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Governance and Economic Integration: Stakes for Asia

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Abstract

This paper assesses the nexus between changes in governance structures—at national and cooperative international levels—and evolutionary processes of economic integration in light of regional policy targets in Asia. The analysis highlights the importance of improved governance as an essential condition for effectively attaining an “Asian Economic Community” while arguing that the experience of the European Union (EU) offers valuable insights regarding the process of integration.

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Contents

1. INTRODUCTION AND OVERVIEW

The impact governance, including notably institutions, can have on a country's economy is well established, while the determinants and mechanisms defining this interrelation have been the focus of considerable analytic and empirical study.[1] The tenet "governance matters" has been one of the World Bank's key research and policy initiatives in its drive to foster growth and development while alleviating poverty. A central concern has been with the extent to which the effectiveness of foreign aid and debt relief may be contingent on the quality of governance in recipient developing countries.

Yet, far less attention has been given to how governance structures and associated performance implications can condition countries' international economic activities, including trade and foreign direct investment, as well as how the latter potentially impact governance. In this regard, a crucial set of analytic and policy issues concern the extent to which the realization of varying degrees of regional economic integration can depend on the interrelation between national governance and regional institutions. This paper focuses on the nexus between changes in governance structures—at national and cooperative international levels—and evolutionary processes of economic integration in light of regional policy targets in Asia. The analysis highlights the importance of improved governance as an essential condition for effectively attaining an "Asian Economic Community" while arguing that the experience of the European Union (EU) offers valuable insights regarding the process of integration.

The European experience underscores the potential endogeneity of national and regional governance structures and practices to the process of market integration and heightened international economic cooperation. Collective mechanisms and incentives have been introduced at a more centralized EU level to upgrade standards, improve public goods and services, reduce international transactions costs and uncertainties, as well as to redefine other forms of multi-layered government intervention. The EU's goal of a Single Market has led to a collective regional consensus to dismantle an array of national government practices that had fostered market segmentation and generated "border effects." Yet, several factors are relevant to assess the validity of the lessons that Asia can learn from the European experience. How far down the road Asian countries should go to a more top-down, versus the prevailing bottom-up, approach to regional cooperation depends on the degree of policy ambitions and extent of consensus regarding a shared goal on achieving greater market integration. The best design of regional governance undoubtedly also depends on the heterogeneity of governance, economic, and social conditions that characterize sets of countries in different hypothetical regional integration "clubs."

The rest of this paper is structured as follows. The discussion in the next section offers a summary analysis of governance. Key aspects of the interrelation between national governance performance and regional economic cooperation aimed at heightening economic integration across markets are then identified. Section 3 examines salient empirical characteristics of the evolution in governance performance in Asia in a global context while including comparisons between different configurations of Asian and EU countries, as well as country-specific estimates of governance efficiency. Section 4 gives a detailed analysis of the interrelation between governance and economic integration processes, while highlighting generic lessons from the EU experience. The discussion stresses, nonetheless, that insights from Europe need to be adapted to the context of regional integration in Asia, or elsewhere. The concluding

[1] Notable contributions include the research of Acemoglu, Johnson, and Robinson (2001, 2005); North (1990, 1991); Dixit (2009); and Rodrik, Subramanian, and Trebbi (2004).

analysis in Section 5 assesses the policy challenges and stakes many Asian countries face on the road to greater regional economic integration. It is argued that there is a tradeoff between maintaining the status quo in governance structures and performance, and realizing more ambitious, market integration targets. In that regard, an upgrading of national governance standards and a redefined role for cooperative regional institutions are called for. Finally, operational policy strategies and recommendations are identified.

2. DEFINING GOVERNANCE AND ITS RELATION TO ECONOMIC INTEGRATION

Governance can be understood to concern the nature and distribution of decision-making power within organizations and societies. This includes the formal and informal structure of decision-making processes across subsets of agents and entities in the public and private domains. An essential issue is whether hierarchies, network structures, and other key dimensions of such processes are optimally designed to promote the interests and objectives of specific institutions and collective social welfare. Crucially, "good" governance entails not just achieving such specific objectives as efficiency, but it also necessitates a critique of the moral and social validity of the ostensible goals being pursued. Governance entails organizational questions relating not only to economics, but also to political science, business, sociology, law, and other disciplines. As such, it is inherently multidimensional, while its determinants are often interdependent and potentially complex.

In an insightful overview of the performance implications of alternative governance structures for economic activity, Dixit (2009: 5) characterized governance as "the structure and function of the legal and social institutions that support economic activity and economic transactions by protecting property rights, enforcing contracts, and taking collective action to provide physical and organizational infrastructure." Dixit elaborates on the role of public intervention in providing public goods and controlling public "bads," while pointing out that collective action needs to include "not just physical, but also institutional and organizational infrastructure. Provision of social safety nets, facilitation of international of externalities, and the control of public bads, for example management of common pool resources." More specifically, collective action is argued to often be warranted to respond to free-rider problems and associated multi-person prisoner's dilemmas.

The innovative statistical work of Kaufmann and Kraay, et al. (1999, 2002, 2009) has identified distinctive dimensions of governance, thereby placing implications of national institutional performance across countries at the center stage of empirical and policy research, concerned with the determinants of governance and its relation to processes of growth and development. Specifically, six key governance indicators are proposed, relating to: (i) political stability and violence; (ii) the rule of law; (iii) regulatory burden and effectiveness; (iv) government efficiency; (v) voice and accountability; as well as (vi) corruption and graft.[2] Alternative, but often closely related, measures of governance have also been analyzed by other organizations, including the World Economic Forum (WEF) (2009). In a study sponsored by the World Economic Forum, Lawrence, Hanouz, and Moavenzadeh (2009) explore the implications of governance for international economic performance.

