

# Relevance of an Asian Economic Community

## Strong Trend of Regional Trading Blocs in the World

The 1990s have witnessed a strong trend in different parts of the world especially the developed countries to form regional trading blocs. These attempts include formation of the Single European Market (SEM) in the European Union and North American Free Trade Area (NAFTA). The formation of these trade blocs had been prompted by the increased emphasis on competitiveness with the conclusion of Uruguay Round negotiations. An immediate effect of these regional integration agreements (RIAs) has been the rising proportion of the world trade that is conducted within the trading blocs. Over half of world trade is now conducted within RTAs and its proportion is growing fast.

## Diversion of Trade and Investment by Trade Blocs

Thus the trading blocs in Europe and North America have become an important factor in shaping the patterns of location of production and competitive advantage. Given their weight in the world economy and the world trade that EU and NAFTA enjoy, this diversion of trade and investment away from the rest of the world economy in favour of intra-regional trade has adversely affected the growth process in regions that are not part of these blocs. The Asian countries, on the other hand, have pursued multilateralism in their trade and investment policy throughout except for sub-regional attempts at economic cooperation such as SAARC Preferential Trading Arrangement (SAPTA), ASEAN Free Trade Area (AFTA).

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. 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 2002 at Boao, in Hainan province

of China, as a pan-Asian economic forum. The East Asia Vision Group (EAVG) has proposed formation of an East Asian Economic Community.

## Potential of Asian Economic Community

The world economy region may now be trapped in a prolonged slump. Japan's economy has been in a recession for over a decade. The Japanese recession has also affected the growth in the rest of Asia. The lost output because of under-utilization of capacity could be of the order of 10-15 per cent of the GDP of the region or about a trillion dollars a year. A more intensive cooperation for matching the under utilized capacity in some countries of the region with unmet demand in others could go a long way in pulling the region out of the current slump.

## Limitations of Sub-regional Cooperation

The sub-regional attempts at regional co-operation that have been initiated such as those under the framework of ASEAN and SAARC are unlikely to exploit the full potential of the regional economic integration in Asia. This is because the extent of complementarities are limited at the sub-regional levels. It is clear from the fact that trade of South Asian countries with the East Asian countries is much larger than the intra-regional trade. The same is the case with ASEAN. At the pan-Asian level, 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.

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. The formation of AEC will also help the region to play a more effective role in shaping the emerging world trading and financial system responsive to its needs.

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

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**Table 1: Proposed JACIK Economic Community in relation to the European Union and NAFTA in 2000**

(billion US \$)

Parameter	EU	NAFTA	JACIK (14)
GDP	7260	11147	7262
GNI PPP	8315	11350	13361
Exports	2025	1226	1367
International Reserves	381	197	751
Population (millions)	354	411	3012

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

services as well as labour and capital amongst Asian countries sustained over several centuries.

## **An Approach to Asian Economic Community**

An ambitious programme of Asian economic integration would have to be implemented in a phased manner. This is the approach that has been adopted by the successful regional blocs of today, viz. EU and NAFTA which started an effective skeleton with a core group of countries before expanding the membership later to others.

### ***JACIK Provides a Useful Road Map for AEC***

In view of the attempts already made at regional economic integration, the Asian economic community in the initial phase, it is arguable that five blocs of the Asian regional economy might form a core group, viz.: Japan, Asean, China, India and Korea (JACIK). Once the process of integration is consolidated and some gains of integration are visible, AEC could be thrown open to other economies of the region.

JACIK economies combine between them fourteen of the largest and fastest growing economies with vast complementarities. 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 \$ 750 billion will be much larger than those of the US and the EU put together. Therefore, the region would have sufficiently large market and financial resources to support and sustain expedited development of the region's economies.

Some process of cooperation among the JACIK economies has already started. An important step was taken under the Chiang Mai Initiative launched in May 2000 with a currency swap plan established between 10 member states of ASEAN and Japan, China and South Korea (10+3) linking the international reserves of these countries.

