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Broader Economic Integration in Asia: Trends, Potential and a Possible Roadmap

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Broader Economic Integration in Asia: Trends, Potential and a Possible Roadmap

1. Introduction

Regional economic integration has been adopted as a strategy for development in different regions of the world over the 1990s following the formation of single market by the European Union and of NAFTA by the North American countries. With the growing popularity of the regional economic integration worldwide, more than half of world trade is now conducted between members of regional trading arrangements (viz., on preferential basis) and not on MFN basis. Regional integration has also become an important factor in shaping the global patterns of production and investment.

Having been the faithful adherents of multilateralism till nearly the turn of the millennium, Asian countries have been slow to respond to the global trend of regionalism. Over the past few years, Asian countries have also recognized the potential of regional economic integration and have started taking steps to benefit from it. Besides sub-regional attempts in the framework of ASEAN, SAARC and BIMSTEC groupings, a number of initiatives of broader economic integration are underway to push the agenda of regional economic integration. Besides deepening the subregional cooperation between its 10 member states, ASEAN has also served to bring major Asian countries viz. Japan, China, South Korea and India together as Summit-level dialogue partners who meet annually at the ASEAN Summits. A complex web of free trade arrangements linking all these countries and ASEAN countries is in progress and a virtual Asian or East Asian economic community is emerging out of this.

There is now growing recognition in Asia of the importance of regional economic integration for generating growth impulses from within, especially in the wake of the East Asian crisis. At the ASEAN+3 Summit held in conjunction with the ASEAN Summit in Laos in November 2004, a decision was taken to hold an East Asian Summit (EAS) in December 2005 in Malaysia. The participants at EAS will comprise ASEAN and the four dialogue partners including India as per the criteria adopted at the Meeting of ASEAN Foreign Ministers held at Cebu, the Philippines in April 2005. EAS is likely to launch the process of formation of an East Asian Community (EAC) combining the ASEAN10, Japan, China, India and S. Korea and possibly Australia and New Zealand.

Against that backdrop, drawing upon the work done as a part of the on-going research programme, this paper briefly summarizes the relevance of broader regional economic integration in Asia, it highlights the gains from such integration and outlines an approach for broader or pan-Asian economic integration. At the end a few concluding remarks are made.

2. Regional Economic Cooperation in Asia

Asian developing countries had made a number of attempts at regional economic cooperation in the 1970s with UN-ESCAP's initiative. These include the Bangkok Agreement established in 1975 which covered exchange of tariff concessions between five member governments viz. Bangladesh, India, Lao PDR, South Korea and Sri Lanka. In 2000, China also joined the Bangkok Agreement. The Asian Clearing Union with seven members in the region viz. Bangladesh, India, Iran, Myanmar, Nepal, Pakistan and Sri Lanka, came into being in 1974. It is generally agreed, however, that these

early experiences have not been very successful. The reasons for the results not coming up to the expectations have been varied. For instance, Bangkok Agreement has suffered from its limited coverage of membership as well as products covered, preference margins not being deep enough and its scope not extending to the non-tariff barriers.

Successful experiences with regional economic integration in the industrialized countries since the mid-1980s in Europe and North America have also prompted Southeast and South Asian countries to adopt economic integration strategies. For instance, although set up in 1967, ASEAN had limited co-operation in economic areas until 1992 when it decided to set up the ASEAN Free Trade Area (AFTA). Similarly SAARC came into being in 1985, it adopted a programme of economic cooperation on its agenda only in 1991 with the formation of Committee on Economic Cooperation (CEC). It has since created a SAARC Preferential Trading Arrangement (SAPTA) in 1995. In 2004 it eventually agreed to create a SAARC Free Trade Agreement (SAFTA) to be implemented over ten years. Besides regional economic integration, bilateral free trade agreements between India and Nepal and between India and Sri Lanka have also speeded up economic integration in the South Asian sub-region. Another notable initiative in Asia is BIMSTEC (Bay of Bengal Initiative for Multisectoral Techno-economic Cooperation) involving five South Asian countries viz. Bangladesh, Bhutan, India, Nepal, and Sri Lanka and two Southeast Asian countries viz. Myanmar and Thailand. Hence, it is seen as a bridge between South and Southeast Asia. BIMSTEC also adopted a Framework Agreement for an FTA to be implemented within ten years at its first Summit held in Bangkok in July 2004.

The East Asian Crisis of 1997 also highlighted the importance of regional economic cooperation. The ASEAN countries expedited the programme of implementation of ASEAN Free Trade Area (AFTA) and moved on to further deepen the economic integration. The crisis also led to launch of several regional initiatives such as the Chiang-Mai Initiative which involves ASEAN+3 (Japan, China, and South Korea) countries. Besides this the ASEAN's policy of engaging key Asian countries namely Japan, China, India and South Korea as dialogue partners have provided much needed cohesion in the Asian region as is clear from the numerous schemes of regional and bilateral free trade arrangements that are at different levels of implementation. China, Japan, and India are all engaged in negotiations of free trade arrangements with ASEAN and South Korea considering one.

