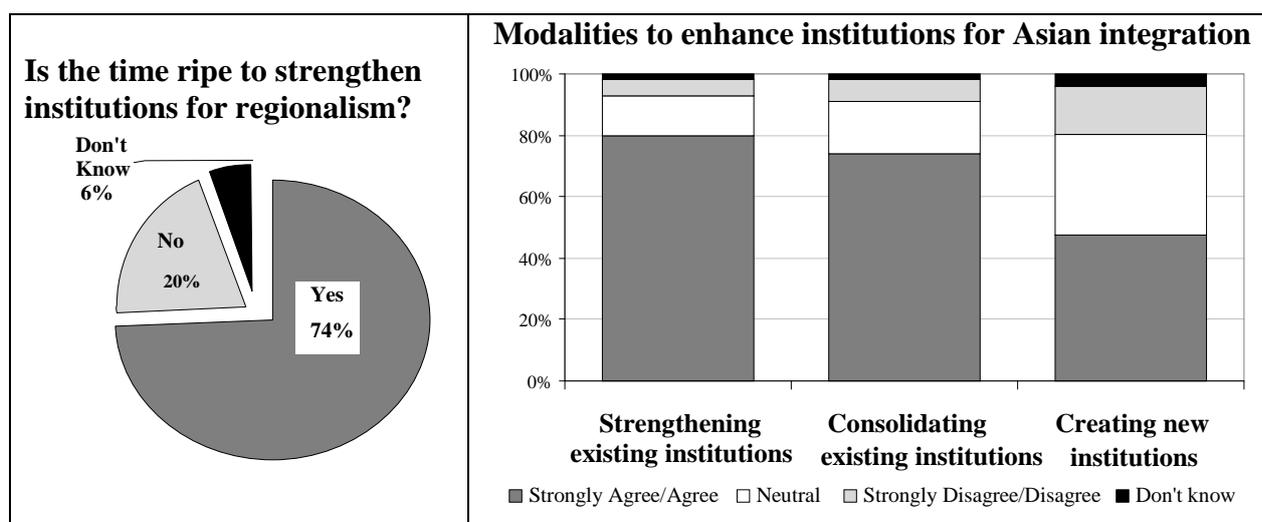
Source: ADB (2010).

As Figure 4 shows, nearly 75% of the region's opinion leaders believe that Asian policy makers should build stronger institutions for regionalism. They agree that existing institutions should be strengthened by increasing human and financial resources, receiving more delegated powers from national agencies, improving their governance structures, eliminating unnecessary functional duplications, consolidating existing arrangements into region-wide ones, and defining a clear division of labor among similar institutions.

Around half of opinion leaders believe that new institutions should be created where gaps exist or where existing ones are inefficient or ineffective. In particular, two main areas where new regional institutions are deemed to be more urgently needed are in developing infrastructure and providing regional public goods. At the same time, opinion leaders believe the need to create new institutions is less pressing in areas such as trade and investment or money and finance, where closer regionalism can be achieved by empowering existing institutions.

⁴ The ranking of advantages remained the same in 2007 and 2010, as did the general intensity. The proportion believing that the creation of a region-wide free trade and investment area would have high or very high benefits increased from 69% of respondents in 2007 to 76% in 2010.

Figure 4: Readiness and Modalities for Asia's Institutions for Regional Integration



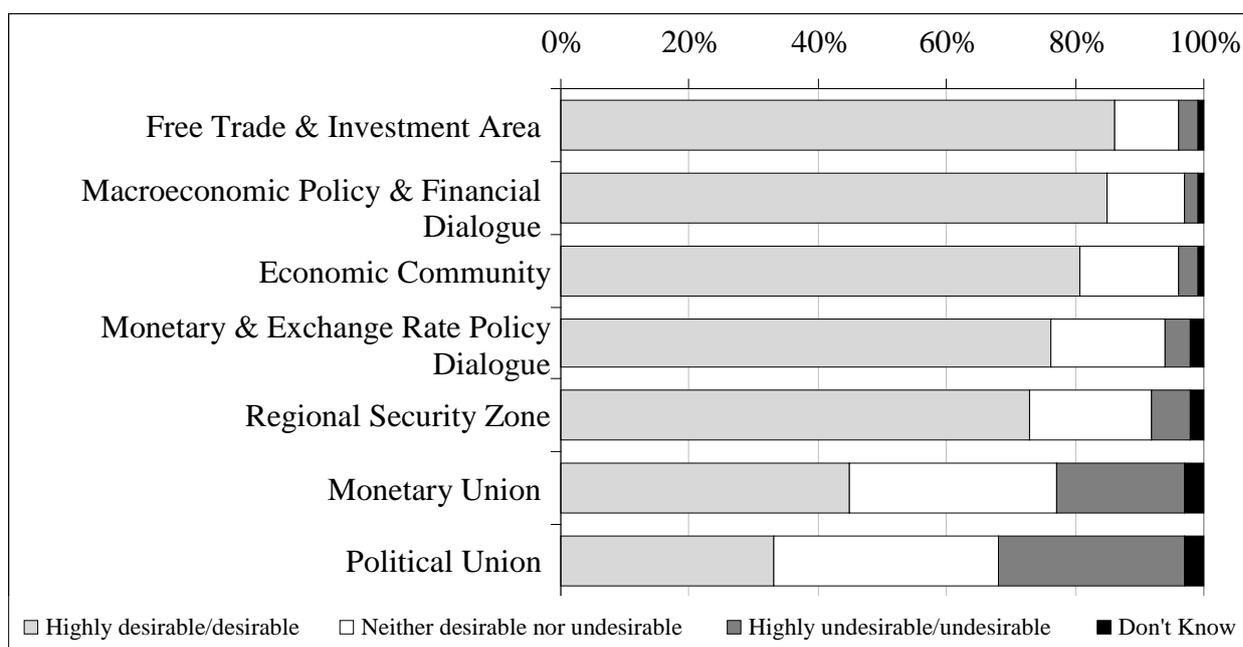
Note: Values are based on total response (1,000). The questions were: Q1: Do you share the view that the time is ripe for leaders in Asia and the Pacific to greatly strengthen the capabilities of institutions for regional integration? Q2: Indicate to what extent you agree (disagree) with the appropriateness of the different modalities to enhance institutions for regional integration in Asia and the Pacific.

Source: ADB (2010).

The creation of an “Asian economic community” is considered by the largest majority of surveyed opinion leaders (more than 80%) as one of the main long-term objectives of regional economic integration. While the actual structure and articulation of such a community was not clearly specified in the questionnaire responses, it is generally regarded as a comprehensive institution covering a wide range of operational areas and member countries. Besides a regional economic community, Asian opinion leaders see the formation of a region-wide free trade and investment area and a dialogue to strengthen financial stability and coordinate macroeconomic policies as an even more desirable objective of regionalism.⁵ A closer dialogue on monetary and exchange-rate policy and the creation of a regional security zone also featured near the top in the list of preferences. Creating an Asian single currency or a political union received considerably less support. In particular, only 33% of respondents felt a political union was desirable or highly so, while 35% remained neutral (Figure 5).