[2] Cross-country comparisons have been integrated into the World Bank's annual publications, notably those reporting World Development Indicators.

It is the international dimension of governance and, notably, the interrelation between national governance performance and the potential returns from collective regional cooperation and economic integration that are central to the principal concerns of this brief. The first key aspect of this interface involves the extent to which a country's effective pursuit of collective regional goals, as policy priorities, may require the subordination of certain historical national policy prerogatives linked to sovereignty. Historically, differences in the structure and functioning of institutions, including legislation and legal practices, have tailored distinctive economic environments across countries. Such divergences are, to some extent, incompatible with realizing heightened regional economic cooperation, leading, ultimately, to full market integration at a regional level.

The foregoing characterization of governance has also underscored its key role in offering an optimal framework, notably through contractual arrangements, as well as physical and social infrastructure, for supporting economic transactions and activities. In this regard, a second key issue relates to the extent to which distinctive national legal environments and the existing provision of public goods and services could hinder the facilitation of regional interconnectivity. Complete market integration would entail the elimination of additional transactions costs and uncertainties at an international level that impede the mobility of goods, services, and production across countries so that there are no longer any "border effects." In sum, the optimal design and quality of institutions—at national and pan-national levels—potentially needs to be transformed to promote heightened regional economic cooperation and integration.[3] Existing configurations and differences in governance quality and economic performance at national levels potentially determine whether regional policy objectives are attainable within given time frameworks. The extent to which certain countries must upgrade their governance and make concessions on national sovereignty may be essential considerations when assessing the prospects for deepening regional economic integration. The subsequent analysis will focus on empirical and policy issues relating to governance and economic integration in Asia while highlighting the relevance of key insights from the European experience, which has spanned more than six decades.

3. GOVERNANCE PERFORMANCE IN ASIA FROM A GLOBAL PERSPECTIVE

An overview of governance in Asia is provided for different regional configurations of countries in Figure 1, on the basis of a comparison of all six, major World Bank indicators between 1996 and 2009.[4] The Association of Southeast Asian Nations (ASEAN) countries, as a whole, are characterized by relatively low governance performance in terms of the different indicators. The overall levels fall well below those for ASEAN+3 (comprising the ten ASEAN members plus the People's Republic of China, Japan, and the Republic of Korea [henceforth, Korea]) and ASEAN+6 (ASEAN plus Australia, PRC, India, Japan, Korea, and New Zealand). Nonetheless, ASEAN's relative performance in regulatory quality and government efficiency is much better than for other measures, such as corruption control, voice and accountability, the rule of law, as well as political stability and absence of violence. With the exception of voice and accountability, which remains the lowest indicator, the ASEAN countries saw a sharp decline in all the other

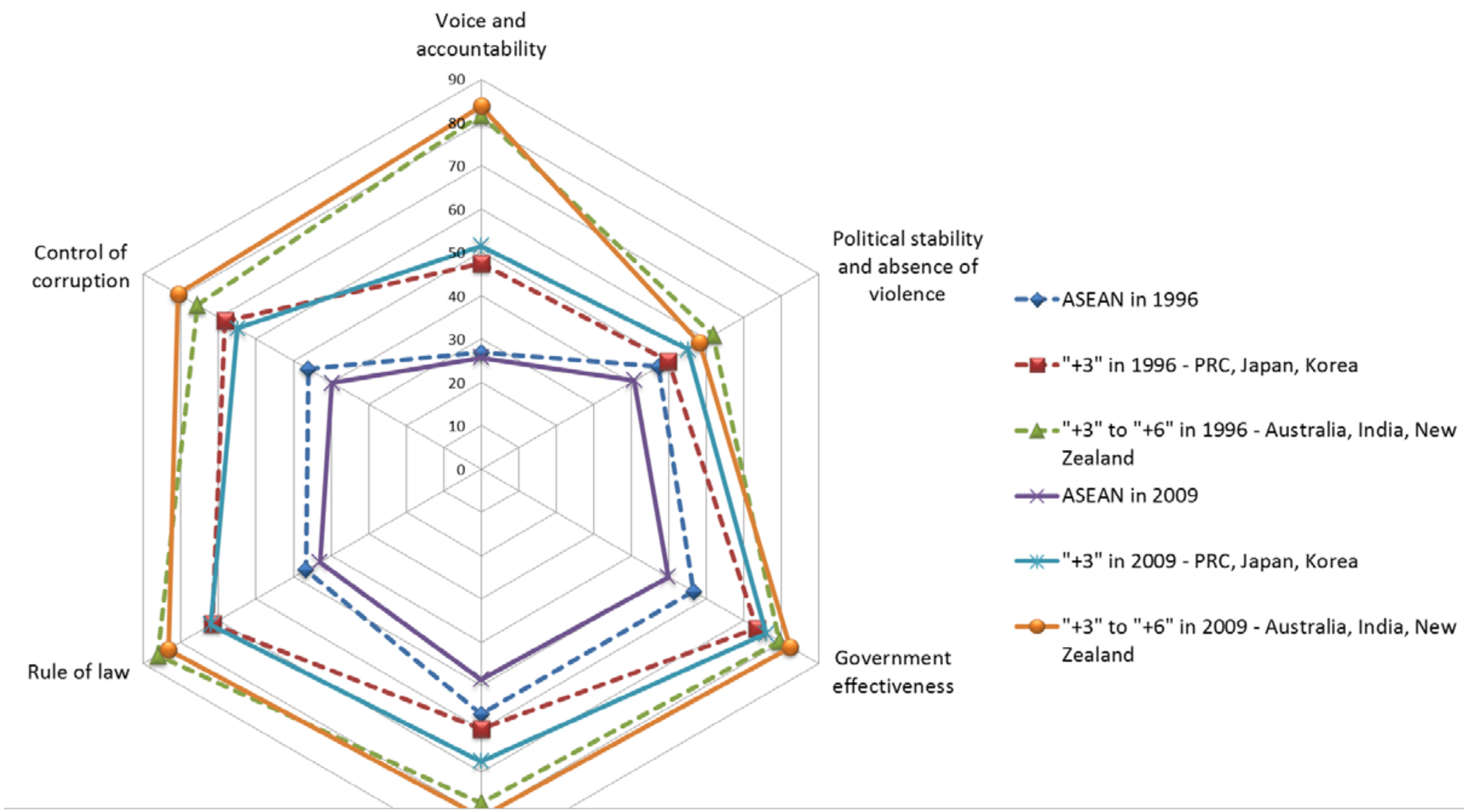
[3] Certain aspects of these issues have been considered in an Asian context by the ADB (2010), which outlines a policy agenda for strengthening regional cooperation in Asia in a move toward achieving an "Asian Economic Community," while another study by the ADB and ADBI (2009) examines ways to improve regional infrastructure.