However, it can be argued that the sub-regional or bilateral attempts at regional co-operation that have been initiated such as those under the framework of ASEAN and SAARC or the dialogue partners while desirable are unlikely to exploit the full potential of the regional economic integration in Asia and hence are sub-optimal. This is because the extent of complementarities are limited at the sub-regional levels because of similar factor endowments and economic structures within a neighbourhood. It is clear from the fact that trade of ASEAN or SAARC countries with the East Asian countries is much larger than their intra-subregional trade. It is for this reason that the success achieved so far from the sub-regional or bilateral attempts at cooperation have so far been meagre. At the broader Asian level, on the other hand, the diversities in the levels of economic development and capabilities are quite wide thus providing for more extensive and mutually beneficial linkages. The diversity in economic structure provides its own indigenous capacity and markets for dynamic industrial restructuring within the region on the basis of 'flying geese' patterns. Hence, Asia needs an overarching Asia-wide scheme of economic integration to fully exploit the full potential of efficiency-seeking industrial restructuring or to exploit the synergies that exist in the region. Among other factors the twin scourges of SARS and terrorism have also promoted East Asian regionalism¹.

¹ See Eric Teo (2005).

There is now growing recognition in Asia of the importance of regional economic integration² for generating growth impulses from within, especially in the wake of the East Asian crisis. Voices emanating from different parts of the region in support of pan-Asian cooperation and integration are ample proof of the growing recognition of the importance of Asian economic integration. At the initiative of Prime Minister Dr Thaksin Shinawatra of Thailand, the Asian Cooperation Dialogue (ACD) was launched on 18-19 June 2002 at Cha-Am, Thailand. Similarly the Chinese President Jiang Zemin had launched the Boao Forum for Asia in 2001 at Boao, in Hainan province of China, as a pan-Asian economic forum. The Prime Minister Dr Manmohan Singh of India has been making case for an Asian Economic Community combining Japan, ASEAN countries, China, India and South Korea as an 'arc of advantage' across which there will be large-scale movement of people, capital, ideas and creativity....Such a community would release enormous creative energies of our people'. At the ASEAN+3 Summit held in conjunction with the ASEAN Summit in Laos in November 2004, a decision was taken to hold an East Asian Summit in December 2005 in Malaysia which could possibly launch formation of an East Asian Community (EAC). As per the criteria adopted at the Meeting of ASEAN Foreign Ministers held at Cebu, the Philippines in April 2005, the participants at EAS will comprise ASEAN and the four dialogue partners viz. Japan, China, South Korea and India and possibly Australia and New Zealand. It is clear therefore, that there is a widespread recognition in Asia for the relevance of broader regional economic integration.

3. Relevance of a broader Asian Framework for Economic Cooperation

It is clear from the previous section that the ongoing attempts in Asia towards regional cooperation at sub-regional and bilateral levels are unlikely to enable the region to exploit the full potential of regional economic integration. The multiple attempts at sub-regional and bilateral levels that are underway in the region do suggest however, that there is now growing recognition of the importance of intensive economic integration at the pan-Asian level in the region or of the opportunity cost of not doing it. There is the realization that stimulus for future growth in the region has to increasingly come from within given the trend of formation of regional trading blocs in rest of the world. Substantial complementarities exist between Asian economies that remain to be exploited for their mutual common benefit. For instance, while the region has economies that are surplus in capital resources, there are also economies which have inadequate domestic savings for rapid development. The region is similarly characterized by complementarities in the demand and supply of other resources such as technology, and skilled manpower. Regional cooperation by generating intra-regional demand could supplement the external demand and reduce the vulnerability of the region due to over dependence on outside regions. Regional cooperation could also help in exploiting the existing capacities in the region fully. The lost output because of under-utilization of capacity in Japanese and Korean construction and engineering industries could be of the order of 10-15 per cent of the GDP of the region or about a trillion dollars a year³. A more intensive cooperation for matching the underutilized capacity in some countries of the region with unmet demand in others could go a long way in putting the region on a high growth trajectory and help Asia to reemerge as a center of gravity in the world economy that it was until 1800.⁴

The Asian region combines some of the fastest growing economies in the world. Together they form a huge market that is growing faster than any other region in the world and could form a vibrant regional grouping that would be roughly of the size of the EU in terms of GDP, will have larger magnitude of trade than NAFTA and international reserves bigger than those of EU and NAFTA put together. The formation of a broader Asian grouping will also help the region to play a more

² See the writings of Yamazawa (1998, 2001a, 2001b), Ali Alatas (2001), Shinawatra (2001), among others, for arguments for closer economic cooperation in Asia.

³ See Agarwala (2002) for more details.

⁴ See Madison (2000); also see RIS (2004).

effective role in shaping the emerging world trading and financial system responsive to its needs. The broader regional grouping will also formalize a high level of functional integration that has taken place in Asia especially between ASEAN and its dialogue partners. The intra-regional trade in Eastern Asia has increased substantially and now accounts for over a half of their total trade and their collective foreign exchange reserves comprise two thirds of the world.

The Asian region has a distinct Asian identity shaped by history and cultural exchanges over several centuries. There have been vibrant flows of goods and services as well as labour and capital amongst Asian countries sustained over several centuries. In the ancient time, the famed Silk Routes provided the channels for such exchanges. Marco Polo's tales are just one of many such descriptions. During the nineteenth century, the colonial powers provided the framework for extensive and liberal trade within Asia in goods and services as well as massive movements of labour and capital. Assisted by Japan's rise, trade was brisk. Even during the first half of the 20th century the intra-regional trade ratio was over 50 per cent. These trade and investment flows were disrupted by political and military factors during the colonial period and in the post-war Asia. Along with the trade there was a vibrant exchange of ideas. Chinese scholars visited India and visa versa. Ideological influences spread across the nations binding them in ties of religion. Hinduism and with it the art of governance of Chankya found its way across to much of Indonesia, Malaysia and Thailand. The sweep of Buddhism is well known. Religion has been a strong unifying factor for with the religious beliefs comes a way of life and as religious influence spread so did the cultural ties. Pagan, Borobudur and Angkor Wat are only but a small testimony to the vast trading and cultural network that Asia had in ancient times⁵.