On a parallel track, the other member of JACIK, viz. India has also intensified her economic cooperation

with the JACIK economies. During the 1990s India has also adopted a Look East Policy to strengthen her economic cooperation with Southeast and East Asian countries. In 2002, India and ASEAN partnership has been upgraded to the Summit level dialogue with ASEAN as applicable in the case of ASEAN plus Three. The India-ASEAN cooperation has progressed substantially in many spheres, in particular in science and technology, IT and electronics, human resource development, transport and infrastructure, space technology, tourism and trade and investment, among others. Besides a large (US\$ 500 billion) market, the Indian economy has shown strong fundamentals and has sustained one of the fastest growth rates in the world over the past two decades with macroeconomic stability in the region. India has intensified her global and regional economic integration with a decade of economic reforms and the economic structure is fast converging with the ASEAN levels in terms of trade and investment policy. India and other JACIK economies have considerable complementarities between them.

## **Priority Areas of Regional Economic Integration**

### ***Monetary Cooperation for Exchange Rate Stability***

An important area of regional cooperation would be to create some mechanism for greater stability in real effective exchange rates. Substantial regional funds under a possible Reserve Bank of Asia (see Policy Brief #3) are essential for achieving stability of real effective exchange rates and for an orderly response to external shocks. Some progress has been made in this direction with the creation of the ASEAN+3 Swap Arrangement. However, the funds available under these arrangements without IMF conditionality are only about \$ 3 billion, grossly inadequate for meeting the balance of payments security of Asian countries. The available swap funds need to be expanded and greater independence from IMF programmes is needed. Furthermore, another step to invigorate the Swap Arrangement would be to extend it to all JACIK countries.

### ***Financial Cooperation for Reviving Demand***

Some countries of the region have large excess capacity in sectors such as construction and IT and some others have large unmet demands in these areas. In such a scenario, regional pump-priming or regional Keynesianism could be quite effective in reviving demand for utilizing the excess capacity. Regional efforts can be particularly successful if a suitable mechanism can be devised for funding such regional Keynesianism without adding to the Government expenditure in the surplus countries. The proposed Reserve Bank of Asia can help here. One possible avenue is creation of an Asian SDR backed by deposits of surplus countries (which are currently going mostly to the US) and will be used to finance infrastructure and IT investments in the region. The borrowers could be regional

companies (such as Channel Tunnel Company for the UK and France) jointly owned by governments and private sector in the region. The Asian SDR can be used increasingly as a unit of account and as reserve asset in the region. A mechanism also needs to be created for seeding and developing viable Regional Infrastructural Projects such as Asian Railway, Asian Highway, Asian power grid, Asian gas grid or pipeline, Asian satellites, Asian Information Infrastructure (such as a broad band cable).

### ***A Regional Trade and Investment Arrangement (RTIA) to Facilitate Exploitation of Complementarities***

The relevance of a regional trading bloc for JACIK region is to be evaluated on the basis of relative costs and would generate substantial welfare effects. The presence of substantial diversity in the endowments and levels of development of JACIK countries provides a prima facie justification for an RTA. RIS studies find considerable evidence of complementarities between the JACIK countries' production and trade structures. Formation of an RTA may help in exploitation of these complementarities for mutual advantage. The experience of APEC shows that countries are less enthusiastic of liberalization without any reciprocity. Hence, open regionalism may not be an effective means of trade integration. The experience available from EU and NAFTA suggests that deeper and wider forms of economic integration are necessary for realizing the full benefits of integration such as efficiency-seeking industrial restructuring. 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. 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.

The resource endowments and skill bases of JACIK countries complementary to each other. Japanese (and increasingly Korean) MNEs are leading sources of FDI in the region. Japan has also established its leadership as a source of technology in a number of industries such as semiconductors, automobiles, industrial automation, electronics and some chemicals. Korea, China, India, Singapore are also emerging sources of technologies in different areas. The share of JACIK in world-wide generation of technology as measured in terms of share in US patents has gone up from 14 per cent to 22 per cent over the 1990s. Furthermore, the technological capabilities of Asian countries are essentially complementary in nature. For

instance, Korea in auto, consumer electronics, semiconductors, shipbuilding; China in consumer electronics and light engineering; India in biotechnology, pharmaceuticals and computer software, and so on. Within industries too, there are patterns of complementarity.

