

5

Expanding the Agenda for Regional Economic Cooperation

JESUS P. ESTANISLAO

The Asian financial crisis, which affected large swathes of the East Asian economic region slightly more than a decade ago, is remembered in a typically Asian manner. The enormous cost of the crisis is properly acknowledged. At the same time, the ability of the region to tap new opportunities, thereby enabling it to recover from the crisis is quietly celebrated.

Not only has the cost been counted in terms of amounts lost and resources spent in economic and financial restructuring, but it has also been reckoned in terms of the destabilization that inevitably spread from the economic and financial spheres into the political and social spheres. In some economies of the region, changes in government were unexpectedly accelerated as millions of citizens were swept back below the poverty line.

There can be no underestimating the cost of the Asian financial crisis. But neither can we close our eyes to the opportunities that virtually all economies in the region seized in trying to recover. With the hindsight that a decade now affords, it appears that the lights switched on by opportunities smartly seized look brighter than the shadows cast in the immediate aftermath of the crisis.

Indeed, there is hardly any talk in the region of a decade lost. Rather, much of the reference is to the remarkable recovery that the region has

been able to stage. Looking at the region as a whole, real gross domestic product (GDP) has grown at an annual average rate of 9 percent. Export growth has been even higher, to the extent that the region now accounts for one-fifth of the global export volume.¹ Complemented by significant inflows of foreign direct investment (FDI) into the region, these export surpluses have enabled virtually all economies in the region to significantly boost their foreign exchange reserves.

Moreover, in contrast to what was seen in the immediate aftermath of the crisis, two positive developments need to be highlighted. First, in the decade since the onset of the Asian financial crisis, it is estimated that on a net basis, some 300 million people in the region have crossed back above the poverty line, offsetting the millions who were thrown below it at the start of the crisis. And second, the region is no longer a set of individual economies gasping for financial support from those outside the region. It has become much more integrated, giving greater substance to references to East Asia as one economic region. After all, intraregional trade now accounts for 54 percent of East Asia's total trade. This is admittedly still a shade below the 60 percent that the European Union (EU) claims, but it is already above the corresponding 45 percent for the North American Free Trade Agreement (NAFTA).²

Much of what has been achieved in the region can be traced to the remarkable economic performance of China. Its economy has been growing, generally at double-digit rates or at rates very close to double digits. China's ability to sell in export markets and to attract significant amounts of FDI has enabled it to build its exchange reserves to unparalleled heights. Looking up at those heights, other economies—particularly the United States and those in the EU as well—have been pressing China to allow its exchange rate to move accordingly. In the decade after the Asian financial crisis, China has loomed very large, not only in affecting the recovery of the entire East Asian region but also in shaping economic perceptions in global financial markets.

China's dramatic economic performance during the past decade has been phenomenal indeed. No other economy in the region or beyond comes anywhere close. But China has not been alone in growing its GDP and its export volume. Neither has it been alone in attracting FDI and in building foreign exchange reserves. Virtually all other economies in

1. Indermit Gill and Homi Kharas, *An East Asian Renaissance: Ideas for Economic Growth* (Washington DC: World Bank, 2007), 1.

2. Gill and Kharas, *An East Asian Renaissance*, 8.

the region have been following suit, in part being pulled up by China's economic dynamism.

All of the other economies in the East Asian region have been playing a part in driving the region forward. Through mainly market-driven policies, they have been able to achieve higher levels of GDP growth. And as a natural byproduct of higher GDP growth rates and of relatively more open trade regimes, they have been able to raise their export growth rates even more significantly. In the process, they too have been able to contribute to the much higher degree of regionalization in East Asia.

Japan, in particular, has been notable for its contribution to a higher degree of regionalization. Despite the much slower growth of the Japanese economy during this period, Japanese multinationals have still been able to play a very significant role in making East Asia a more cohesive economic region in the decade since the onset of the Asian financial crisis. Japanese multinationals have been sending as much as 80 percent of their exports from their East Asian affiliates to other countries in the region. And they have been sourcing as much as 95 percent of their imports from their affiliate plants elsewhere in East Asia.