4. Approaches to broader Asian Economic Integration

The preceding section has provided a rationale for a pan-Asian regional economic integration. It has been highlighted that such a grouping would be able to generate internal impulses for growth besides other favourable effects for the region. Keeping in mind the experiences of regional economic integration from other regions, a practical approach to regionalization in Asia would be a phased one, as outlined below.

An Approach to Integration

The approach towards the process of broader regional economic integration has to be take into consideration the process of cohesion in Asia brought about by ASEAN. As argued earlier, ASEAN has helped to bring together four major economies of Asia as its annual Summit-level dialogues partners viz. Japan, China, South Korea and India. These countries meet annually at the ASEAN Summits in ASEAN+1 Summits besides an ASEAN+3 (Japan, China and Korea) Summit. It has been observed that ASEAN+1 approaches have become more attractive compared to ASEAN+3 as is clear from the FTAs being evolved by China, Japan, India and Korea with ASEAN⁶. FTAs between Japan, Korea and China and those between India-China, India-Korea and India-Japan are being studied. In other words ASEAN and the four dialogue partners namely **J**apan, **A**sean, **C**hina, **I**ndia and **K**orea (**JACIK**) countries are all engaged in evolving FTAs between their different pairs, as shown in Figure 1. Through this complex web of FTAs a virtual JACIK or an East Asian FTA is emerging. However, these bilateral or sub-regional FTAs do not allow full exploitation of potential of regional economic integration that exist in view of substantial complementarities arising from diversity in the factor endowments and levels of development. Hence a vision for the Asian economic integration is to begin by coalescing these multiple FTAs between JACIK countries into an overarching East Asian RTA⁷. A broader overarching framework alone will allow optimal utilization of Asia's resources and synergies for their mutual common benefit. As one observer has pointed out,

⁵ See Shankar (2004) for more details.

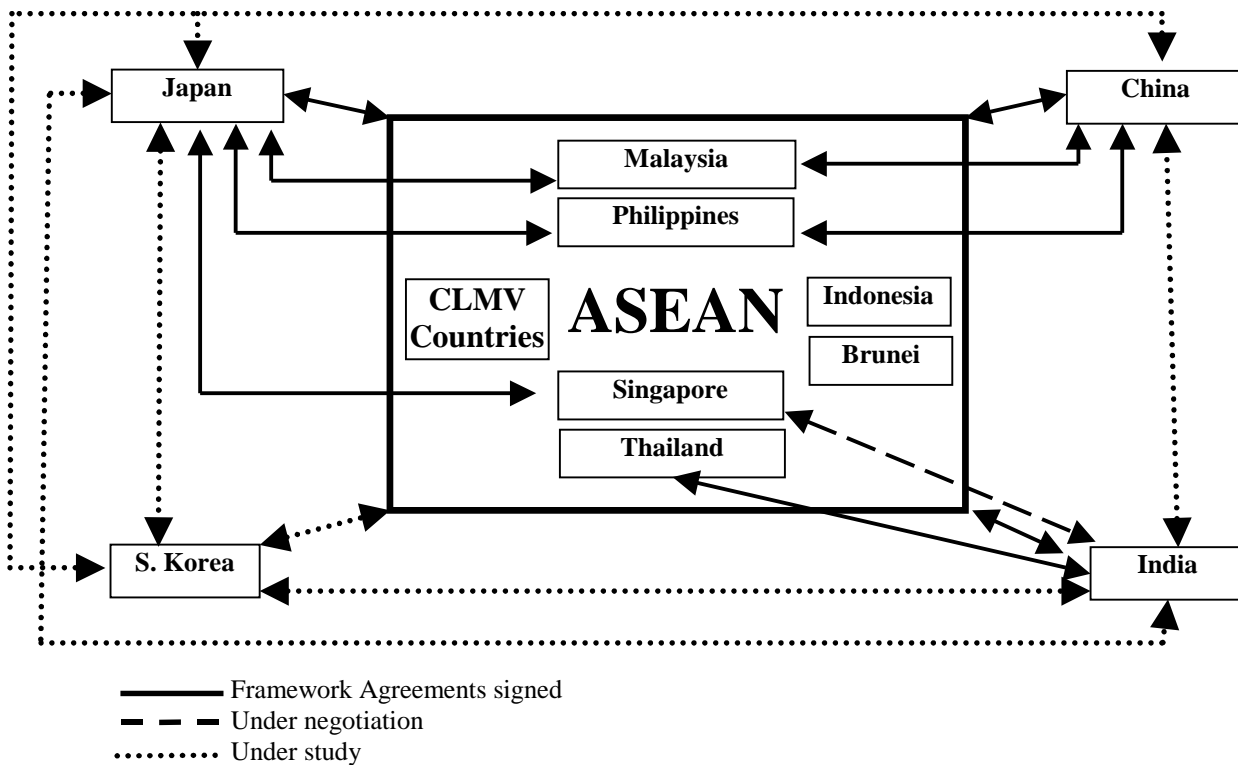
⁶ See Bonapace (2005).

⁷ Among experts who have favoured such an approach include Wei (2004), Yao (2005), Bonapace (2005)

without some form of overall regional framework within which to work, capital, human and natural resources may all be deployed at less than their optimal value⁸.