⁵ Respectively 86% and 85% of surveyed opinion leaders marked them as highly desirable or desirable long-term objectives of integration among Asian countries.

Figure 5: Desirability of Regional Integration Objectives

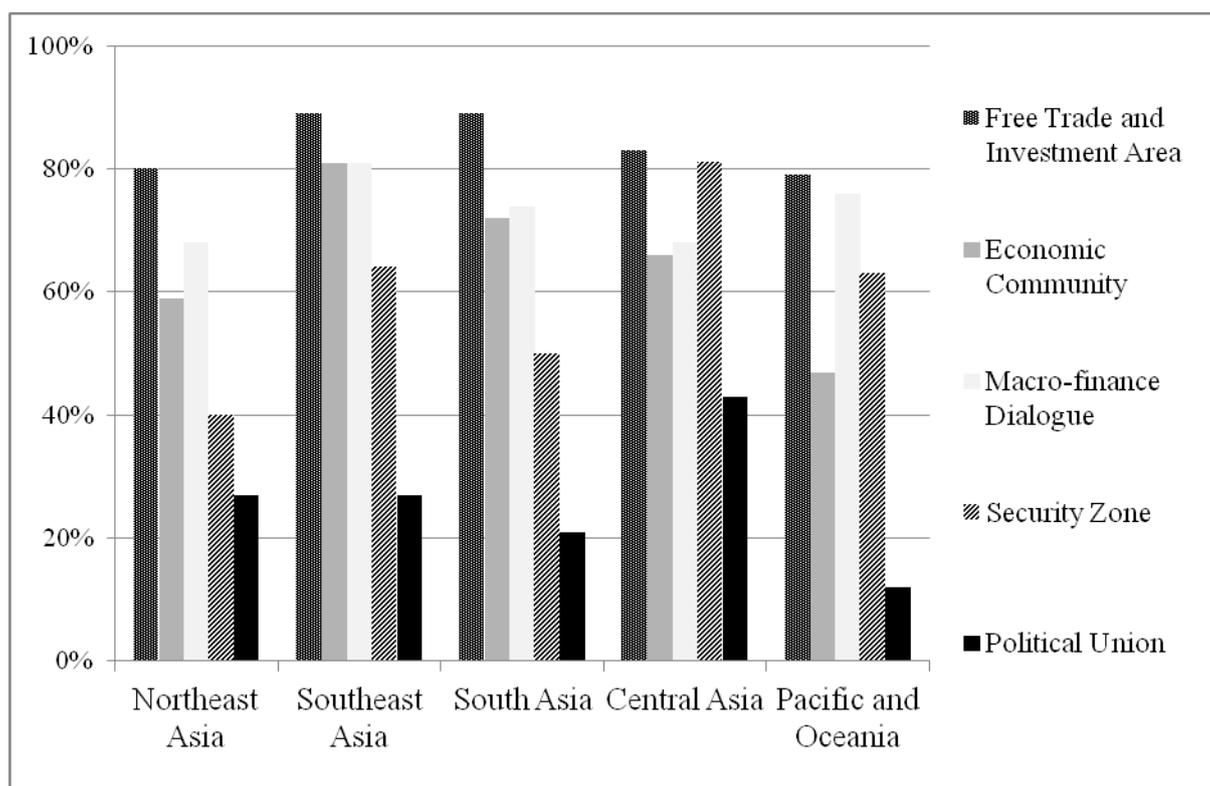


Note: Values are based on total response (1,000). The question was: Thinking of your long-term vision for regionalism, rate the desirability of various integration objectives among countries in Asia and the Pacific.

Source: ADB (2010).

Creating an economic community at the subregional level, is seen as a high priority in Southeast and South Asia, perhaps partly because ASEAN and SAARC have both been promoting similar ideas. In particular, ASEAN is committed to creating an ASEAN Economic Community based on a single market and production base by 2015. On the other hand, opinion leaders from Central Asia and the Pacific consider the establishment of an economic community a much lower priority. Opinion leaders from Central Asia were more interested in establishing a security zone and they also registered the highest inclination to create a political union. These results are not too surprising, given Central Asian countries' recent past as part of the Soviet Union. In the Pacific, the highest priorities were to establish a free trade and investment area and a dialogue on macro-financial issues (Figure 6).

Figure 6: Desirability of Selected Regional Integration Objectives by Asia’s Subregions