East Asia, then, seems to have emerged from the financial crisis as a much more integrated region—to a point where referring to an East Asian economic region has almost as much substance as referring to the EU as one European economic region and, even more so, to NAFTA as one North American economic region. As described above, the higher level of regionalization in East Asia has been achieved mainly through intraregional trade, which has been facilitated by higher real economic growth, greater reliance on market-driven policies, and more open trade regimes.

In this light, the dream of eventually building an East Asia community, initially through more free and open trade, has been gradually realized in the past decade. The tentative arrangements for more free and open trade in the region that were put in place in a fashion that can be described as almost gingerly—starting with ASEAN and more recently extending ASEAN to include other East Asian economies—seem to have survived the skepticism generally heaped on them. These arrangements may yet provide a useful framework and one of several venues for efforts to bring the regionalization in East Asia to a much higher level.

THE FOUNDATION AND CONTEXT FOR FURTHER REGIONALIZATION IN EAST ASIA

Having been brought to a fork in the road by the Asian financial crisis, the economies of the region could have chosen to go down the road of putting up barriers and closing themselves off from the crosscurrents of more open economic interaction with each other and with the rest of the world. To their credit, they chose instead to move along the road toward freer and more open trade. The choice may not have been easy for a few economies in the region. But it was helped by the much greater reliance on markets that key economies in the region (e.g., China and Japan) decided to pursue and by the generally favorable environment for exports into other key markets, particularly the United States and other developed economies.

It is sometimes easy to turn a blind eye to the positive boost that progress toward freer and more open markets can give to economies. The debate on further market opening never stops. And negotiations on moving up the ladder toward freer and more open trade arrangements on the global scale can be tortuous and stretched. The Doha Round has continued to miss deadlines and, at the time of writing, it would appear to need heroic efforts to be brought back to life. Nonetheless, it is difficult to ignore the positive developments over the past decade in East Asia that have been facilitated by more open trading regimes.

More open trade regimes raise trade volume not only on the basis of factor endowments but increasingly also on the basis of economies of scale. Through the tight supply-chain management that new technology now makes possible, East Asia has made significant strides in intra-industry trade. Trade in parts and components has boosted intraregional trade, with various plants located in different countries being able to work in close sync with one another in order to more effectively and efficiently serve final consumer markets, particularly more developed markets such as the United States and the EU. Under supply-chain arrangements, specialized firms are being continuously pressed to innovate, improve quality, and cut costs as they try to take advantage of the increased size of the market they jointly serve. The combination of specialized focus and much larger volume gives greater impetus to further innovation.

Innovation used to be a near monopoly of the West, and East Asian firms had the reputation of being merely good copiers, cheap imitators,

and technology pirates. In the past decade, however, as the relationship between production sites and final markets has become much closer and as supply chains have become more efficient, research and development networks have grown stronger and multiplied. Ideas have traveled more quickly and freely, and more innovation has occurred much closer to production sites in East Asia. The number of patents taken out by individuals and institutions in Northeast Asia—particularly in Japan, China, South Korea, and Taiwan—has gone up dramatically in recent years. The more open transmission of skills and the greater exchange of ideas and scientific insights have also been facilitated by easier and more frequent travel and by longer stays abroad on the part of research personnel from East Asia.

Where trade and technology lead, there finance follows. As real economic growth picked up and as the region's trade volume rose even more impressively, investment opportunities in the region became more attractive. China in particular, and to a lesser extent the other economies in East Asia, became the destination of FDI flows. In fact, every East Asian economy has taken advantage of higher FDI inflows and higher trade surpluses to build up their foreign exchange reserves. They also started to engage in initial conversations to set up at least limited arrangements through which to jointly mitigate financial risk. Through the Chiang Mai Initiative, economies in the region decided to set up a limited pool of exchange reserves as a first step toward ensuring against the return of the financial crisis of the 1990s. They also began discussion of an Asian bond market, and in 2002 the Asian Bond Markets Initiative was launched under ASEAN+3. All these are just slightly more than straws in the wind for now. But they point to the direction where winds will be blowing in the future, and that is toward greater regional financial cooperation.