The East Asian RTA combining JACIK economies could become a core of an East Asian Community which could be expanded later to include other Asian countries into an Asian Economic Community. This approach is supported by a number of Asian leaders including former Singapore Prime Minister Lee and Indian Prime Minister⁹. President Arroyo of the Philippines has observed that ‘the emerging ASEAN+3+India ... will be a formidable regional grouping that can negotiate then with the European Union, the Americas, Africa and such regional groupings’¹⁰.

Figure 1: Emerging (East) Asian Community



Combining fourteen of the largest and fastest growing economies of Asia with vast complementarities, East Asian or JACIK trade bloc is a potential third pole of the world economy. For instance, they combine between them a population of 3 billion or a half of the world population and a GNP of over \$ 7.2 trillion comparable to that of EU in 2000 (see Table 1). In terms of purchasing power parity, the JACIK grouping will have the gross national income of \$ 13 trillion, much larger than either NAFTA or EU. JACIK's exports will add up to \$1.37 trillion compared to \$ 1.2 trillion of NAFTA. The combined official reserves of the JACIK economies at \$ 1.3 trillion in 2002 are much larger than those of the US and the EU put together. In fact the latest estimates suggest that foreign exchange holdings of JACIK countries are more than US\$ 2 trillion. Therefore, the region would have sufficiently large market and financial resources to support and sustain expedited development of the region's economies.

⁸ Anthony Rowley (2004).

⁹ See for instance, address of Singapore's Mentor Minister, Mr Lee Kuan Yew at the Foreign Correspondents Association of Singapore reported in *The Straits Times*, 22 December 2004. Prime Minister Dr Manmohan Singh has envisioned an Asian Economic Community evolved using a building bloc approach to begin with Japan, ASEAN, China, India and Korea at the Laos Summit in November 2004.

¹⁰ See speech delivered at the ASEAN Business Summit, Vientiane, Laos, 28 November 2004.

Table 1: Proposed East Asian or JACIK Community in relation to European Union and NAFTA in 2000

(billion US \$)

<i>Parameter</i>	EU	NAFTA	JACIK (14)
GDP	7260	11147	7262
Per cent to World total	23.17	35.57	23.17
GNI PPP	8315	11350	13361
Per cent to World total	18.68	25.50	30.02
Exports	2025	1226	1367
Per cent to World total	31.89	19.31	21.53
International Reserves (2002)	426	246	2000
Population (millions)	354	411	3012
Per cent to World total	5.85	6.79	49.76

Source: *World Development Report 2002 & WDI 2001*, CD-ROM

Combining both China and India, the two most populous emerging economies of Asia that are projected to emerge as the two of the three largest economies of the world with their rapid growth in the next 3-4 decades, JACIK is likely to be the center of gravity of the world economy.

5. Gains from East Asian or JACIK Economic Integration

The studies conducted by RIS have found considerable evidence of complementarities between the JACIK countries' production and trade structures¹¹. Formation of an RTA may help in exploitation of these complementarities for mutual advantage. Furthermore, trade policy liberalization needs to be accompanied by additional measures such as freer capital mobility, harmonization of customs procedures and product standards and mechanisms to ensure an equitable distribution of gains. RIS studies conducted in computable general equilibrium (CGE) model framework have shown that a trade liberalization in the framework of an RTA in JACIK could produce efficiency gains worth US\$ 147 billion (see Table 2). However, when an RTA is combined with investment liberalization and mobility of skilled manpower, the gains from integration add up to US\$ 210 billion representing more than 3 per cent of combined GDP of JACIK economies. What is more, all the JACIK countries benefit from integration. Interestingly the welfare of even the rest of the world also improves by US\$ 109 billion in the Scenario III suggesting that Asian economic integration will be Pareto optimal. Furthermore, creation of regional institutional infrastructure to mobilize even a moderate proportion of the region's considerable savings of about US\$ 2 trillion for investment in creation of regional public goods such as transport infrastructure, gas and oil pipelines, satellites and broadband cables has the potential to generate additional output and welfare effects that could add up hundreds of billions of dollars in view of substantial underutilized capacity in Japan, Korea and other Asian countries in engineering and construction industry.

Table 2: Welfare Gains from Economic Integration in East Asia or (JACIK)

	Estimated welfare gains in US\$ million		
	Scenario I (Trade liberalization)	Scenario II (Trade and Investment liberalization)	Scenario III (Trade, Investment and mobility of skilled workers)
Japan	107626	111807	150695
Korea	13043	13317	14076

¹¹ See Sinha-Roy (2004)

China-HK	6327	7100	16328
ASEAN (5)	13451	13553	19405
India	6971	7379	9937
JACIK	147418	153156	210441
Rest of the world	-27293	-45306	109916
World	120125	107849	320357

Source: RIS Simulations. See Mohanty et al (2004) for details.

The above findings have been corroborated by a recent study conducted by the Asian Development Bank¹². Using GTAP 6 database with a version of World Bank's Linkage model, the ADB team generated projections of income and trade to 2025 for different scenarios to examine the relative relevance of regional integration vis-à-vis global trade liberalization. The findings suggest that 'regional trade and integration offer Asia great potential for rapid and sustained growth'. ADB study finds that much of Asia's benefits from global trade liberalization can be realized by regional initiative alone. Significantly, they find that combined gains from removing tariff and structural barriers to Asian trade far outweigh those of global tariff abolition. Hence, regionalism should be very high priorities for Asia. ADB study also finds that regional integration can promote Asian economic convergence, raising average growth rates and benefiting poorer countries. In particular, greater regional integration will propagate commercial linkages and transfer the stimulus of Asia's rapid growth economies, particularly China and India, to their neighbours. The Asian economic integration increases trade and incomes for the rest of the world. Hence it is a win-win for the region and the world!