[4] Owen (2011) provides a more detailed statistical analysis of the subsequently reported comparisons between Asian and EU governance indicators while examining determinants of their evolution.

dimensions of governance performance from 1996 to 2009. Figure 1 also highlights a gap in the averages of national governance performance, corresponding to expanded frameworks of regional cooperation, going beyond ASEAN to include other Asian countries. The so-called “+3” and “+6” scenarios comprise a number of “club” members with stronger national governance performance. Admittedly, the reported averages largely reflect the robust governance measures for the developed economies of Australia, Japan, Korea, and New Zealand. Yet, this statistical analysis highlights a potentially crucial policy question regarding the extent to which heightened regional cooperation could generate positive governance spillover effects across countries. Hypothetically, many ASEAN countries could be major beneficiaries, provided such a larger regional cooperative frameworks were to target the upgrading and convergence of national governance standards across an expanded set of “club” members.

The preceding scenario for governance performance of many Asian countries can be juxtaposed with the European experience. The case of the EU is illustrated in Figure 2, which depicts changes and levels of indicators for alternative groupings of European countries, corresponding to successive EU expansions. The governance performance for most EU 15 countries is consistently close to the highest levels worldwide in both 1996 and in 2007. Admittedly, there are several shortfalls for certain countries, notably Greece, and for specific indicators such as political stability and the absence of violence. Furthermore, the figure reveals that the successive expansions to EU 27 are associated with remarkable improvements of national governance performance and their convergence toward EU 15 averages. Indeed, this marked upgrading of governance is apparent for the two newest members—Bulgaria and Romania—which were among the poorest of the former communist, Eastern Europe countries to join the EU.

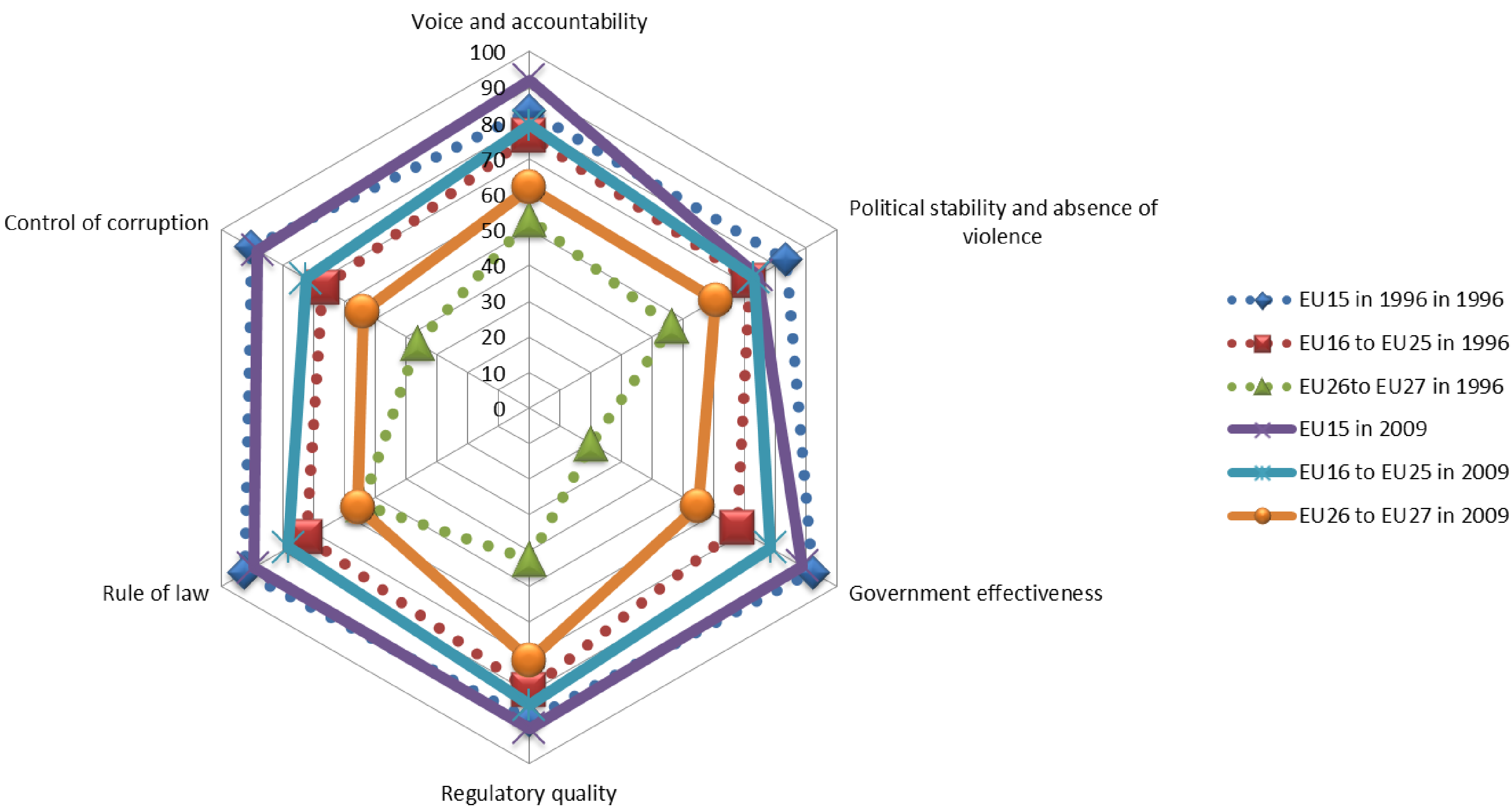
Figure 1: National Governance Indicators, Averaged for Different Subsets of ASEAN + 6 countries—ASEAN, + 3, and from + 3 to + 6, as of 1996 and 2009