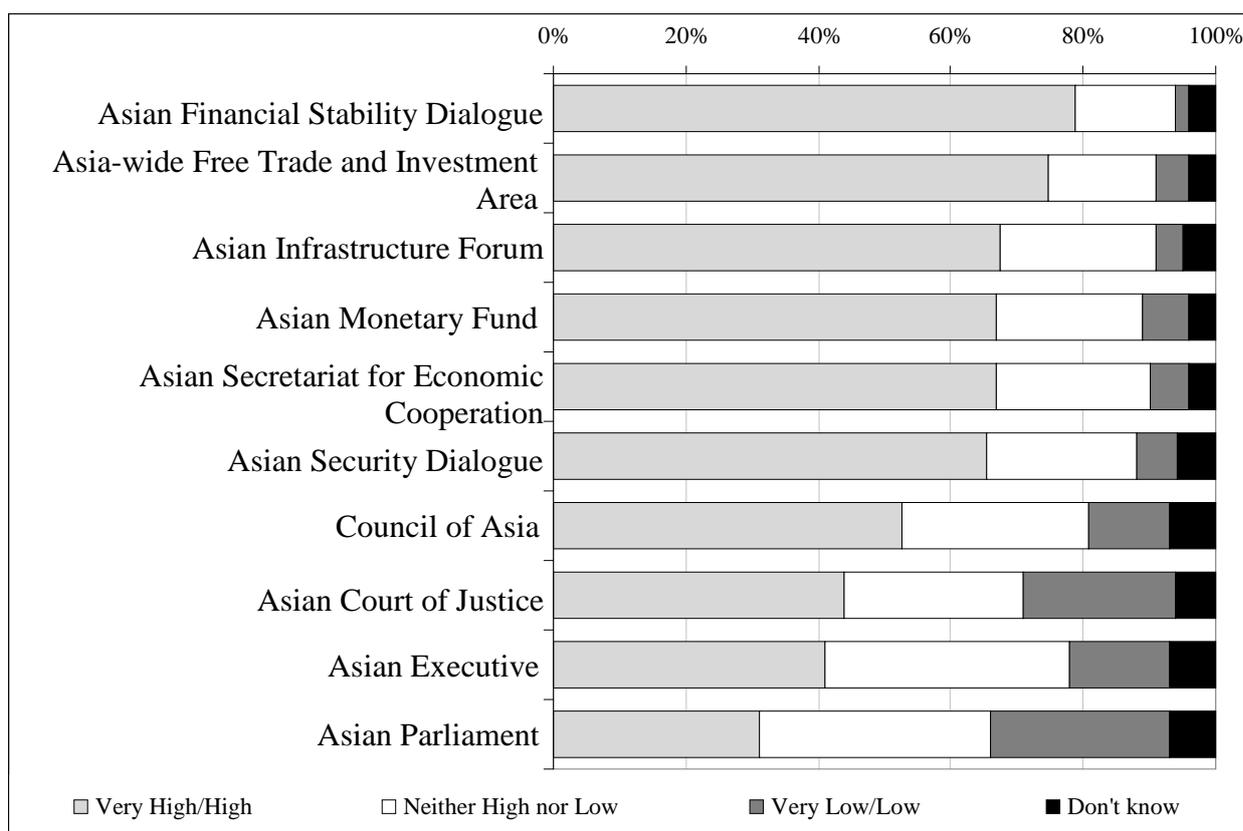


Note: Values are based on total response (1,000). The question was: *Thinking of your long-term vision for regionalism, rate the desirability of various integration objectives among countries in your region.*

Source: ADB (2010).

The realization of these long-term objectives requires the enhancement of existing institutions for regionalism and the creation of new ones. The survey’s results show that opinion leaders believe several new institutions need to be created in the near future to promote Asia-wide economic integration. A “Financial Stability Dialogue” emerged as the most needed new regional institution as the importance to ensure regional financial stability by strengthening regulation, monitoring, and dialogue between the public and private sector was suggested as very high or high by 78% by Asia’s opinion leaders. The consolidation of existing Asia’s FTAs and development of guidelines for best regional practice through the creation of a “Free Trade and Investment Area” emerged as the second most needed institution in the view of Asia’s opinion leaders, as Figure 7 shows.

Figure 7: Support of Institutions for Asian Integration



Note: Values are based on responses from 1,000 opinion leaders in Asia and the Pacific to ADB's 2010 perception survey. The question was: *Rate the importance to create the following institutions for regional integration in Asia and the Pacific, leaving aside the issue of exact membership composition of each institution.*

Source: ADB (2010).

The third priority was the creation of an “Asian infrastructure forum”, which is seen as playing an important role in improving connectivity also by coordinating and integrating existing initiatives at subregional level. The next three priorities in terms of new institutions for regionalism were, respectively, the creation of an “Asian monetary fund”, to conduct regional financial monitoring and pull resources together for liquidity support to regional members, an “Asian secretariat for economic cooperation”, to create a common market and coordinate macroeconomic policies in the region, and an “Asian security dialogue” to ensure the avoidance of military conflicts, the peaceful settlement of disputes, and the solution of security-related issues.

About 50% of opinion leaders believe in the importance of creating a “Council of Asia”, i.e., an umbrella organization which brings together existing region- and function-specific institutions to capture their synergies and complementarities. The lowest priorities, were institutions *à-la* Europe, or, in descending order, the creation of an “Asian court of justice”, to ensure the proper application of the region's rules, norms, and standards, and to adjudicate the region's cross-border disputes, an “Asian executive”, to represent the region's governments, and a “parliament” for raising citizens' instances (which less than one third of opinion leaders considered to be a highly important or important priority).

The remainder of this paper will analyze the progress of monetary and financial cooperation in the region, with a focus on the role played by its institutions. Based on the survey results and the suggestions provided by Asia's opinion leaders, it will also discuss the need to create new institutions supporting regional integration given the perspectives for creating an “Asian economic community” in the medium to long term.

4. PROGRESS OF ASIA'S MONETARY AND FINANCIAL COOPERATION

The Asian financial crisis of 1997–98 was the single main factor that triggered monetary and financial cooperation among countries in the region. Collective action was deemed necessary to address the root causes of the crisis and help solving structural weaknesses related to market development and regulatory frameworks which were—and to a large extent still are—generalized throughout the region. The crisis revealed how Asia was lagging behind in terms of financial systems' development compared with the real sector and production networks. Poor performance was due to several factors including: (i) financial intermediation predominantly conducted by the banking sector; (ii) scarcity of long-term credit and underdevelopment of capital markets, especially public and private bonds; (iii) several weaknesses in regulatory and supervisory frameworks, such as underdeveloped domestic credit bureaus, or accounting and reporting standards; (iv) lack of competition in domestic financial sectors; and (v) poor corporate governance.

In response to the crisis, an important tool used by Asian policy makers to address their financial systems' structural weaknesses was the introduction of domestic reforms aimed to increase efficiency and stability. Regional cooperation initiatives were also strengthened as safeguards against the whims of global markets and as a platform for promoting economic development. In 1998, as the crisis was still unfolding, ASEAN members started a regional Surveillance Process to monitor the trend of their macroeconomic variables including monetary, financial, and fiscal indicators. The Executives' Meeting of Asia-Pacific Central Banks (EMEAP) also strengthened its role to coordinate Central Banks' initiatives and the ASEAN+3 Finance Ministers Process was set up. The latter established the Economic Review and Policy Dialogue (ERPD), which prompted the creation of the Chiang Mai Initiative (CMI) in 2000, and the Asian Bonds Markets Initiative (ABMI) in 2002.

The existing main forums for Asia's financial cooperation and their functions are summarized in Table 2. The ERPD was established as an intergovernmental institution to support regional discussions on macroeconomic policies and structural reforms, including collaboration on a broad range of issues, from monetary to fiscal policies, financial regulation and development of market infrastructure, as well as early-warning systems to assess financial vulnerabilities.

Table 2: Main forums for Asia’s financial cooperation

	ASEAN	ASEAN+3	EMEAP	APEC	ASEM	EAS
Year established	1967	1999	1991	1989	1996	2005
No. of members	10	13	11	21	45	16
<i>Functions</i>	Policy dialogue/ information exchange	√	√	√	√	√
	Surveillance/ Peer review	√	√	√		
	Regional financing arrangements	√	√	√		
	Regional capital- market development	√	√	√	√	
	Capacity building	√	√	√	√	√
	Research	√	√	√	√	√

Notes:

APEC=Asia-Pacific Economic Cooperation (includes Australia, New Zealand, Papua New Guinea, USA, Canada, Chile, Mexico, Peru, and Russia; ASEAN=Association of Southeast Asian Nations; ASEAN+3=ASEAN countries plus The PRC, People’s Republic of, Japan, Korea, Republic of; ASEM=Asia-Europe Meeting (includes Mongolia, Pakistan, and 27 EU member countries); EMEAP=Executives’ Meetings of East Asia-Pacific Central Banks; SEACEN=South East Asian Central Banks (includes Mongolia, Papua New Guinea, Fiji, Nepal, and Sri Lanka); SEANZA=South East Asia New Zealand and Australia (includes Mongolia, Macao, Papua New Guinea, Australia, New Zealand, Pakistan, Nepal, Sri Lanka; Bangladesh, and Iran); ACD=Asian Cooperation Dialogue; and EAS=East Asia Summit.