Trade, technology, and finance have thus reinforced each other in a manner that has more broadly integrated East Asian economies with the global economy. In the process, they have also become much more closely integrated with each other, so that, substantively speaking, an East Asian economic region has emerged. The main pillars of this economic region are the big economies, Japan and China. Both have maintained largely open trade regimes. They also have relied more on the dynamics of market forces to drive the economic reforms they have been undertaking and, particularly in the case of China, to rev up their economic and export engines. The smaller economies in the region have

pursued a similar market orientation and more open trade regimes. They too have contributed dynamically to the increasing integration of East Asia into the global economy, as well as to the emergence of the East Asian economic region.

As the East Asian economies have become increasingly integrated with the global economy mainly through greater reliance on market processes, they have increasingly been faced with challenges to their internal integration in the face of domestic disparities in economic opportunity and income. The economies of scale that trade, technology, and finance have made possible also have had consequences that put increasing pressure on the domestic cohesion of several East Asian societies.

Perhaps the most noticeable consequence is the increasing concentration of people and economic activity in cities. Increased economic activity tends to be location specific, and it tends to be concentrated in a few centers. Indeed, economies of scale call for concentration and even further agglomeration of economic activity and of people. People generally migrate from the less developed countryside, which has much fewer economic opportunities, to the centers of industrial production, trade, and export activity.

All this tends to widen the inequality of economic opportunity and income levels. The urban-rural divide widens, and gaps also grow between geographical segments of a nation's population (e.g., between south and north, east and west, or interior and coastal areas). Furthermore, the pressure of immigration into a few industrial urban centers brings spatial challenges such as congestion, garbage and sewage disposal, pollution, snarled traffic, and—where city governments are relatively weak—slums and squatter colonies as well. When all these challenges are not properly and adequately met, crime surges and the sense of security in urban areas deteriorates considerably.

The burden of having to meet these challenges falls on city governments, which have been required to adjust their governance paradigms and improve their technical capacity at a faster pace than normally expected. As challenges grow, so too do opportunities, as new and greater resources flood into these areas. Together with these opportunities comes greater temptation for graft and corruption on a large scale. For some ordinary city government officials, temptations are often too great to resist, so corruption quickly becomes a top priority as a public concern.

East Asia in the past decade has had to face these consequences, which challenge the internal, domestic cohesion of their societies. They have become increasingly serious concerns, and they keep crying out louder for more attention and purposeful action. The failure in some instances to meet these challenges has often given a bad face to globalization. Even in the societies of East Asia that have been benefiting from closer integration with the global economy, the word “globalization” itself often attracts the ire of demonstrators who are sufficiently incensed by the “triple Cs” that have come in the wake of economies of scale: cohesion, congestion, and corruption.

As East Asia moves forward toward becoming one economic region, the key issue that has to be resolved is how to continue to take advantage of the positive consequences of economies of scale while effectively confronting their negative consequences. In other words, how can East Asia continue to become more interconnected internally and with the rest of the world—i.e., continue with *global integration*—while resolving the difficult problems associated with cohesion, congestion, and corruption that are putting enormous pressure on the *domestic integration* of many societies in the region?

It is the need to face up to this issue that has opened many avenues for East Asia to move forward, beyond being merely one economic region to becoming more than an economic region, if not a community, in the decade ahead.

THE ROAD AHEAD FOR EAST ASIA

If East Asia has been able to post a remarkable recovery from the Asian financial crisis of a decade ago with heavy reliance on market-driven forces and more open trade regimes, then moving forward should draw impetus from the region’s continued commitment to allowing markets to work. It would be foolhardy for the economies in the region to scale down on such a commitment, which can continue to provide tailwinds to their economic sails. Three areas in particular—trade, innovation, and finance—provide rich and fertile ground for the region to make further progress.

Either individually or through regional arrangements such as ASEAN+3, or more fittingly under the newer and broader auspices of the East Asia Summit, the economies in the region should continue

to exploit economies of scale by facilitating the further growth and development of networks engaged in the parts and components trade. Indeed, there is wide scope for further expanding the regional production networks by broadening and further integrating the logistical supply-chain systems that already span several economies in the region. Intergovernmental initiatives could aim at simplifying, making consistent, and eventually unifying the wide variety of rules, such as those related to rules of origin, and more broadly the special economic partnership arrangements or bilateral trade agreements that have been and are in the process of being forged within East Asia.

