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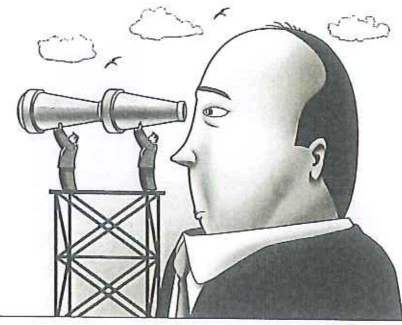
POINT OF VIEW



Asia's economic integration will continue despite Europe's woes

Iwan Azis

The euro zone crisis may be providing fodder for opponents of regional integration, but Asia is and must continue to further mesh its economies and increase cooperation.

Maritime piracy: A threat to our security and the global economy

Giulio Terzi

Increasingly sophisticated and violent pirate gangs pose a major threat to maritime trade. Nations must work together – including respecting the immunity of Navy personnel while on duty at sea – to curb this global threat.


AFP PHOTO

Asia's economic integration will continue despite Europe's woes

Iwan Azis
is head of the Office of Regional Economic Integration at the Asian Development Bank in Manila.

Europe's ongoing sovereign debt and banking crisis threatens to tear apart the 17-nation euro zone, putting paid to decades of government-led efforts to harmonize economies in the region. Nonetheless, Asia continues to work hard to boost cooperation and integration among its many countries.

The 10-member Association of Southeast Asian Nations is pushing ahead with plans to create the ASEAN Economic Community by 2015, while the signing of the Trilateral Investment Agreement by China, Japan and South Korea in May was a milestone in cooperation between three countries that together account for nearly 20 percent of global gross domestic product and trade.

The agreement could ultimately lead to a three-way free trade pact between the economic giants. India, too, has stepped up its economic integration with East Asia; trade and investment have grown sharply and it has concluded a series of free trade agreements. Financial cooperation within ASEAN+3 has also been accelerating. The region's emergency financial safety net, the Chiang

Mai Initiative Multilateralization (CMIM), has doubled in size and become somewhat less dependent on International Monetary Fund conditionality. The group has also enhanced the Asian Bond Markets Initiative to strengthen the push to develop large and effective local currency debt markets. In addition, the ASEAN+3 Macroeconomic Research Office, which is tasked with monitoring the region's economies, is now up and running in Singapore.

So given that Europe's long experiment with economic integration seems to be on the verge of failure, is Asia heading in the wrong direction? Not at all. In fact, Asia's push for greater integration makes an awful lot of sense.

Economic integration in Asia requires a balance of common interests and a balance in the ways they are satisfied, whether through trade, investment, finance or public goods.

To resolve its current problems, Europe needs to find a new balance between three policy alternatives: imposing fiscal austerity to reduce large government deficits, providing support for economic growth and ensuring enough policy consistency and predictability to restore confidence to the jittery financial markets that threaten to bring down the whole single currency framework. To do that, Europe may need greater economic integration, not less. Common eurobond issuance, greater coordination on market and economic policy and a firm commitment by the region's leaders to the single currency may be the only way to avoid economic and financial collapse.

Integration in Europe should be more market-driven. The sequence of enhanced integration, and the way it is done, matters enormously. This is a lesson that Asian nations have taken to heart as they shape their collective future. Economic integration in Asia requires a balance of common interests and a balance in the ways they are satisfied, whether through trade, investment or financer public goods. In Asia's case, the steps taken thus far have been generally market-consistent, yet deliberate. In most cases, regional integration initiatives have grown out of unilateral or bilateral policy actions such as trade and tax agreements. Open regionalism has followed in fits and starts, and fortunately or unfortunately, depending on your viewpoint, usually with an economic crisis as an impetus.

One must remember that Asia is made up of a highly disparate set of economies in terms of size, natural resources and human capital, and in terms of systems of government. Against that backdrop, its remarkable progress in building consensus in favor of enhanced cooperation during the past two decades has occurred because nations have been extremely realistic about what is achievable as a region and, so far at least, have avoided excessive expectations. In 1967, one ASEAN official harked back to the Roman Emperor Augustus when he said the grouping's five founding nations – Indonesia, Malaysia, the Philippines, Singapore and Thailand – had been "making haste slowly" to forge the ASEAN Declaration.

Far from being a criticism, this approach has worked well for the region. Cooperation is happening in a multi-track, multi-speed manner. Integration occurs naturally when open markets offer opportunities to work together. Then formal cooperation hustles to catch up when economic distortions arise, usually exacerbated by market failure, and nations get together to work on a rules-based system to respond to the situation.

The differences between ASEAN and the European Union are stark, and they revolve around motive. Integration in ASEAN, and in Asia more generally, has been market-driven, outward-oriented and institution-light. The European project, on the other hand, was conceived and driven by politicians, internally oriented and has become institution-heavy.

So where is Asia today? Asia is leading growth in global trade through its increased openness. Intraregional and "South-South" trade is growing faster than trade with traditional markets in the US and Europe, for example. In January, the EU and the US accounted for 25.3 percent of Asia's trade, down 4.9 percentage points from 30.2 percent in 2007, while the share of exports to Latin America, Africa and the Middle East rose by 2.3 percentage points and intra-regional exports ticked up 1.5 percentage points. While the depth of trade integration varies across subregions, there is a strong bias toward trade in intermediate goods, which reflects the region's increasingly complex supply chains and expanding production networks.