ACD Working Group on Financial Cooperation meets once a year. Proposed Finance Ministers Meeting in 2006 was postponed.

EAS held its first Informal Senior EAS Finance Officials’ Dialogue in September 2007 in Jakarta, Indonesia.

Source: (ADB 2008).

It must be noted, however, that while ASEAN+3 financial cooperation covers a wide range of activities, from information exchange to regional financing arrangements and capacity building programs, EPRD cooperation remains mostly limited to information exchange. In fact, besides initiatives such as the CMI and ABMI, East Asian authorities have yet to consider adopting common monetary and exchange rate regimes, financial regulations, or binding policy coordination agreements. In other words, the ERPD represents the first, necessary step for regional cooperation, where member countries share peer information through macroeconomic and financial monitoring and policy dialogue. A second step could be the harmonization of regional standards introducing the mutual recognition of existing regulations and practices. Eventually, more advanced cooperation could occur through a gradual shift of sovereignty from national agencies to regional institutions and ultimately through full policy coordination (Kawai and Takagi 2005).

Two major initiatives of financial cooperation through which Asian countries have made some progress towards setting regional standards are the CMI and the ABMI, with the former seeking to shield East Asian economies from the recurrence of currency and liquidity crises, and the latter aiming to help develop East Asia’s local-currency bond markets and deploy the region’s savings for regional investments. The development of East Asia’s bond markets is also being fostered by the introduction of Asian Bond Funds (ABFs) promoted by EMEAP.

4.1 The Chiang Mai Initiative and its multilateralization

Designed to address short-term foreign exchange liquidity problems, the CMI expanded to the PRC, Japan, and Korea the ASEAN Swap Arrangement (ASA) introduced in 1977 by the monetary authorities of the then ASEAN members (Indonesia, Malaysia, the Philippines,

Singapore, and Thailand) to establish reciprocal currency swaps. It also expanded the ASA to the newer ASEAN members (Brunei Darussalam, Cambodia, Lao PDR, Myanmar, and Viet Nam), although the swaps with the “Plus-Three” countries were limited to the original five members, that were in effect the ones hardest hit by the crisis. Modeled on the ASA, bilateral contracts and repurchase facilities under the CMI defined the amount, duration, and currency to be used in the swap, providing at the same time an institutional mechanism to pursue further negotiations among ASEAN+3 countries.

Such institutional mechanism proved to be an important factor in transforming the system of bilateral swaps into a regional pooling arrangement of collectively managed reserves through the CMI’s multilateralization (CMIM), which was initially announced by ASEAN+3 Finance Ministers in 2008, later introduced at their meeting in Bali in 2009, and finally made effective in 2010. The CMIM implied adopting a new approach to contributions by member countries to a common reserve pool, a new decision-making mechanism to govern the fund, and the conduct of a new regional surveillance process to ensure that members maintain proper macroeconomic and financial conditions to repay loans to the fund.

In terms of contributions, the “Plus-Three” countries agreed to collectively cover 80% of the common reserve pool, leaving the remaining 20% to ASEAN members. In particular, the PRC and Japan were able to reach an important compromise by agreeing to contribute equally to the fund (32% each)⁶ while it was agreed that the Republic of Korea would provide half of that amount (16%). Contribution shares to the CMIM fund from ASEAN countries were agreed based on individual members’ financing capacity. Table 3 shows the CMIM details, including not only its financial contributions, but also borrowing arrangements and voting powers. It is worth noting the intrinsic bias in favor of small countries built into the CMIM, as the largest economies (the PRC, Japan) can borrow no more than 50% of their contributions from the fund, while the five smallest ASEAN economies are entitled to borrow up to five times their contributions. Similarly, small countries have a larger voting power compared with their share of the fund’s total value.

⁶ The 32% share actually includes a contribution from the PRC of 28.5% and Hong Kong, China of 3.5%.

Table 3: Contributions, Borrowing Multipliers, and Voting Power under the Multilateralized Chiang Mai Initiative

Members	Financial contributions		Borrowing arrangements		Voting power			
	\$ billion	% share	Multiplier	Quota (\$ billion)	No. of basic votes	No. of votes based on contributions	Total no. votes	% share
PRC + Hong Kong, China	38.40	32.00					40.00	28.41
- PRC	34.20	28.50	0.50	17.10	1.60	34.20	35.80	25.43
- Hong Kong, China	4.20	3.50	2.50	10.50	0.00	4.20	4.20	2.98
Japan	38.40	32.00	0.50	19.20	1.60	38.40	40.00	28.41
Republic of Korea	19.20	16.00	1.00	19.20	1.60	19.20	20.80	14.77
Plus Three Countries	96.00	80.00			4.80	96.00	100.80	71.59
Brunei Darussalam	0.03	0.03	5.00	0.20	1.60	0.03	1.63	1.16
Cambodia	0.12	0.10	5.00	0.60	1.60	0.12	1.72	1.22
Indonesia	4.55	3.79	2.50	11.36	1.60	4.55	6.15	4.37
Lao PDR	0.03	0.03	5.00	0.20	1.60	0.03	1.63	1.16
Malaysia	4.55	3.79	2.50	11.36	1.60	4.55	6.15	4.37
Myanmar	0.06	0.05	5.00	0.30	1.60	0.06	1.66	1.18
Philippines	4.55	3.79	2.50	11.36	1.60	4.55	6.15	4.37
Singapore	4.55	3.79	2.50	11.36	1.60	4.55	6.15	4.37
Thailand	4.55	3.79	2.50	11.36	1.60	4.55	6.15	4.37
Viet Nam	1.00	0.83	5.00	5.00	1.60	1.00	2.60	1.85
ASEAN	24.00	20.00			16.00	24.00	40.00	28.41
ASEAN+3	120.00	100.00			20.80	120.00	140.80	100.00

Note: ASEAN+3 = ASEAN countries plus the People's Republic of China (PRC), Japan, and the Republic of Korea.