Meanwhile, as innovation centers gain further ground and achieve more success within the region, more open mechanisms should be set up to ensure and enhance regional knowledge and technology spillovers. The flow of knowledge and technology should be expanded from the vertical channels running from the more developed economies outside the region, such as the United States and the EU, to the economies in Northeast Asia. This should be increasingly complemented by horizontal channels established between several of the economies in the region. To begin setting up these alternative horizontal channels and to systematically develop them, governments in the region should encourage and facilitate cooperation between research centers, scientific laboratories, and graduate institutes, including eventually between universities in the region. In the next few decades, regional cooperation should therefore include among its top priorities greater coordination and support for upgrading postsecondary education and creating more meaningful exchange programs, as well as for scientific and technical interaction between research institutes and graduate centers in various economies in the region.

Regional financial cooperation also needs to be pushed further. Now that the symbolic agreements to pool limited amounts of exchange reserves have been forged with the Chiang Mai Initiative, more substantive steps should be taken to expand on this. These may include the wider spread of improved risk management systems and the possible sharing of best practices in risk management at both the microeconomic and macroeconomic levels. Corporate bond markets need to be given further impetus so that financial markets can be further developed and strengthened in various economies. The initial efforts to link the region's capital markets more closely and more interactively should not be allowed to flag. The region's resolve to undertake these efforts should,

instead, be strengthened by the stark imbalances—and the problems those imbalances create—in the financial relations between the individual economies in the region (e.g., China) and the more developed financial markets—particularly the US financial market.

The market trinity of trade, innovation, and finance, therefore, does provide rich and fertile ground for further economic growth and forward movement for the economies of the region. As they continue to work on this favorable ground, they need to consider undertaking further initiatives, such as those indicated in very broad terms above, either individually or preferably in solidarity with many other market-minded economies in the region. As they attempt to do so, they will find that they continue to rely mainly on governmental leadership and intergovernmental cooperation.

But the role of governments—i.e., the role of the state—in regional efforts needs to be increasingly complemented by the role of business enterprises and postsecondary educational institutions, such as universities and graduate research centers. Corporations and universities in the region need to be drawn much more proactively into the effort to address the challenges—there are always new and greater numbers of challenges—that market-oriented economies face. Moreover, these challenges arise from the dynamics of more open and robust competition within markets. And it is corporations, with postsecondary educational institutions playing a positive and supportive role, that need to meet the challenges of market competition. Beyond a certain point, after the “rules of the game” have been set and the framework for competition policy has been provided by governments and intergovernmental agreements, it is corporations, as organizations that stand or fall on the basis of their competitiveness and their general ability to maneuver effectively in the face of market forces, that should carry the ball. At that point and beyond, states should play less and less of a role within the economy, and corporations should take on more and more strategic and operational responsibility. In the decade ahead, East Asia may well be reaching this point.

If East Asia is to enter that stage in the next decade, and if business corporations are to play a much greater role on their own, with much less dependence on the state and state-managed arrangements, then the manner in which corporations are governed becomes a critical concern. The corporate governance of businesses that compete in increasingly free and open markets needs to be subject to clear “rules of the game” and a

publicly accepted framework. Markets are increasingly demanding that these rules and this framework should be in line with professional and ethical standards as well as with the demands of social responsibility. Governments should insist on setting these rules and standards and on ensuring that the demands of social responsibility are met. But compliance remains the responsibility of the corporations themselves, which should increasingly hold themselves more transparently accountable to free and open markets. In living up to professional, technical, ethical, and social responsibility standards, corporations should be able to bank on the active and dynamic support of independent postsecondary educational institutions with their various graduate research centers and technical institutes.