Other Economic and Strategic Gains from Broader Economic Cooperation in Asia

Trade and investment cooperation among the JACIK economies can be fruitfully complemented by monetary and financial cooperation, cooperation for energy security and in core technologies as summarized below.

Mobilizing Asian Foreign Exchange Reserves for Asian Development

Combined foreign exchange reserves of JACIK countries now add up to nearly US\$ 2 trillion and comprise the bulk of such reserves in the world. It has been argued that these funds have been invested in low yielding US treasury bonds and are able to contribute to the Asian development more meaningfully. There is a growing consensus that Asia needs a regional institution for mobilizing these resources for its own development besides for achieving stability of real effective exchange rates and for an orderly response to external shocks¹³. Studies have shown that there is growing macroeconomic interdependence between Japan, Korea and ASEAN. Such interdependence is likely to include China and India, besides Australia and New Zealand with ongoing reforms, liberalization and market opening¹⁴. RIS has developed a proposal of a Reserve Bank of Asia. It is argued that even a moderate proportion say 5 per cent of combined JACIK reserves i.e. US\$ 100 billion will be adequate to make a beginning with the Reserve Bank of Asia. An institution with a reserve of US\$ 100 billion at its disposal, it can create an Asian monetary unit of account¹⁵ or an Asian SDR. The Asian SDR can be used increasingly as a unit of account and as reserve asset in the region. Besides providing a mechanism for exchange rate stability, and facilitating trade transactions within the region, the Asian SDR can also provide a channel for funding development of regional public goods and other huge infrastructure development projects without putting pressure on the Government budgets in the member countries¹⁶. On the basis of such a reserve, an instrument like an Asian SDR can be created and used to finance infrastructure and IT investments in the region. The borrowers

¹² Douglas Brooks, David Roalnd-Holst and Fan Zhai, 2005.

¹³ See Wolf (2004), among many others.

¹⁴ See Kawai (2004).

¹⁵ See Kawai op.cit.

¹⁶ See Agarwala (2004).

could be regional companies (such as Channel Tunnel Company for the UK and France) jointly owned by governments and private sector in the region. Similarly there is also substantial potential of bond market development in Asia and some steps have been taken in that regard¹⁷. This will help in creating demand for the underutilized construction capacity in parts of Asia as observed earlier. Among other possibilities for monetary and financial cooperation in Asia are to develop an Asian Bond Market for which a couple of initiatives have been taken, or to set up an Asian Investment Bank for facilitating infrastructure financing, and creating an Asian Exim Bank with the participation of the national exim banks of the region.

Cooperation for Energy Security

Major countries of Asia namely Japan, China, India, Korea among others are highly dependent upon oil and gas imports and could benefit by mutual cooperation in the area. The regional cooperation in the area of energy could cover, for instance, to ensure security and sustainability of energy supply, overseeing efficient utilization of natural energy resource in the region, rational management of energy demand, with due consideration of the environment, establishing policy framework and implementation modalities for setting up of energy networks in the region such a region-wide oil or gas grids, and coordinate, manage and monitor the implementation of such a network. One of the target areas of Asian energy cooperation could be to build an Asian Strategic Petroleum Reserve and to create an Asian Emergency Response System. An Asian SPR would be like a global energy security insurance policy. The Asian SPR would be a safeguard against OPEC's ability to raise oil prices and would prevent any market failure, by enabling governments to provide supply liquidity in an emergency situation. Asian countries have some ongoing cooperation in the area as joint exploration or oil equity sharing by Japanese, Korean, Chinese and Indian oil companies in exploration projects in third countries within the region such as in Myanmar and Vietnam and outside the region as in Sudan. Japan, Korea, China and India have begun to coordinate their positions in their negotiations with OPEC with respect to Asian premium that is being charged by the Middle East countries on their supplies to Asian countries¹⁸. The cooperation could also extend to cover the joint patrolling of the sea-lanes through which the bulk of the oil and gas supplies for the region pass through such as Malacca Straits to prevent piracy. Finally JACIK countries could contemplate building an Asian gas/oil pipeline connecting them. Asian energy ministers have met January 2005 in New Delhi to advance cooperation in this area¹⁹.

Regional Cooperation in Development of Transport Infrastructure and Connectivity

Benefits of regional contiguity are often lost due to inadequate transport and communication links within the region. Major investments in development of regional public goods and regional infrastructural projects such as Asian Railway, Asian Highway, Asian satellites, Asian information infrastructure (such as a broad band cable) need to be made. Such projects would not only facilitate trade and other economic exchanges within Asia but would also generate a lot of demand for the idle capacity for engineering and construction industry in Asia. Besides funding regional projects some of the JACIK countries are projecting a tremendous demand for infrastructural investments in the coming years.

Cooperation in Core Technologies for Addressing the Digital Divide and Nutritional and Health-Related Issues

Region's substantial capacities in hardware and software areas could be pooled together to address the digital divide to empower poor to benefit from the fruits of new technologies. This would require joint development of cheaper hardware and development of software in local languages and graphic interfaces. This would call for the pooling of complementary strengths of East Asia and India in

¹⁷ See presentation by Ambassador M. Xuto at the High-level Conference on Asian Economic Integration organized by RIS in Tokyo, 18-19 November 2004.

¹⁸ See Ito et al. (2005) for more details.