Asia's financial integration has lagged trade integration. In general, Asian investors still prefer to invest either in their home markets or in mature markets such as the US and Europe. In 2010, only 23.7 percent of the region's cross-border assets were held in Asian equities and a tiny 7.3 percent in the region's debt securities. But as advanced economies move forward on the long process of restructuring both their fiscal and household balance sheets, the degree of financial integration in Asia is likely to increase as financial markets in the region develop to better accommodate Asia's vast savings. These savings can be put to productive use within the region, including financing corporate expansion or infrastructure, for example. This is likely to be the case in emerging markets worldwide.

Increased trade and financial integration is a welcome development. However, policymakers need to understand both the potential benefits of regionalism and its potential pitfalls.

Although Asian financial markets are still more closely connected to global markets than to each other, regional financial integration has accelerated in varying degrees across Asia since the 2008 global crisis. Going forward, the gradual internationalization of the Chinese renminbi is likely to further boost regional cooperation and integration, particularly in East and Southeast Asia. Given the current state of the global economy, Asia is clearly at a pivot point. Increased trade and financial integration is a welcome development. However, policymakers need to understand both the potential benefits of regionalism and its potential pitfalls.

Regional integration can expand export markets and provide new sources of needed inputs. It means better allocation of resources across a wider geographical area. It boosts economic growth and should – and


AFP PHOTO

Workers convey bags of starch imported from Vietnam to China on the border of the two countries.

this is a major "should" – provide greater risk-sharing. But there are also downside risks, ranging from potential contagion from closely enmeshed financial systems, to trade diversion and growing polarization in levels of economic and social development. And change doesn't always occur as we expect. For example, while the level of Asia's financial integration has increased, benefits in terms of consumption and investment risk-sharing have been limited.

The distributional impact of integration cannot be overemphasized. We have seen that closer economic links have helped reduce income disparities across Asia, but they may have also have contributed to widening inequality within countries as, for example, workers in a given sector may lose their jobs because of increased competition from workers in neighboring countries, while those in other sectors find they are in greater demand. Access to financial assets that are able to cross borders yields returns to only a small group of the urban-based population, with most others lacking both information and opportunity. Indeed, across Asia income inequality has worsened, and in many countries the degree of polarization has increased. This can cause both political and social problems.

Like any policy or strategy, the goal of integration must be to improve the welfare and quality of life for the majority of people both within and across countries. Large portions of Asia's population still do not benefit from the increased prosperity of the past few decades. Benefits from the rapidly growing financial sector and innovation

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supported by integration, for example, have not been widely felt. Thus, financial inclusion remains a major challenge for Asia.

The disconnect between the financial and real sectors is another conundrum confronting Asian policymakers. Rising volumes of cross-border financial flows to an assortment of assets may help allocate resources more efficiently, but it also adds more liquidity to each country's excess savings. Despite that, the region suffers from a huge infrastructure deficit – both physical and social such as in health and education. Unless these shortfalls are dealt with, some countries may find themselves slipping into the "middle-income trap," in which growth stagnates.

Yes, Asia needs more financial development and further integration can help. But it should focus more on those components that will bring the most widespread benefits. This can be realized most effectively through sensible national policies. So while collective regional policies certainly have merit – and unilateral policies tend to benefit individual countries and the region – it is still important that national economic and social priorities remain the crux of major regional initiatives. Countries benefit, the region benefits and ultimately people benefit. Integration is not the same as cooperation. As opportunities arise, the natural process of economic integration in Asia will accelerate. That comes with both benefits and risks, so regional cooperation is needed to manage those risks without jeopardizing the benefits.

One obvious risk is financial contagion during a crisis. Cooperation in providing an effective regional financial safety net is therefore needed. In ASEAN+3, the CMIM is a start, although it still has a long way to go before it can become truly effective. The fact that the CMIM has never been used is a good thing, as it shows the resilience of the region's economies. But we live in a financial world with huge uncertainties. The next crisis could be rooted in vulnerabilities as yet unseen, and it could be transmitted through new channels we may not be able to detect. We may not know the problem until we are faced with it. Domestic safety nets alone may be inadequate to deal with these new unforeseen vulnerabilities, especially if future contagion channels do not mirror past events.

So Asia needs support from effective regional safety nets. Ironically, the region's current resilience may stand in the way of building a deeper, better, more effective financial safety net. The belief that Asia has unlimited resilience is bravado and naiveté, or simply complacency. We must use Asia's resilience today to prepare the safety nets that may be needed as protection from future shocks.

As Asia continues on its steady path toward greater integration, we must, unlike Europe, allow markets to continue to drive the process, with the region's governments and institutions cooperating when and where needed to smooth the process and manage potential future contagion in a region where economic and financial ties are becoming ever stronger.

AFP PHOTO/ROSLAN RAHMAN

Maritime piracy: A threat to our security and the global economy

Giulio Terzi
is the foreign minister of Italy.

Maritime piracy is a deadly threat to the lives of all men and women working at sea. It is also a threat to the maritime industry and international trade, and to the basic rights we all enjoy to travel freely and safely. It is, after all, an attack on the global economy, as more than 80 percent of global trade is carried out by maritime transportation.

The audacity, scope and intensity of today's pirates – we should actually call them sea terrorists – is unprecedented. We have never witnessed something comparable to the number of attacks and hijacking of ships, and seafarers kidnapped or killed, in the past three years. Their frequency and cruelty are particularly worrying.

Piracy has expanded over the years. Previously, attacks were carried out by small and disorganized groups of fishermen. During the last decade, however, we have witnessed the steady growth of the piracy phenomenon in both frequency and intensity of attacks, which today are well-coordinated and unfortunately sometimes successful. Particularly for its disruption of the main maritime trade