Business corporations and postsecondary educational institutions operate at the microeconomic level within the macroeconomic “rules of the game” and market competition framework that governments provide. In the next few decades, the economies in East Asia will continue to rely on their governments to further improve the rules of the game and to enter into intergovernmental regional arrangements that further refine and operationalize the market competition framework for the region. More macroeconomic work needs to be undertaken and accomplished. But even more work at the microeconomic level needs to be accomplished so as to complement and give further substance to the work of and between governments in the region. Institution building in the corporate sector and at the level of specialized postsecondary educational and research institutes becomes even more compelling and important when viewed as a complement to continued nation building. Success in East Asia with regard to the former (institution building) as a major complement to the latter (further nation building) could help secure the further progress of East Asia as something more than an economically integrated region. Moreover, it would be a decisive step toward the loftier and more ambitious dream of becoming an East Asia community.

These steps, to be taken within the rich ground marked out by the market trinity of trade, innovation, and finance, need to be complemented by steps addressing the triple challenges that have come along with economic growth and high export volumes in the past decade—congestion, cohesion, and corruption. These need to be faced decisively and effectively, since the failure to address them properly could slow and eventually stall the economic and export engines of the region.

Megacities have developed and metropolitan centers have spread in the region, making the problem of congestion acute.³ Fortunately, the development and spread of these megacities and metropolitan centers have been accompanied by the growth of many more mid-sized and small cities. Some of the congestion can be alleviated by providing more efficient connections between megacities or metropolitan centers and the emerging mid-sized and smaller cities. Resources are increasingly available, in part as a consequence of higher economic growth, from within the economies of East Asia for constructing the necessary infrastructure, such as roads, railways, airports, and harbors. Moreover, standards of public governance, even for mid-sized and small cities, are being raised. And greater efforts should be directed in the next decade toward sharing best practices in the public governance of cities and of the component cities and municipalities of metropolitan centers. More attention should be paid to closer coordination between governance initiatives of various local governments—and between the public works and infrastructure projects embedded in those initiatives—so that economies of scale can be positively tapped for greater interconnection between them. The external economies resulting from more efficient interconnections between cities and surrounding municipalities should be tapped to help address urban congestion and to make cities both more livable and more economically competitive.

The challenge to cohesion from rising inequality—brought in part by high economic and export growth in a few industrial centers—needs to be met by providing wider access to skills training, continuing education, and other social services, such as basic health care, as well as by mobilizing communities. To varying degrees, this access is already being provided through various programs that governments and civil society organizations (CSOs) are undertaking. Governments are finding, however, that there are limits to their effectiveness, particularly their cost-effectiveness, in providing such access to the much wider range of the population that such programs need to cover. CSOs, for their part, are also finding that they are subject to deficits of accountability and transparency. Moreover, the limited resources for—and the even more limited coordination between—their social outreach programs generally limit their overall effectiveness. Clearly, a greater exchange of best

3. A megacity is generally defined as an urban area with a population over 10 million. There are currently 25 megacities worldwide, and roughly one-third of these are in East Asia.

practices within economies as well as between economies in the region should be placed as a priority item on the regional cooperation agenda of East Asia. In particular, the exchange of best practices in providing access to various social services, and particularly access to skills formation and continuing education for those segments of the population unable to go on to postsecondary education, should be facilitated between the various economies in the region.

The challenge from corruption cannot be fully met by a simple decentralization of governmental power. Decentralization has to be accompanied by positive efforts to help local governments raise the standards of their public governance practices, starting with those responsible for mid-sized and smaller cities. Raising these standards requires more effective mechanisms for ensuring greater transparency and public accountability, and these mechanisms need to be systemic, involving the participation of the socially responsible sectors in the city. Often, a multisectoral coalition made up of business, academe, media, CSOs, and professional organizations can be encouraged to work positively and constructively with local officials of the city to pursue a common roadmap for the community. The public governance paradigm would call for their participation in and contribution to the accomplishment of various projects and targets embedded in the city roadmap. Thus, responsible citizens and public officials would have a joint stake in promoting the development of their city in a more transparent environment, with shared accountability and zero tolerance for corruption.

Indeed, throughout the region, political power is becoming more contestable. In many of the region's economies, a transition from the rule of man to the rule of law is well underway. As this transition gathers momentum, public governance initiatives aimed at raising transparency, accountability, and the standards of professionalism and social responsibility can be more openly shared. The emerging best practices, which have already been tested in a number of cities and local government units, should be more freely exchanged and more broadly spread across the region.