Source: ASEAN Secretariat. <http://www.asean.org/22536.htm>

At their 2009 Bali Meeting, ASEAN+3 Finance Ministers agreed to set the initial CMIM size at \$120 billion, expanding considerably the value of existing bilateral contracts, which amounted to only \$84 million at the end of 2008. Although it is not easy to assess the optimum size of this fund, many analysts argue that \$120 billion is inadequate to tackle possible liquidity shortages of Asian economies and are in favor of a substantial increase of the fund's total amount, also considering the very rapid expansion in the size of Asian economies and their international reserves. For example, when challenged by the 2008–09 global financial crisis, Asian countries required approximately between \$40 and \$60 billion in liquidity support, while the largest five ASEAN economies are able individually to access less than \$12 million from CMIM funds. As matter of fact, when the global financial crisis unfolded, the Korean and Singaporean monetary authorities did not try to activate the CMI but asked instead for the mobilization of bilateral support lines from the US Federal Reserve. Considering that the current CMIM size is approximately only 2.5% of total ASEAN+3 countries' international reserves, there seems to be large room to increase the CMIM fund's size (Soesastro 2009).

Another criticism of the CMIM is the close link to programs of the International Monetary Fund (IMF), which many would like to reduce or eliminate. Following the existing financing arrangements, the mobilization of more than 20% of individual countries' quotas needs to be reviewed by the IMF, which may decide to apply conditionality rules linked to its programs. Although the introduction of the new IMF's Short-Term Liquidity Facility—which enables

certain countries to borrow without conditions—has partially softened this criticism, several analysts have been arguing for a considerable increase (up to 100%) of the amount of money CMIM countries should be able to borrow without IMF conditionality.

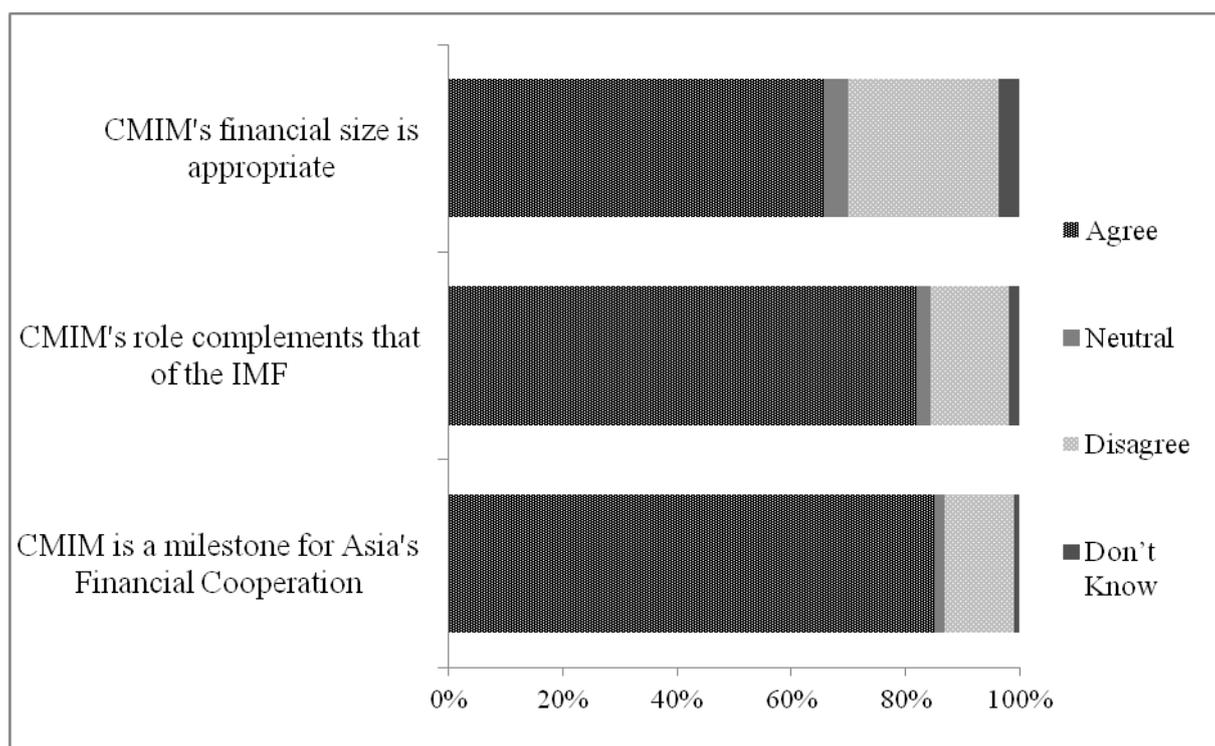
Leaving aside the issues of size and IMF conditionality, the CMIM remains a fundamentally important step for the institutionalization of Asia's financial cooperation. In addition to the agreement on individual countries' contributions reached in Bali, CMIM members agreed to adopt a flexible decision-making structure, whereby only decisions on fundamental issues⁷ require consensus, while operational issues on lending and repayment conditions can be decided by a weighted majority system linked to individual countries' contributions. This development—constituting a revision to ASEAN's consensus principle—represents a major boost for the fund's effectiveness and it helps preventing any of the “Plus-Three” countries individually, or ASEAN as a group, from holding veto power on operational issues.

In terms of regional macroeconomic and financial surveillance, the innovation introduced by the CMIM is the setting up of a new agency, AMRO, with the mandate to detect emerging vulnerabilities and monitor the trend of key macroeconomic and financial variables, to avoid the moral hazard problem related to unconditional financing and ensure that CMIM members maintain proper conditions to repay loans from the fund. Recently established in Singapore, AMRO is expected to perform regional macroeconomic surveillance, supplementing—not replacing—the national and global surveillance functions performed by the IMF through Article IV missions and the publication of reports. As it becomes fully operational, the amount member countries can withdraw from the CMIM free from the IMF conditionality clause could be increased, allowing ASEAN+3 members to rely more on their own assessments when making lending decisions.

The opinion leaders' survey included a question on the ASEAN+3 Finance Ministers' decision to multilateralize the CMI. The results, summarized in Figure 8, show that more than 80% of respondents agreed on the importance of CMIM as a milestone for Asia's financial cooperation, while approximately 75% believed that AMRO is not a substitute for the IMF, but that its role in regional surveillance will complement the work being done by the IMF.

⁷ Such as reviews of membership, size, borrowing multiples, terms of lending, IMF conditionality ratios.

Figure 8: Views on the Multilateralization of the Chiang Mai Initiative



Note: Values are based on responses from 1,000 opinion leaders in Asia and the Pacific to ADB's 2010 perception survey. The question was: *Please indicate to what extent you agree or disagree with the following statements on the creation of the new ASEAN+3 surveillance agency.*

Source: ADB (2010).

Overall, the CMIM represents a highly significant institutional development for the progress of Asian regionalism as it not only reduces transaction costs and duplications, but also offers a new platform for the management of regional monetary arrangements. In particular, it sets a model for addressing other priority areas for regional cooperation besides monetary issues. For example, enhanced intergovernmental dialogue has spurred further cooperation in areas such as trade, investment, and financial supervision and regulation. The CMIM governance structure could be used as a model for delivering regional public goods such as environmental preservation, disaster preparedness, and disease prevention. The new CMIM institutional set up could also serve to speed up financial market development, for example, by establishing a fund to invest in developing regional bond markets, and in turn promote a better use of the region's huge savings to help finance its massive investment requirements.