Note: The different groups are for historical sets of Asian countries, which have either participated to ASEAN, or one possible prospective participants. Specifically, ASEAN includes: Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, Viet Nam. ASEAN+3 includes "in addition" PRC, Japan, and Korea. While ASEAN+6 comprises ASEAN+3 as well as Australia, India, and New Zealand

Source: The governance indicators are aggregates of statistics reported by the World Bank website, "Aggregate Governance Indicators 1996–2009".

Figure 2: National Governance Indicators, Averaged for Different Sets of Countries Integrated into the EU, as of 1996 and 2009



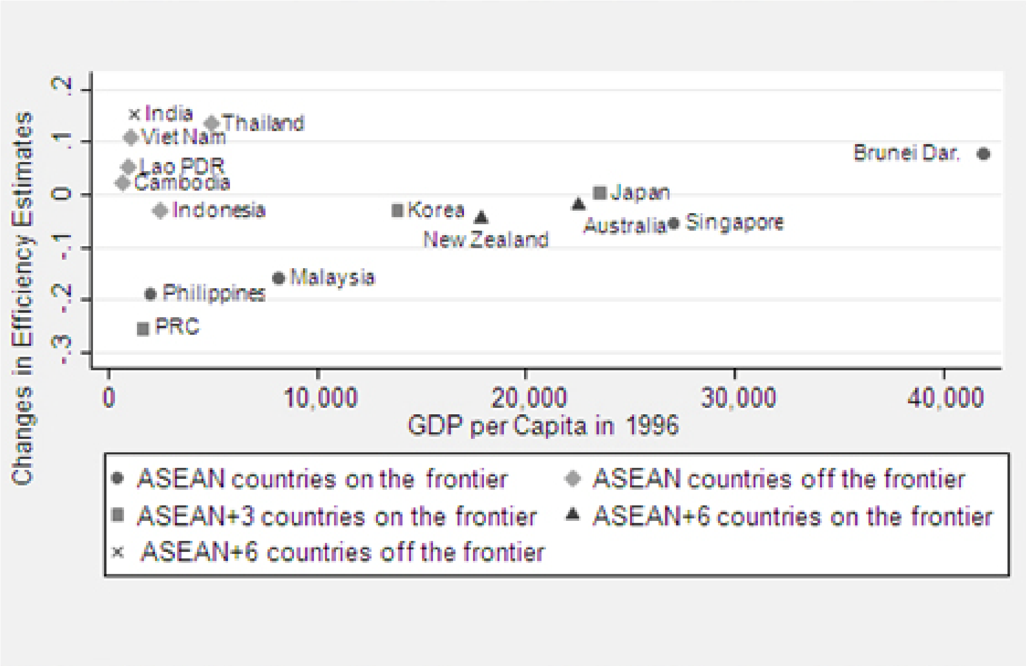
Source: The governance indicators are aggregates of statistics reported by the World Bank website, "Aggregate Governance Indicators 1996–2009".

A more rigorous determination of whether specific countries are characterized by a shortfall in the quality of governance is offered by assessments of government efficiency scores, based on estimates of world governance efficiency frontiers for different representative dimensions of governance. Such an approach could control, at least in part, for the potential interdependency between countries' governance performance and their standards of living. A sensitivity analysis can then identify the extent specific countries are experiencing a governance shortfall, relative to "best practice" governance countries on the efficiency frontier, which, in this instance, corresponds to a positive concave relation between countries' relative institutional performance and their GDP per capita.