¹⁹ India hosted a Meeting of Asian Energy Ministers in New Delhi in early 2005 to discuss issues of mutual concern. See *New Asia Monitor*, January 2005 for details.

hardware and software respectively. Similarly cooperation in biotechnology could focus on nutritional and health needs of poor in Asia. Appropriate regional institutional mechanisms need to be created for facilitating pooling of resources and capabilities from different member countries for these tasks. Some thinking on pooling resources for addressing the common needs of the region is already on as Asian IT Ministers met in Hyderabad, India in early 2004²⁰.

Global Governance, Peace and Security

Regional economic integration is also likely to strengthen Asia's role in global economic governance. Although Asian countries hold two thirds of world's foreign exchange reserves, the decision-making powers in the Brettonwoods institutions, for instance, is dominated by the western countries. By forming credible schemes of regional economic integration, Asia will be able to seek its due place in the global economic governance and contribute to building a more democratic and multipolar world economy. Asian economic integration by increasing the interdependence of countries in the region will ensure peace and stability. That is why Prime Minister Dr Manmohan Singh has argued that the Asian economic community would constitute an 'arc of advantage and prosperity and stability and closer economic integration' and would release enormous creative energies of its people.

6. Relevance of India for the East Asian Economic Integration

India's economic integration with East Asia can be a win-win for the economic integration in Asia for the following reasons:

Imparting its own dynamism to the grouping

With a US\$ 700 billion economy growing at 7-8 per cent per annum and even faster growing and sizeable (300 million strong) middle class, India brings its own dynamism to the emerging Asian regionalism. With foreign exchange reserves of over US\$ 140 billion, one of the best performing stock market in Asia²¹, low rates of inflation, market determined exchange rates, abundant human capital and entrepreneurial resources, rapidly growing industry and services, prudently managed financial system²², India is attracting attention for its strong macro-fundamentals. India has now been ranked among the top three investment destinations in the world by AT Kearney in terms of FDI Confidence Index recently²³. Recent studies by Goldman Sachs indicate that India is poised to emerge the third largest economy in the world by 2032. 'India has the potential to show the fastest growth over the next 30 and 50 years'²⁴. Another study by IMF finds India poised to sustain about 7 per cent growth rates for over next 30-40 years with very few downside risks²⁵. With two major dynamos viz. China and India propelling regional growth, the Asian dream will be realized faster²⁶.

With booming demand for infrastructure investments that are projected to be over US\$ 500, India can help neutralize any loss of demand in Asia resulting from US trying to curb its mounting trade deficit. Malaysian companies, among others, have already won substantial projects in roads construction in open competitive bidding. Booming middle class in the country is increasingly

²⁰ See *New Asia Monitor*, March 2004 for details.

²¹ India's capital markets are highly developed with world-class electronic settlement system and rapidly improving corporate governance systems. Over 6000 companies are listed on India's stock exchanges next only to NYSE. India topped the MSCI index for Asian countries in terms of stock market returns for September-December 2004 period as reported in *Financial Express*, 17 December 2004.

²² Ratio of non-performing assets to GDP is just 3 % compared to China's 41 %, Japan's 11 per cent and Thailand's 9%.

²³ http://www.atkearney.com/shared_res/pdf/FDICIOct_2004_S.pdf

²⁴ See Goldman Sachs BRICs study (2003).

²⁵ An IMF Working Paper (04/118) projects India's growth rate to 2025 at 7% 'with more upside potential than downside risks'

²⁶ Kesavapany (2005) has used the metaphor of dynamo: 'one can ask why we should deny ourselves the benefits to be derived from one of the two major dynamos propelling regional growth'.

becoming a source of final consumption with rising income levels. India, for instance, has emerged a major market for high spending tourists for a number of countries in East Asia.

Growing Integration of India with East Asia

As a part of the Look East Policy, India has consciously integrated its economy with East Asia since the early 1990s. With this, the share of East Asia in India's trade is approaching nearly a third thus making it a more important trade partner compared to the EU or the United States. India's trade with China grew by nearly 75 per cent in 2004 to surpass US\$ 13 billion. Her trade with Korea grew by 48 per cent in 2003. ASEAN-India trade has grown by over 30 per cent over the past couple of years and is projected to cross US\$ 30 billion by 2007. As India's tariff levels become more closely aligned to those of East Asia, recent sharp growth in merchandise trade is expected to continue. India has autonomously brought down applied tariffs drastically since 1991. In the Budget 2005/06, the peak tariffs were brought down from 20 per cent to 15 per cent. Because of economic growth and ambitious unilateral trade liberalization, India's imports have grown by 27 per cent a year on average over the past three years and crossed US\$ 100 billion in 2004/05.

To further strengthen her economic links with East Asian countries India is evolving FTAs with ASEAN and +3 countries. India signed a Framework Agreement on Comprehensive Economic Cooperation with ASEAN at the Bali Summit involving an FTAs to be implemented in ten years. This is complemented by bilateral agreements signed with Thailand and Singapore. India is currently studying an FTA with China, Japan, Korea and Malaysia. With FTAs either under negotiation or under study with ASEAN, Japan, China, and Korea, it is very much part of the growing web of FTAs linking the East Asian countries.