As AMRO grows to become a strong and solid institution and the CMIM is delinked from the IMF, the region could acquire a de facto "Asian monetary fund". In fact, once proper governance structures and technical expertise are in place, and once AMRO is capable of introducing relevant policy conditionality, it could effectively evolve into the Secretariat of an "Asian monetary fund" created through an expansion of the CMIM's size and an enlargement of its membership and functions to include new financing instruments such as precautionary credit lines and others. Such a "Fund" is to be seen as complementing the IMF role in the region by intensively monitoring Asian economies and by working independently of the IMF during idiosyncratic and localized crises, while closely cooperating with it in the provision of liquidity financing and conditionality rules during bigger financial crises.

4.2 Developing bonds markets in Asia

The main reason behind the establishment of the ABMI and ABF was the intention to achieve a more efficient recycling of Asian savings into Asian investment by developing bond markets denominated in local currencies and strengthening national financial systems'

resilience to economic shocks. The 1997–98 crisis was indeed made more severe by the absence of well-developed bond markets, which left Asian companies no choice but to rely on bank loans and borrow in foreign currency (Eichengreen and Luengnaruemitchai 2004). As regional financial authorities realized such weakness of their domestic systems, they decided to promote regional initiatives—namely the ABMI and ABF—to develop local-currency denominated bond markets, together with the introduction of domestic regulatory reforms.

These initiatives have generally facilitated a better understanding of how financial operators could overcome market impediments and promoted the alignment of national policies with international best practices. As a result, capital markets today play a much larger role in East Asian countries' financial intermediation than in the period immediately before the 1997–98 crisis (ADB 2008, 2010). In fact, recent data show that bond markets increased from about one fifth of total financial intermediation in East Asian countries in 1995 to approximately one third in 2010. During the same period the share of total outstanding local-currency bonds issued in East Asia in relation to the world's total increased from about 2.5% to more than 8%.⁸

Created in 2002, the ABMI became fully operational in 2003, also with the establishment of a dedicated website (AsianBondOnline) which offers a one-stop market data and information portal for institutional investors. Over the years the ABMI has implemented several activities organized under various working groups aiming at improving national regulatory frameworks by: (i) establishing a credit guarantee mechanism, (ii) strengthening domestic credit rating agencies; (iii) disseminating information on national and regional bond markets; (iv) assessing the feasibility of regional foreign exchange clearing and settlement systems; and (v) creating new securitized debt instruments.

More recently (April 2010) ASEAN+3 Finance Ministers endorsed the creation of the Credit Guarantee and Investment Facility (CGIF), facilitating in turn capital markets' development and making the regional financial system less vulnerable to fluctuations induced by abrupt changes in macroeconomic variables. Established as an ADB trust fund with an initial capital of \$700 million, the CGIF mandate is to provide credit guarantees to local corporations to enable them raise long-term funding instruments by improving the conditions to issue bonds within their domestic markets and across ASEAN+3 countries, facilitating in turn a solution to currency and maturity mismatches and promoting the harmonization of standards and practices for bond issuances in regional infrastructure and other key areas.

Regional cooperation initiatives promoted by East Asian central banks through the creation of the ABF1 and ABF2 under the EMEAP have also contributed to improving the attractiveness of the region's bond markets. Established in 2003, the ABF1 gathered a total of US\$ 1 billion of international reserves, which were invested in US\$-denominated sovereign and quasi-sovereign debt issued in East Asian economies. Subsequently, with the creation of ABF2 in 2005, the amount of invested reserves was doubled to US\$ 2 billion and its focus shifted to local-currency denominated sovereign and quasi-sovereign bonds. A further \$2 billion were allocated by EMEAP economies to the Pan-Asian Bond Index Fund, which also invests in local-currency sovereign and quasi-sovereign bonds.

Overall, ABMI and ABFs have greatly helped the growth of bond markets in East Asia and reduce currency and maturity mismatches. As a result, East Asian economies were able to withstand the 2008–09 crisis showing relatively stronger resilience than the US and Europe. A lot still remains to be done, however, to harmonize rules across the region, strengthen market infrastructure, overcome remaining market impediments, and tighten legal and regulatory frameworks. Local corporate bond markets remain, with the exception of the

⁸ For detailed figures, see the AsianBondsOnline website at: <http://www.asianbondsonline.adb.org/>

Republic of Korea, underdeveloped, and Asian authorities need to promote their growth to attract more investment in the region. Domestic reforms and regional cooperation initiatives are needed in this area especially to improve accounting standards, market infrastructure, and legal systems.

An important institutional development in support of financial cooperation is the possible creation of an “Asian bond markets forum” with the aim of standardizing market practices and harmonizing cross-border regulations of financial transactions. Another possible development relates to the enhancement of domestic rating agencies through capacity building programs, as credit rating agencies of East Asian countries are often relatively small and tend to use non-comparable methodologies and benchmarks in their rating process, needing therefore some form of standardization and harmonization across the region (ADB 2010).

The survey results of opinion leaders shown in Figure 6 and Figure 7 suggest that Asian countries may find it convenient to further institutionalize their regional cooperation initiatives by promoting closer dialogue on macro-financial issues. As Asian policy makers strengthen existing measures, there is room to create a new institution to facilitate a dialogue in promoting financial stability: an “Asian financial stability dialogue”—as it was proposed by the ADB—could indeed reveal itself to be very helpful for improving the efficiency and effectiveness of Asia’s financial markets as well as macroeconomic policy formulation (ADB 2008).

Such new institution would promote the development of the region’s financial markets and address their vulnerabilities by bringing together all relevant authorities—from central banks, to finance ministries, financial supervisory and regulatory agencies, as well as private sector corporations. The “Dialogue” would help authorities strengthen their domestic regulations and supervisory functions and coordinate their regional efforts through information exchange, the mutual recognition of market practices, and the harmonization of minimum supervisory rules in a wide range of areas including capital flows and capital account liberalization. The “Dialogue” would also give Asian authorities a stronger voice in international forums and play a role similar to that performed by the Financial Stability Board at a global level. Its ultimate aim is to make Asia a more stable and resilient region in terms of dealing with future crises through improved regulation and supervision, including closer coordination with global agencies.

5. TOWARDS AN ASIA-WIDE ECONOMIC COMMUNITY

The institutions supporting Asia’s monetary and financial cooperation discussed in section 4 cannot be taken in isolation: they need to be understood in the wider context of strengthening Asia’s move towards closer regional and global integration. The pillars of Asian regionalism presented in Figure 1 include initiatives not only in the area of money and finance, but also in trade and investment, infrastructure and connectivity, and regional public goods: an Asian economic community should cover these pillars as well.