The triple challenges across the region from congestion; rising inequality straining internal, domestic cohesion; and corruption can be met in the next decade with the heavy involvement of governments. Not only national governments, however, need to be involved. Increasingly, local governments must also be given a greater share of the responsibility. These local governments, however, need to have their capacity for public

governance brought up to higher levels of transparency, accountability, and professionalism. Also, at the local level, there is greater imperative, as well as greater opportunity, for the involvement and participation of various sectors and citizens groups. Provided they are steeped in the discipline of responsible citizenship, these groups can and should be brought into the public governance process as positive and meaningful contributors to good governance and community development. In light of this, the sharing of best practices in public governance, particularly at the local level, offers a rich field for regional cooperation in East Asia.

PROSPECTS FOR GREATER SOLIDARITY IN THE REGION

Moving forward, the agenda for the region is extremely broad, including initiatives that can be undertaken individually, within the economies in East Asia, as well as initiatives to be undertaken through greater regional cooperation. It spans a wide range, from initiatives building on the strengths already achieved through commitment to greater reliance on open and competitive markets to those addressing the weaknesses that have put heavy pressures on domestic cohesion and that have come largely in the wake of greater integration with global markets. The expansion of the agenda comes from the wider and deeper realization that East Asia has recovered from the financial crisis of a decade ago, and that it has done so by following a framework relying heavily on economies of scale and the imperative of maintaining domestic cohesion through higher standards of public governance practice.

Indeed, there is fertile ground for positive initiatives that draw impetus from the continued and even deeper commitment to market competition on the part of economies in East Asia. These initiatives would aim to improve the conditions in which the market trinity of trade, innovation, and finance can flourish. All these would require the continued involvement of national governments dealing with macro-economic issues. But even greater involvement will be necessary on the part of business, supported by postsecondary research and educational institutions. Their involvement, necessarily more at the microeconomic level, must be guided by the principles and best practices of corporate and institutional governance in line with the professional and ethical standards that markets increasingly demand.

There is equally fertile ground for initiatives responding to the pressures exerted on domestic cohesion arising in part from higher economic and export growth in many parts of the region. Indeed, the pressures associated with the “triple Cs”—congestion, rising inequality that threatens domestic cohesion, and corruption—would have to be mitigated by positive initiatives on the part of national governments in the region. However, in many economies, governments at the national level are finding it necessary, even increasingly essential, to count on greater and more socially responsible involvement by local governments and intermediate social groups, starting with associations, particularly those promoting the interests of families within the community, and other local community groups. But at the subnational, local level, the standards of public governance practices need to be significantly improved. Transparency and accountability, as well as greater professional and technical competence, need to be added to social responsibility in the public governance practices of local governments that, meanwhile, must bank on the participation and sustained involvement of intermediate groups in the community.

All these initiatives will benefit from, and in some instances are ripe for, greater and more intense cooperation between the economies in the region. Therefore, it is clear that, moving forward, the agenda for regional cooperation in East Asia extends to concerns that go beyond the narrow fields traditionally reserved for macroeconomics and finance. It includes related fields that are made essential by more open market competition between business corporations at the microeconomic level as well as more substantive cooperation and mutual support between research and graduate institutions. Issues related to economic geography, such as the rise of middle-sized cities that are increasingly interconnected with each other and particularly with the larger metropolitan centers, also need to be on the agenda. The priority list also includes issues related to welfare economics such as access to skills training, continuing education, and other vital social services, especially for the more marginalized segments of the population. And looming up as umbrella issues are those directly connected with corporate, institutional, and public governance.

By taking on such a broader agenda, the economies of East Asia can find many concrete steps they can take individually and, increasingly, together as a regional group. These steps can add many more facets to the economic region they have already built in the decade after the Asian

financial crisis. Should they succeed in adding these facets, it is possible that a realistic foundation can be laid for the East Asian economic region to begin moving more decisively toward building the components of greater cooperation, which in time can be put together to form an East Asia community. The impact could also lend wind to the sails driving further economic growth, and could even lead to much higher levels of integration within the region.