Figure 3 provides a summary perspective, between 1996 and 2009, regarding initial levels and changes of governance frontier estimates for ASEAN+6 countries in the case of corruption control. Different symbols distinguish whether countries were initially on or off the world efficiency frontier in 1996.[5] The extent to which there are movements toward (away from) the global efficiency frontier, as of 2009, is then captured in terms of positive (negative) net changes along the vertical axis, reflecting heightened governance efficiency (inefficiency). Table 1, then, presents the associated frontier efficiency scores and governance index values in the two years. Among ASEAN countries, the analysis suggests that Brunei Darussalam, Malaysia, the Philippines, and Singapore were on the frontier in 1996, whereas the level of corruption control in Cambodia, Indonesia, Lao PDR, Thailand, and Viet Nam fell well below the estimated efficiency frontier. A marked deterioration in the performance of Malaysia and the Philippines was seen as of 2009. Indeed, the efficiency score in the Philippines fell far below the world average, which was used as a benchmark threshold to demarcate countries either on or off the efficiency frontier. Among ASEAN countries, only Thailand saw sufficient improvement in its corruption control efficiency score to reach the world average in 2009. Clearly, however, the scenario for most "+6" countries differed from that for ASEAN, corresponding to a stronger hypothetical "club" of countries in terms of their governance performance. The PRC saw a sharp worsening of corruption control between 1996 and 2009, and its efficiency measure fell far below the frontier at the end of this period. India went from below to well above the global average efficiency score.

[5] The frontier estimates were obtained using the stochastic frontier feature of STATA. Fitted values on the nonlinear frontier reflect estimates of "best practice" governance levels, while controlling for differences in countries' standards of living. Efficiency scores for specific countries, evaluated on a scale from zero to one, correspond, then, to what proportion a country's governance measure constitutes, relative to the fitted frontier values. The distinction evoked here, regarding whether a given country is on or off the frontier, is based on whether its estimated efficiency level lies above a benchmark mean value for the efficiency scores for all countries worldwide.

Figure 3: Changes in Estimated Frontier Efficiency Values for Control of Corruption for Asean+6 Countries between 1996-2009



Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic; PRC = People's Republic of China.

Notes: The criteria for classifying countries as being on or off the frontier is based upon whether the efficiency estimates are above or below world average in 1996. Positive values reflect decreased distance from the frontier in 2009 relative to 1996.

The above analysis for ASEAN+6 countries can be compared with the evolution in the performance of the 27 EU countries shown in Table 2. A salient observation is the much stronger overall governance performance of 27 EU countries as of 2009, as reflected by a smaller dispersion of the efficiency index values. This is principally accounted for by a remarkable improvement for a number of Eastern European countries participating in the two membership expansions from 15 to 27 "states," following the fall of the Berlin Wall in 1989. Estonia, Lithuania, Bulgaria, Latvia, and Romania saw notable reversals in their governance efficiency performance. Indeed, Bulgaria, Latvia, and Romania advanced from below to well above the average scores for the world in 2009. Thus, the process of EU adhesion appears associated with a substantial upgrading of governance performance. This remark is in keeping with announced, governance improvement policy targets and implementation programs proscribed by the EU. Finally, while the global perspective on Asian governance performance proposed here has focused on corruption control, an extension of this analysis, reported in Owen (2011), has examined frontier efficiency estimates for other measures of governance performance. A comparison of such efficiency scores reveals consistencies and distinctive patterns across alternative indicators. For example, among ASEAN countries, Cambodia, Lao PDR, and Viet Nam were off the frontier for the rule of law in 1996, but Lao PDR had experienced a substantial improvement by 2009. Yet, for these same two years, while Indonesia, Malaysia, the Philippines, and Thailand were initially on the frontier, their efficiency scores subsequently deteriorated. A similar scenario applies for the PRC, but not for India, which has had a more consistently strong performance for the rule of law.

In sum, the foregoing analysis suggests a need for heightened policy concern across much of Asia regarding specific dimensions of governance performance and overall trends since the mid-1990s. An inescapable conclusion is that ASEAN can be characterized as a club comprising a relatively large number of countries suffering from an efficiency shortfall in several critical areas of governance. An apparent policy issue concerns the extent to which conceivable expanded regional clubs, in such configurations as ASEAN+3 or ASEAN+6, could generate improved national governance performance among member countries, relative to ASEAN by itself. Indeed, as subsequently elaborated, a strong rationale for advocating cooperation within such larger regional frameworks exists when collective policies are aimed at upgrading national governance. Mechanisms include the transfer of “best practice” governance across countries and the substitution of higher quality regional governance for lower quality national practices. Crucially, underwriting the costs of such measures requires intraregional financial transfers from relatively larger or wealthier countries. It is noteworthy that relative to ASEAN, the additional participants in a hypothetical ASEAN+6 configuration of deepened regional integration are, with the exception of the PRC and to a certain extent India, relatively high quality governance countries. Furthermore, many of the economies are larger and more prosperous, which is a precondition for significant inter-country transfers. Hence, to the extent that either national governance performance conditions regional integration processes, or national governance performance can be upgraded through intraregional transfers of financial and other resources, the preceding empirical analysis suggests a rather strong rationale for basing regional cooperation initiatives not just among ASEAN countries, but in a larger Asian-Pacific framework.