Asia’s opinion leaders suggested that new functional institutions be created in each pillar, including regional security as a public good. They indicated that an umbrella organization such as a “Council for Asia” may also be needed to coordinate the overall regional architecture. In addition to the new functional institutions for monetary and financial integration already discussed in section 4, opinion leaders suggested the need to establish several new regional frameworks and organizations including a “ , an “Asia-wide FTA”, and several forums for “regional public goods” (Figure 7).

A recent study by the Asian Development Bank Institute (ADBI) articulated the need to create a “pan-Asian infrastructure forum” to help coordinate and integrate existing regional and subregional infrastructure initiatives. The idea is to provide a venue to help build a

regional consensus among key Asian stakeholders and prioritize regional infrastructure projects with the assistance of an expert advisory group. Such an institution could help to develop harmonized regulatory standards based on international best practices, and extend national treatment to foreign investors to encourage private sector participation. It could contribute to exchange information, conduct joint-research, and develop a common regional framework to handle and mitigate negative social and environmental impacts created by infrastructure projects. In addition to the *forum*, the ADBI study also proposed the creation of an “Asian infrastructure fund” to finance selected projects for regional infrastructure development (ADBI 2009).⁹

To date, Asia’s approach to regional infrastructure cooperation has been flexible, pragmatic, and driven by the market. While large top-down programs such as the Asian Highway and the Trans-Asian Railway did not perform as expected and proceeded only at a slow pace, bottom-up cooperation, based on good relations among a small group of members pursuing common objectives, has been relatively more successful, manageable, and flexible. The GMS and CAREC programs are good examples of bottom-up cooperation in subregional infrastructure development by a relatively small group of countries (Kuroda, Kawai, and Nangia 2008).

During the last twenty years, cooperation initiatives under the trade and investment pillar experienced an exponential growth in FTAs involving Asian countries. The number of FTAs that were signed by Asian economies increased from a total of four agreements in 1990 to 45 in 2000 and 112 in 2010. Similarly, the total number of FTAs that were only proposed or still under discussion and that involve at least one Asian country increased from only one in 1990 to nine in 2000 and 109 in 2010 (ADB 2010; Capannelli, Lee, and Petri 2010). Such proliferation of Asian FTAs, which is largely related to the crisis of global trade and investment negotiations in the Doha Round of the World Trade Organization (WTO), has helped to deepen trade links between Asian countries. But it also creates regional coordination problems as the contents of these FTAs, including their coverage and rules of origin, are usually very different from each others, creating a “noodle bowl” effect and requiring some form of regional cooperation initiative to limit their costs (Baldwin 1996, 2006; Feridhanusetyawan 2005; Menon 2009).

The creation of an “Asia-wide FTA” which consolidates existing bilateral and plurilateral FTAs agreements into a single regional agreement offers an effective solution, with great potential benefits not only for Asia but also for the rest of the world. On the one hand, such a large FTA would help realize sizeable economies of scale, boost the region’s business environment by eliminating domestic-policy distortions to intra-regional trade and investment, and facilitate technology transfer. At the same time, it would also help to solve the Doha Round impasse as it would create an incentive for non-Asian countries to align themselves with the content and structure of an “Asia-wide FTA” given its size-effect on global trade. Once a region-wide FTA is formed, it may also be easier for Asian countries to establish a customs union by introducing a common external tariff among its members, as the European Economic Community did in 1968 (ADB 2010).

The geographical coverage of an “Asia-wide FTA” could be gradually expanded through concentric circles, using the “ASEAN+” concept. From an ASEAN+3 FTA¹⁰, a region-wide agreement could expand into an ASEAN+6 agreement¹¹, and eventually embrace other

⁹ As a matter of fact, in May 2011 ASEAN countries agreed to establish an ASEAN Infrastructure Fund (AIF) with an initial capital of \$800 million. The aim of the fund is to finance regional infrastructure projects.

¹⁰ There is an existing proposal for creating an East Asia Free Trade Agreement (EAFTA).

¹¹ There is also a proposal to create a Comprehensive Economic Partnership in East Asia (CEPEA) among ASEAN+6 countries.

Asian countries willing to join the group. An “Asia-wide FTA” could eventually be linked with APEC¹² and the EU as well, forming a major building block for global trade negotiations and help the completion of the Doha Round. While it remains quite difficult to have many parties (and interest groups) reach consensus on a single agreement, an Asia-wide FTA could target to consolidate at least a core set of fundamental issues setting a minimum common regional denominator, while leaving non-fundamental issues to be governed by the existing FTAs.

As discussed in section 3, the results of the survey of Asia’s opinion leaders highlighted the relative lack of formal cooperation initiatives in the area of regional public goods, when compared with those already started in other areas. The creation of several “forums” aimed at improving the delivery of “regional public goods” would help complete the formation of an Asian economic community and reduce the region’s vulnerability which has intrinsically emerged with the negative externalities generated by its increased intraregional interdependence. Asia still lacks proper institutions to coordinate the delivery of regional public goods in areas such as environment and climate change, disaster risk management, energy and food security, health concerns, and drugs and human trafficking. Indeed, the list of issues related to each of these areas can be very long.

For example, environment-related issues include loss of biodiversity, deforestation, coastal management, aquatic resource depletion, rising sea levels, air and water pollution, and several others. Natural calamities such as earthquakes, tsunamis, volcanic eruptions, flooding, and drought seem to have increased in frequency and intensity in the last few years and regional forums dealing with disaster risk management can help find sustainable solutions for the affected areas. International cooperation has also proven to be very effective in health-related areas such as prevention and management of communicable diseases such as human immunodeficiency virus/acquired immune deficiency syndrome, avian influenza, and severe acute respiratory syndrome. Energy and food security is another area where regional forums could help Asian economies to diversify their sources and mitigate the impact of uneven distribution of natural resources across countries. Most of the initiatives in these areas are still initiated by special interest groups, individual countries, or existing forums at global level. They rarely originate from Asian institutions and initiatives, or coordinated region-wide (Sandler 2005).

Creating an Asian economic community requires several of the institutions listed above to be created to deepen regional integration in a broad range of issues. At the same time, establishing a regional economic community also requires enough buy-in from individual countries. This condition implies that for each proposed new initiative, or institution, the net benefits from integration should be made explicit and it should be clear that national sovereignty losses be more than compensated by gains in shared regional sovereignty. Moreover, to achieve an adequate balance of powers, an Asian economic community should be built on the concept of collective leadership to make all participants feel they have an important role to play in the regional institutional setup.