The RTIA would also facilitate exploitation of complementarities in technology and industrial capabilities that exist in Asia. For instance, in IT industry East Asia has huge hardware capacity and some countries like India, and the Philippines have the software capacity. A similar situation exists in chemicals, pharma, biotech, etc. This emerging pattern of complementary capabilities provides a great potential for intra-regional FDI and technology transfers. Furthermore, Asia has its own model of industrial restructuring, viz. flying geese model which provides for industrial specialization and division of labour based on changing comparative advantage. Asia also combines a number of economies that are deficient in skilled manpower and human resources such as Japan, Singapore, Malaysia, and those that are relatively plentiful in these resources such as India, China, the Philippines. The formation of an economic community would help these complementarities to be exploited for mutual advantage, as demonstrated by the CGE computations of welfare gains.

### **Concluding Remarks**

The foregoing discussion has shown that Asian Economic Community is an idea whose time seems to have come. It is clear from the voices emanating from different places. Therefore, formation of a broader pan-Asian Asian economic community could enable the region to resume its rapid growth despite the uncertain global economic outlook and emerge as the center of gravity in the world economy. Regional trade liberalization accompanied by freer movements of investment, technology and skills among the Asian countries would generate substantial efficiency gains by enabling the participants to exploit their complementarities to mutual advantage. 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.

However, an ambitious programme such as this has to be implemented in a phased manner. First of all, there could be a phasing of the participation of countries, taking cue from the experience of successful groupings of the world. Similarly a phasing of the areas of cooperation could be advisable with cooperation in finance and money taking the lead and trade and investment liberalization following it closely.

While one should not underestimate the political challenges to getting an ambitious programme such as this off the ground, these challenges are no more than those faced by the European countries when they began their plans for economic integration.

## Work Programme on the Asian Economic Community

RIS organized an International Conference on 'Building a New Asia: Towards an Asian Economic Community', held in New Delhi on 10-11 March 2003. This conference had participation of eminent scholars, experts and policy makers from China, India, Indonesia, Japan, Korea, Malaysia, the Philippines, Singapore, and Thailand. The participants have been affiliated with premier think-tanks of Asia such as the Chinese Academy of International Trade and Economic Cooperation, Korea Institute for International Economic Policy, Centre for Strategic and International Studies, Jakarta, Malaysian Institute of Economic Research, Institute of South East Asian Studies, Singapore, National University of Singapore, Wee Kim Wee Centre Singapore, National Economic Action Council, Malaysia, Chulalongkorn University, Thailand, International Institute for Trade and Development, Bangkok, Reitaku University Japan, Tamagawa University Japan, Japan Centre for International Finance, RIS India, Indian Institute of Foreign Trade, Asian Development Bank, among a number of others. The Conference was inaugurated by Hon'ble Shri K.C. Pant, Deputy Chairman, Planning Commission. Hon'ble Mr Koichi Kato delivered the keynote address and Hon'ble Shri I.K. Gujral, the former Prime Minister of India, delivered the Valedictory Address. Hon'ble Shri Yashwant Sinha, External Affairs Minister of India, received a delegation of participants at the Foreign Office.

There was a general consensus at the Conference that the Asian Economic Community is an idea whose time has come. Voices for more intensive economic cooperation among Asian countries are emanating from different places. It is also evident from the importance that is being attached by different Asian countries to regional economic integration at the bilateral or sub-regional levels. Formation of a broader pan-Asian economic community could enable the region to resume its rapid growth despite the uncertain global economic outlook and emerge as the centre of gravity in the world economy.

The think-tank community of Asia has a critical role to play in realizing the dream of building a New Asia by showing the way forward to the policy makers with specific proposals for implementation. The Conference emphasized on the need to keep the informal network of think-tanks created at this Conference alive and active as a springboard for generating new ideas. This Network (or New Asia Network) should conduct research on different aspects of Asian economic integration to follow-up and further refine the ideas generated at this Conference. It should regularly exchange ideas among the participants and others interested in the subject and launch a Newsletter to serve as a forum of exchange of views and research. In view of its initiative taken to organize the Conference and assemble these think-tanks under one roof, RIS was asked to serve as a nodal point of the New Asia Network and coordinate its work until alternative arrangements are made. The Conference also called for organization of follow-up conferences in Tokyo (2004) and New Delhi (2005) with possible government participation.

RIS is working on the follow-up action as mandated by the Conference, in consultation with SPF and other think-tanks.

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- ☆ *South Asia Development & Cooperation Report 2001/02*, 2002.
- ☆ *Globalization and the Quality of Foreign Direct Investment* by Nagesh Kumar, Oxford University Press, New Delhi, 2002.

### Occasional Papers

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