Growing synergies and integration with East Asian production networks

India's strengths in software and services fruitfully complement the hardware and manufacturing prowess of East Asia and together could produce a formidable strategic combination. With the growing recognition of these complementary strengths by corporations, India is increasingly getting linked with the East Asian production networks. These links may not be very substantial in value terms as yet but are certainly critical as they generally relate to more knowledge intensive parts of the value-chain such as software development, R&D, engineering and designing, and high quality manufacturing. Indeed East Asian companies have begun to exploit India's strengths in R&D, software and design by locating their global R&D centers in India. For instance, Samsung's R&D Centre in India, recently announced successful development of a hybrid mobile phone that works across GSM and CDMA environments. China's Huawei Technologies, like many others, employs hundreds of engineers doing chip design or embedded software development in Bangalore. Hyundai uses its Indian operations as a sourcing base for compact cars. Toyota is sourcing engines from its Indian plant for Southeast Asian markets. Furthermore, these production networks not only include those belonging to Japanese or Korean companies but also those being developed by Indian enterprises. For instance, Daewoo Trucks has become linked with the production chain of Tata Motors with its acquisition by the latter. Several Indian companies have also begun to take advantage of cheaper manufacturing costs for hardware in China and other East Asian countries by rationalizing their production. The trend is likely to be more firmly entrenched as the emerging free trade arrangements between India and East Asian countries come into effect.

Win-win opportunities for trade in services

India ranks 19th in world exports and imports of commercial services ahead of any ASEAN country²⁷. India is increasingly playing a role in two way flow in education services, among others. Many Indian students study in rest of Asia, while Indian schools (two are already operating in Singapore) and Universities are venturing in Southeast Asia. India is also expanding collaboration with Malaysia beyond just medical education. India's world class technical and management

²⁷ Source: *International Trade Statistics 2003* by WTO

institutions are being recognized in the rest of Asia as well. Its media and entertainment industry is influencing audiences in Asia as well as the rest of the world, and 'Bollywood' is now a global brand²⁸.

Complementary demographic trends

There are complementarities in demographic trends of East Asia and India. Just as East Asia is about to enter into a phase of demographic burden, implying lower share of working age population, and higher median age of workers, India is entering a demographic gift phase, with higher share of working age population. Through IT, an India integrated into Asia could help address East Asia's demographic challenges²⁹.

Geographical contiguity, shared history and culture

India shares land boundaries with China and Myanmar and maritime boundaries with Thailand and Indonesia. India's geographical contiguity with East Asia was highlighted vividly by the ASEAN-India Car Rally organized in November 2004 in conjunction with the ASEAN Summit. India has deep age-old civilizational links with a number of East Asian countries. As noted Thai journalist Kavi Chongkitavorn has argued 'India feels much more East Asian because of its cultural influence and aspirations in the ASEAN region, than for example, Mongolia³⁰.' Even in the modern history, Pandit Nehru, India's first Prime Minister spoke about the need for Asian regionalism fifty years ago and substantiated his vision with Panchashila, the Five Principles of Coexistence subsequently adopted at the Bandung Conference that still remain the cornerstone of India's foreign policy.

India as a bridge to South, West and Central Asia for East Asia

With its excellent trading and transport links and emerging preferential trading arrangements with South Asian countries, GCC and West Asian countries India could act as a bridge for East Asia for the markets in South, West and Central Asian countries.

India as a balancing force in East Asia

It can be argued that India's participation in the grouping will make it more balanced and less susceptible to domination by any particular large country. As Hon'ble Keizo Takemi, Member, National Diet, Japan has argued, India is needed for maintaining a balance in East Asia given the huge influence of China³¹. Noted Singapore diplomat Mr K.Kesavapany has observed that 'any such group without India in it will seem unbalanced, as though one leg of the table is missing'³².

Growing popular support for East Asia-India Economic Integration

Growing economic integration of East Asia and India and its potential is catching peoples imagination. A survey conducted by the World Economic Forum and Taylor Nelson Sofres at the World Economic Forum's New Asian Leaders (NALs) Retreat held in Seoul in June 2003, covering all participants and invitees and other Asia-based Global Leaders for Tomorrow revealed that over 37 per-cent of New Asian Leaders view an extended Asia – Asean+4, including China, Japan, India, and Korea – as the most desirable model of economic integration, with only 26.8 per-cent preferring Asean+3³³. Former Singapore Prime Minister and Minister Mentor Lee Kuan Yew has argued that 'India should join in, as there is nothing to be lost. It will expand the market, force more specialization, division of labour, and India has some thing to contribute in economic, political, diplomatic as well as the security field. So I believe it is to the advantage of the ASEAN countries that any such East Asian Community should include India'.

²⁸ Asher and Sen (2005).

²⁹ see Asher and Sen (2005)

³⁰ See *New Asia Monitor*, October 2004, p.6.

³¹ See *New Asia Monitor*, October 2004, p.7.

³² Kesavapany (2005).