Openness and transparency should be used as two general principles to help shape the new regional institutional architecture. Asia’s original “open regionalism” concept reflects an approach that minimizes discrimination against non-members (Drysdale 2006; Garnaut 1994; Yamazawa 1990). Although Asia’s traditional high dependency on non-regional markets and technologies may have imposed this approach by necessity more than virtue, the openness principle ensures that initiatives for economic integration also foster Asia’s global links. At the same time, ensuring transparency of regional institutions is an important factor to enhance their accountability. Introducing a proper feedback system to evaluate

¹² Recent discussions on the expansion of the Free Trade Agreement of Asia and the Pacific (FTAAP) to large APEC economies such as Japan and the US represents a promising development. FTAAP’s potential impact may however be limited by the fact that it seems unlikely that the PRC will decide to join the agreement.

results and ensure greater participation of the civil society in the governance structures of regional institutions are also important ingredients in designing effective organizations leading to the creation of a regional economic community.

Will Asia be able to shape a regional architecture for economic and financial integration that covers a wide range of issues and whose institutions provide net gains to their members by using collective leadership and shared sovereignty, while remaining open and transparent? The pronounced diversity existing among Asian economies, societies, histories, cultures, and political systems suggests that the path towards regionalism may not be an easy one to follow. It will be difficult for all countries together to be ready to increase their regional economic interdependence at the same time. Asian cooperation and integration will likely continue to be characterized by variable geometries, following a multi-track and multi-speed approach based on the readiness and interest of each country to join regional initiatives and institutions (ADB 2008, 2010). A regional economic community should capitalize on Asia's diversity by respecting its styles and traditions. It should not impose a single model but be governed by flexibility, adaptation, and continuous transformation to be able to cope with rapidly changing internal and external conditions.

Given the relatively high degree of global integration that characterizes Asian economies, the prosperity that can be generated by a more deeply integrated region is to be shared not only by individual Asian countries but with the entire world. Asian political leaders should be ready, however, to translate into action their declarations of intent regarding closer regionalism, create proper structures and new institutions to start a top-down approach to regional integration, as well as mobilize sufficient financial resources to ensure that future initiatives will be solid and sustainable. The 1,000 Asian opinion leaders who replied to the ADB survey are largely confident that the benefits of regionalism outweigh its costs by a substantial margin. They are part of an expanding and vibrant knowledge community which provides intellectual support to the progressive move towards closer Asian integration. The challenge facing the creation of a regional economic community is to bring this enthusiasm to the grassroots level and give new impetus to the bottom-up approach by involving the civil society in the process.

REFERENCES

- Ando, M., and F. Kimura. 2005. The Formation of International Production and Distribution Networks in East Asia. In *International Trade in East Asia*, edited by I. Takatoshi and A. Rose. NBER: Tokyo.
- Athukorala, P-C. (2005. Production Fragmentation and Trade Patterns in East Asia. *Asia Economic Papers* 4(3): 1–27.
- Asian Development Bank. 2006. Regional Cooperation and Integration Strategy. Manila: ADB.
- Asian Development Bank. 2008. Emerging Asian Regionalism: A Partnership for Shared Prosperity. Manila: ADB.
- Asian Development Bank. 2010. Institutions for Regional Integration. Toward an Asian Economic Community. Manila: ADB
- Asian Development Bank Institute. 2009. Infrastructure for a Seamless Asia. ADBI: Tokyo.
- Balassa, B. 1961. *The Theory of Economic Integration*. Allen & Unwin: London.
- Baldwin, R. 1996. A Domino Theory of Regionalism. In *Expanding Membership of the EU*, edited by R. Baldwin, P. Haaparanta, and J. Kiander.. Cambridge, United Kingdom: Cambridge University Press:.
- Baldwin, Richard (2006). "Managing the Noodle Bowl: The Fragility of East Asian Regionalism", *CEPR Discussion Paper No. 5561*. London: CEPR.
- Capannelli, G. 2010. Perceptions of Economic Interdependence: The view of Asian Opinion Leaders. In: *Asian Regionalism in the World Economy. Engine for Dynamism and Stability*, edited by M. Kawai, J-W. Lee, P. Petri. Cheltenham, UK, and Northampton, MA, USA: Edward Elgar.
- Capannelli, G., J-W. Lee, and P. Petri. 2010. Economic Interdependence in Asia: Developing Indicators for Regional Cooperation and Integration. *Singapore Economic Review* 55(1): 125–161.
- Drysdale, P. 2006. Regionalism in Asia and the Pacific and an Asian Economic Community. Paper presented in a workshop in ICRIER, New Delhi, 30 March.
- Eichengreen, B., and P. Luengnaruemitchai. 2004. Why Doesn't Asia Have Bigger Bond Markets? *NBER Working Paper No. W10576*.
- Feridhanusetyawan, T. 2005. Preferential Trading Agreements in the Asia-Pacific Region. *IMF Working Paper 149*. Washington, DC: IMF.
- Garnaut, R. 1994. Open Regionalism: Its Analytic Basis and its Relevance to the International System. *Journal of Asian Economics* 5(2): 273–290.
- Kawai, M. 2005. East Asian Economic Regionalism: Progress and Challenges. *Journal of Asian Economics* 16(1): 29–55.
- Kawai, M. 2007. Evolving Economic Architecture in East Asia. Discussion Paper No. 84. Tokyo: ADB Institute.
- Kawai, M., and S. Takagi. 2005. Towards Regional Monetary Cooperation in East Asia. Lessons from Other Parts of the World. *International Journal of Finance and Economics*. (10): 97–116.
- Kuroda, H., M. Kawai, and R. Nangia. 2008. Infrastructure and Regional Cooperation. In: *Rethinking Infrastructure for Development*, edited by F. Bourguignon, and B. Pleskovic. World Bank, Washington DC.

- Menon, J. 2009. Dealing with the Proliferation of Bilateral Free Trade Agreements. *The World Economy* 32(10): 1381–1407.
- Petri, P. 2006. Is Asia Becoming More Interdependent? *Journal of Asian Economics* 17(3), 381–394.
- Sandler, T. 2005. Regional Public Goods and International Organizations. *The Review of International Organizations* 1 (1): 5–25
- Soesastro, H. 2006. Regional Integration in East Asia: Achievements and Future Prospects. *Asian Economic Policy Review* 1(2): 215–235.
- Soesastro H. 2009. East Asia, the G20 and global economic governance. Available at: <http://www.eastasiaforum.org/2009/03/08/east-asia-the-g20-and-globaleconomic-governance/>
- Urata, S. 2001. Emergence of an FDI-Trade Investment Nexus and Economic Growth in East Asia. in *Rethinking the East Asian Miracle*, edited by J. E. Stiglitz, and S. Yusuf . New York, NY: Oxford University Press.
- Yamazawa, I. 1990. Economic Development and International Trade: The Japanese Model. Honolulu, HI : East-West Center.