Table 1: ASEAN+6 Governance Inefficiency Estimates for Control of Corruption, Compared between 1996 and 2009

	Country	Frontier efficiency score in 1996	Index Value in 1996	Frontier efficiency score in 2009	Index Value in 2009
ASEAN	Brunei Dar.	0.64	68.93	0.71	79.05
	Cambodia	0.11	7.77	0.14	8.57
	Indonesia	0.42	33.50	0.39	28.10
	Lao PDR	0.10	6.80	0.15	9.52
	Malaysia	0.81	73.79	0.65	58.10
	Philippines	0.57	44.66	0.38	27.14
	Singapore	0.94	97.57	0.89	99.05
	Thailand	0.50	42.72	0.63	50.95
	Viet Nam	0.44	31.55	0.54	36.67
ASEAN+3	PRC	0.71	54.37	0.46	36.19
	Japan	0.84	85.44	0.84	87.14
	Korea	0.74	71.36	0.71	71.43
ASEAN+6	Australia	0.92	93.20	0.90	96.19
	India	0.52	38.35	0.67	46.67
	New Zealand	1.00	98.54	0.95	99.52
	World average	0.566	49.76	0.555	48.36

ASEAN = Association of Southeast Asian Nations; Brunei Dar. = Brunei Darussalam; Lao PDR = Lao People's Democratic Republic; PRC = People's Republic of China.

Source: Author.

Table 2: EU Governance Efficiency Estimates for Control of Corruption

Country	Frontier efficiency score in 1996	Index Value in 1996	Frontier efficiency score in 2009	Index Value in 2009
Austria	0.93	94.66	0.88	93.81
Belgium	0.86	86.89	0.86	90.95
Denmark	0.98	100.00	0.93	100.00
Finland	1.00	99.51	0.92	98.10
France	0.87	87.38	0.87	90.48
Germany	0.94	95.15	0.88	92.86
Greece	0.67	64.56	0.61	61.43
Ireland	0.94	93.69	0.90	93.33
Italy	0.70	70.87	0.57	59.05
Luxembourg	0.87	94.17	0.83	95.24
Netherlands	0.96	97.09	0.91	97.62
Portugal	0.95	91.26	0.84	81.90
Spain	0.86	83.98	0.78	80.48
Sweden	0.97	98.06	0.92	98.57
United Kingdom	0.96	96.12	0.87	91.43
Cyprus	0.94	91.75	0.78	79.52
Czech Republic	0.80	76.21	0.71	69.52
Estonia	0.63	55.83	0.85	80.00
Hungary	0.84	77.18	0.74	70.00
Latvia	0.32	27.67	0.71	65.71
Lithuania	0.59	51.94	0.69	63.81
Malta	0.72	68.93	0.81	78.57
Poland	0.79	71.84	0.76	70.95
Slovak Republic	0.76	69.90	0.69	66.19
Slovenia	0.88	84.47	0.81	81.43
Bulgaria	0.28	24.27	0.61	54.29
Romania	0.53	46.60	0.60	53.81
World average	0.566	49.76	0.555	48.36

Source: Author.

4. GOVERNANCE AND ECONOMIC INTEGRATION: KEY INSIGHTS FROM THE EUROPEAN EXPERIENCE

The foregoing analysis of the evolution of governance indicators since the mid-1990s suggests a need for great policy concern with respect to the state of governance quality in Asia. A critical question regards the extent to which harvesting the returns from heightened cooperation and regional integration is potentially conditioned by the governance quality of hypothetical sets of regional "club" members. Related issues include the potential endogeneity between the evolution of governance performance and processes of regional economic integration, as well as, more generally, how specific levels of multi-layered governance may impact different aspects of international economic performance. Deepening Asian regional integration would demand more ambitious policy agendas aimed, for example, at greater interconnectivity of physical and social infrastructure, heightened market access, and establishing common industrial standards and certification procedures. Based on the EU's experience, success in such policy initiatives appears predicated on upgrading national institutional performance in many countries that have initially poorer governance and economic performance.

European economic integration stands out in the ambition of the regional policy agenda and its record on dismantling market segmentation and fostering more competitive environments aimed at creating a Single Market for goods, services, and production.[6] In this regard, regional integration in Europe can be viewed as a unique economic experiment aimed at eliminating a multitude of non-tariff barriers through the creation of common standards, curtailment of discriminatory national procurement and industrial policies, among other measures. Fundamental changes in multi-layered governance were crucial to this process, which has evolved sporadically since the Treaty of Rome in 1957. These institutional developments include the strengthening of government structures and intervention at a regional level. This process has been accompanied by a progressive shift from national sovereignty toward greater regional governmental authority, along with an upgrading of national governance performance and a bigger role for the provision of regional public goods and services. Three noteworthy pillars of the EU's institutional framework are the European Commission, the European Council, and the European Court of Justice.

Competition policies and collective EU funds have been used to promote European-wide physical and social networks with varying degrees of success in transportation, telecommunications, electricity, education and research, among others. Investments aimed at boosting interconnectivity across national networks and restructuring hub-spoke structures have often been needed to facilitate market access and to realize cost efficiencies potentially generated by direct and indirect network externalities. More generally, an integrated regional market requires identical informational costs, financial and monetary risks, as well as reduced legal and other transactions costs, so that market entry conditions across the region are on equal terms for all agents without any significant "border" effects. The supremacy of European law over national law has been crucial for creating mechanisms that promote regional integration. This is illustrated by the landmark court decision of Cassis de Dijon, whereby the principle of "mutual recognition" was established as a basis for eliminating many non-tariff barriers linked to discriminatory national standards and certification procedures.