³³ *Source*: The World Economic Forum, Press Release, June 18, 2003

India-East Asia Integration, a win-win for Asia: evidence from CGE Simulations

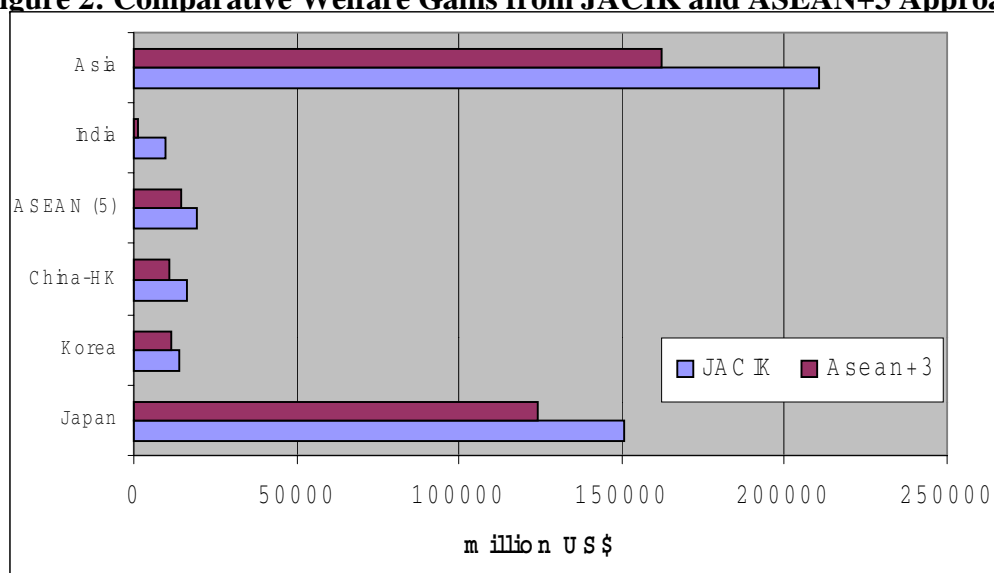
The foregoing discussion underscore the mutually beneficial nature of India's economic integration with East Asia in an East Asian Community. This is also borne out from the CGE simulations conducted to examine the potential gains from Asian economic integration when these were repeated after dropping India from JACIK. The simulation results as summarized in Table 3 clearly bring out that welfare gains for each participant in JACIK are much higher than in a framework excluding India. Significantly India's participation increases the welfare gains for other participants by US\$ 48 billion this is far higher than India's welfare gain of US\$ 8.9 billion. The explanation for considerable improvement in welfare gains with the inclusion of India is possibly the complementary strengths that India brings to the grouping in terms of services and software dimension to East Asia's strengths in manufacturing and hardware thus improving the competitiveness of other East Asian countries besides its dynamism, as summarized above. Obviously India's inclusion is welfare enhancing for all the partners and is a win-win for Asia.

Table 3: Relative Welfare Gains from Economic Integration in JACIK and ASEAN+3

	Estimated welfare gains in US\$ million (Scenario III)		Gain from India's inclusion
	JACIK	Asean+3	
Japan	150695	124065	26630
Korea	14076	11683	2392
China-HK	16328	10810	5517
ASEAN (5)	19405	14585	4821
India	9937	972	8965
Asia	210441	162115	48326

Source: RIS simulations

Figure 2: Comparative Welfare Gains from JACIK and ASEAN+3 Approaches



Source: Table 3

7. Concluding Remarks

The foregoing discussion has shown that broader Asian economic integration is an idea whose time seems to have come. It is clear from the voices emanating from different parts of Asia. It is also clear from the importance that is being attached by different Asian countries to regional economic integration at the bilateral or sub-regional levels. However, sub-regional approaches at co-operation have their limitations given less pronounced complementarities. Formation of a broader economic community in East Asia coalescing the emerging web of FTAs linking Japan, ASEAN, China, India and Korea into a region-wide or an East Asian RTA could be a core of such an East Asian Community. The East Asian Community could be eventually expanded to cover other Asian countries in an Asian Economic Community. It has been shown that economic integration in East Asia or JACIK could enable the region to resume its rapid growth and help it emerge as the center of gravity in the world economy. Furthermore, regional Keynesianism based on cooperation in finance and monetary policy has the potential to help the region recover hundreds of billions of dollars of potential output lost due to underutilization of capacity and pull the major economies such as Japan out of prolonged recession. Fruitful opportunities for cooperation exist in other areas as well for instance, for energy security in the context of high dependence of major Asian countries on imports for oil and gas. Infrastructure development especially the regional public goods is another such area to improve connectivity in the region. Finally cooperation in core technologies such as ICT and biotechnologies may provide a basis for dealing with the digital divide and malnutrition, disease and hence poverty.

It has also been shown that integration of Indian economy with East Asia is a win-win for Asia. With a US\$ 700 billion economy growing at 7-8% p.a., a sizeable large middle class and strong macro-fundamentals, India is able to add its own dynamism to the East Asian integration. Large requirements of infrastructure investments, booming demand of final consumption goods in India may help smoothen the process of macroeconomic adjustment in the world economy. Indian economy is rapidly integrating with the East Asian production networks especially in critical knowledge-based parts of the value chain. Indian enterprises are also developing their own production networks incorporating East Asian countries. With rapid growth of intra-regional trade, East Asia has emerged India's largest trade partner surpassing the US or EU accounting for nearly 40 per cent of her global trade. With FTAs being evolved or studies with all the ASEAN+3 countries, India's is virtually integrated with East Asia. Demographic trends also provide a source of complementarity between India and East Asia. With age-old civilizational links with East Asian countries, India feels much more integrated culturally with the region besides geographical contiguity with a China, Myanmar, Thailand and Indonesia. With its well-developed transport and trading links with West, Central and South Asia, India could also act as a bridge between these regions and East Asia. JACIK approach to East Asian integration is catching popular imagination and is a preferred option over the ASEAN+3 approach as recent surveys of young Asian leaders suggest.

To sum up the above discussion, it is clear that there is great interest in Asia to build on growing functional economic integration and emerging web of FTAs linking ASEAN and its Summit-level dialogue partners namely Japan, China, India and South Korea and possibly with Australia and New Zealand into an East Asian Community which could eventually grow into a broader Asian Economic Community. There is a strong case for ASEAN-Japan-China-India and Korea working together to realize the Asian dream. The forthcoming East Asia Summit in December 2005 in Malaysia provides an opportunity for Asia to take initial first step in the long journey towards broader regional economic integration in Asia!

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