In a number of domains, the higher-level authority of collective regional institutions in the EU has been reinforced at the expense of historical national policy prerogatives. Such heightened

[6] Owen (2001) offers more detailed analysis of the European integration process, while Jacquemin (1992) has stressed the role of imperfect competition when assessing the specificity of sectoral returns to integration.

authority can serve to curtail actions by national governments that may be vulnerable to rent-seeking pressures by local interest groups, which would otherwise undermine the attainment of collective EU goals. Owen (2001) and Wyplosz (2006) argued that a relatively independent institution with certain executive powers, in the form of the European Commission, has played an instrumental role in the design and implementation of Single Market directives. The European Commission has provided vital technical expertise, thereby fostering more nuanced debates among policymakers and civil society, while providing the foundations for legislation and shared policy stances, subsequently validated at European Council ministerial meetings. Cementing a political consensus for change has proven easier when the focus is on more technical policy measures and their implementation, often at the sectoral level. Thereby, policy analysis can focus on identifying concrete outcomes from cooperation, rather than entertaining more vacuous general discussions regarding general principles of regional cooperation, which may not necessarily be respected.

The subsidiarity principle has served as a benchmark for demarcating the relation between European and national authorities and cementing a political economic consensus for national concessions and reforms.[7] Furthermore, two-speed integration and conditionality have been crucial European strategies, increasingly necessitated by the heightened heterogeneity of “club” membership. Successive EU expansions have sought to integrate poorer countries from Eastern Europe, which have different institutional heritages, through a “carrot” and “stick” approach. A precondition for receiving European structural funds aimed at helping poorer countries in their development and regional integration has often been the upgrading of national governance practices. Inter-country and interregional transfers of financial resources have also proven to be essential to respond to obstacles related to the political economy of the integration process because the attainment of longer-term, collective regional gains may entail real and/or perceived short-run losses for specific subsets of economic agents.[8]

A distinctive aspect of European policies, which are designed to promote the EU’s longer-term competitiveness, has been to promote not just hard capacity building, but also Europe’s technological competitiveness through the development of human capital to achieve goals associated with the so-called Lisbon Agenda. A noteworthy set of policy initiatives have focused on the creation of international education and research networks between communities of European students and scholars while promoting international mobility and exchanges, as with the Erasmus Programs.

In sum, a key insight, underscored by the European experience, is the endogeneity of the interrelation between regional integration processes and changes in multi-layered governance structures. Because cross-country financial transfers have proven vital for achieving regional integration objectives, the heterogeneity of “club” membership matters. Notably, the capacity and willingness of certain richer countries to underwrite integration costs through interregional financial transfers appear to be chief considerations. Furthermore, concerns about the sustainability of the European Monetary Union in light of the debt levels of such countries as Greece and Portugal, point to the risks of overly ambitious integration policies, which can be

[7] Bureau and Champsaur (1992) offer a characterization and critique of the Principle of Subsidiarity in terms of necessary and sufficient conditions, justifying more centralized regional intervention. More specifically, actions by EU institutions are argued to be warranted in the presence at a regional level of either (i) economies of scale or scope and (ii) international externalities, provided there is also (iii) a coordination failure between EU member states.

[8] While principally focusing on closed-economy policy issues, Stiglitz (1998) offers a compelling analysis of how the obstacles facing policy initiatives aimed at structural economic changes can generate government failure and block such changes.

undermined by weak national governance and economic conditions. Hence, a lesson for Asia is that alternative scenarios regarding regional "club" membership are of paramount importance to determine the path of international cooperation and integration processes. Extrapolating from the European experience has limits when considering the optimal design of policies and institutions for Asia. The returns and obstacles to regional economic integration could depend on the initial configurations of countries, economic geography, and their distinctive states of governance and economic development. In this respect, ASEAN club membership is much more heterogeneous and geographical dispersed relative to the original sets of countries participating in the European Community. Furthermore, greater international confidence building between countries in Asia appears to be a pre-condition to fostering a shared preparedness to surrender some national policy prerogatives to regional institutions.

5. A CRITICAL POLICY AGENDA—CHALLENGES AND STAKES OF GOVERNANCE FOR ASIA

The preceding analysis provides a background framework for reassessing the optimal structure of regional cooperation and public governance in Asia in light of espoused policy objectives for regional integration. A perceived need to redefine regional cooperation and governance in Asia is a vital argument emanating from the 2009 ASEAN+3 summit in Thailand that called for an East Asian Community. These meetings advanced the explicit proposal that Asia can play an enhanced role to "lead the world" by boosting economic and political cooperation and striving to form an EU-style community.[9] The drive to rethink regional institutions is also manifest in a ADB study (2010). Thus, a central problem is to what extent such a more ambitious Asian policy agenda of regional market unification, as opposed to freer trade among largely sovereign countries, necessitates an upgrading of national governance performance, as well as a revamped architecture and role for cooperative regional institutions. A related issue is the need to analyze limitations to historical strategies for regional economic cooperation in Asia, which can be broadly characterized as bottom-up and market-driven approaches. It is critical to assess what configuration of countries might constitute the most effective regional "club" membership to achieve deepened market integration while bolstering peace and promoting sustainable growth and development.

The forgoing analysis suggests that there is a tradeoff between realizing a more ambitious policy goal of a Single Asian Market and relying wholly on relatively weak regional institutions that lack adequate resources and a degree of policy autonomy, as appears to be the case with the ASEAN Secretariat. There are many reasons for revamping cooperative and multi-layered governance structures in Asia while transferring decision-making authority to more centralized regional institutions. First, to the extent that national government intervention has contributed to market segmentation and border effects, several prerogatives of national authorities need to be curtailed. Because offsetting policy measures are often to the detriment of local economic interests, there is a resistance to relinquishing sources of economic rents, so that national governments often find it difficult to adopt such changes. Furthermore, there are strategic issues of credible policy commitment across countries. To maintain a system of policy concessions and quid pro quo measures between cooperative partners, binding regional agreements, along with structures for their enforcement, are likely to be more sustainable, relative to decentralized, and potentially reversible, initiatives at the level of nations.

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[9] This citation is from The Japan Times (2009).

A second strong rationale for a top-down approach to regional integration is that heightened market integration can entail increased vulnerability to government failures and market externalities in other countries. Thus, the upgrading of governance performance in specific countries is an acute regional policy priority. Asia is characterized by large quality gaps in national governance performance, while many countries do not have the expertise or financial resources to target institutional improvements. This suggests a third rationale for a strengthening of regional government authority. Substantial regional funds and international financial transfers are required to target improvements in national governance performance, including measures aimed at augmenting the supply of regional public goods and services, as well as facilitating market access. To the extent that the institutional and economic performance of regional club members is heterogeneous, as with ASEAN, it becomes vital to include additional stronger performing, country stakeholders. The international transfer of large financial resources needs to be incentive compatible so that at least some elements of conditionality are required to guide national policymaking. Another compelling reason to strengthen regional institutions is the need for adequate technical expertise and evaluations to guide regional and national policymaking. Finally, building a unified Asian market would require establishing a shared regional legal framework, entailing a subordination of national laws and legal practices, relative to those at the regional level.

In short, the prevailing model in Asia of cooperation among independent states, in terms of a bottom-up approach based on voluntary changes in national policies, appears, to some extent, incompatible with the requirements of a more ambitious policy agenda targeting an Asian Single Market. A better architecture of regional institutions could entail the creation of additional regional institutions. For instance, an “Asian Commission” could be assigned twin mandates of (i) contributing to a research-driven policy program of market integration aimed at resolving technical sectoral issues, while also (ii) overseeing the implementation of agreed measures. Such an executive institution would need to be relatively independent, yet accountable to, national member governments. A variety of political-economic considerations suggest that it would be preferable to have ultimate executive authority reside in an institutionalized framework of regular ministerial meetings, which could be an outgrowth of the existing ASEAN Secretariat, and designated as an “Asian Council.” Thus, deepened economic cooperation and development would require multiple institutions to be the “guardians” of collective regional interests. The foundation of a Single Market is necessarily the supremacy of law, determined collectively at an Asian community level, over existing national laws and practices. In this respect, the upgrading of the rule of law in member countries, along with credible sanctions, would be essential to assure the implementation and effectiveness of unified regional legal practices.

ASEAN would undoubtedly constitute an essential base for envisaging membership in an Asian Economic Community. Yet, a pressing necessity to transfer best governances practices across countries, along with associated imperatives of sufficient collective financial resources, suggests that the most effective “club” for Asian integration would be constituted by at least a large subset of “+6” countries. As with EU expansion, individual adhesion should be motivated by a credible commitment to pursuing collective regional goals, even if they entail constraints to the pursuit of national interests and the relinquishing of other elements of national sovereignty. Nonetheless, a two-speed, or multi-speed, approach could be suitable in light of the relative economic heterogeneity of not only ASEAN, but also larger conceivable sets of Asian countries engaged in heightened regional cooperation. A critical issue concerns the means by which a larger political-economic consensus can be forged so that countries can credibly commit to the challenging policy agenda that the creation of an Asian Single Market would necessitate. It is imperative from the start that not just researchers and civil servants, but also business and civil society, should be closely involved in identifying policy concerns, as well as the design and implementation of optimal responses. Such a strategy is crucial to creating a climate of trust and support for economic reforms, and to counter rent-seeking forces opposed to economic changes and more centralized regional cooperation.

In summary, the critical contention of this paper is that a reconfiguration of national and multi-layered collective governance lies at the heart of a viable regional policy strategy aimed at establishing an East Asian Community and delivering the critical elements of a newly espoused goal of creating an Asian Single Market. Realizing the goals of such a policy paradigm shift would entail some transfer of national sovereignty to regional institutions, as well as the recognition of the limitations to relying on a market-oriented strategy of regional cooperation. Such a process could be enhanced by the participation of an enlarged subset of ASEAN+6 countries, as well as the creation of a more effective configuration of cooperative regional institutions having sufficient financial resources and a certain degree of policy autonomy. Creating a unified Asian market would also require the upgrading and curtailment of national government intervention to advance regional physical and social infrastructure, dismantling sources of national market segmentation and creating "seamless" boundaries, and permitting greater mobility of goods, services, and production. Achieving such ambitious policy goals would require a time horizon that is likely to go well beyond the proclaimed ASEAN deadline of 2015. To effectively target market unification, the implementation of more concrete and realistic policy measures is needed. Yet, "Rome wasn't built in one day," nor did the Treaty of Rome instantly fulfill the promise of a European Single Market. Achieving substantial Asian economic integration may take several decades.

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