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Enhancing regional economic integration in Asia and the Pacific

Note by the secretariat

Summary

The Asia-Pacific region’s rapid growth since the 1950s has been supported by a favourable external economic environment and opportunities arising from globalization, but this has changed dramatically in the aftermath of the global financial crisis of 2008-2009. In the new global environment, sustaining the region’s growth and realizing an Asia-Pacific century will critically depend on its ability to harness the potential of regional economic integration, which can also help make it more inclusive, sustainable and resilient.

In the light of the many complementarities arising from its diversity, the region, a late starter in regionalism, has many underexploited opportunities for mutually beneficial regional integration. Regional economic integration can also assist in making regional development more balanced, with the lagging economies receiving a boost through a stronger connectivity and integration with economic growth poles, such as China and India. Apart from fostering peace, such cooperation could also help the region address shared vulnerabilities and risks and exercise its influence in global economic governance in a way that is commensurate with its rising economic weight.

To harness the potential of regional economic integration, the study recommends a four-pronged scheme with a long-term vision of building an Asia-Pacific economic community:

- Coalescing the numerous bilateral and subregional trading arrangements of the region into a broader regional trading and economic cooperation arrangement with built-in safeguards and flexibilities for poorer countries;
- Seamless physical connectivity across the region to spread the benefits of economic integration to lagging regions through transport, energy and information and communications technology links and the adoption of best practices in trade and transport facilitation;
- Financial cooperation for closing the development gaps and to ensure the optimal use of the region’s resources for mutual benefit;
- Economic cooperation for addressing shared vulnerabilities and risks, such as energy and food insecurity, disasters, pressures on natural resources, social exclusion and rising inequalities.

The study also proposes an institutional architecture and modalities to take the agenda forward. The Commission may wish to review the analyses contained in this study and discuss its proposals for enhancing regional economic integration and cooperation.

* The late submission of the present document is due to the need to incorporate additional inputs from various contributors following the associated expert group meeting, which was held on 9 March 2012.

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I. The case for regional economic integration in Asia and the Pacific

1. The Asia-Pacific region's rapid growth since 1950 has been supported by a favourable external economic environment and opportunities arising from globalization. But in a dramatically altered post-global financial crisis scenario, the region's dynamism, which is crucial for the elimination of poverty and hunger, will critically depend on its ability to harness the potential of regional economic integration. Against that backdrop, the theme study¹ that is summarized in the present document examines the relevance and potential of regional economic integration to assist the Asia-Pacific region to sustain dynamism and close development gaps to build an inclusive and sustainable Asia-Pacific century. It then outlines a four-pronged plan to harness the potential of regional economic integration as a part of a long-term vision of evolving an Asia-Pacific economic community, covering the formation of a broader integrated regional market; seamless physical connectivity across the region; financial cooperation for closing the development gaps; and economic cooperation for addressing shared vulnerabilities and risks. The study concludes with an outline of the institutional architecture that would be needed for taking this agenda forward.

A. The re-emerging Asia-Pacific region

2. According to historical data collected by Angus Maddison, the Asia-Pacific region accounted for 56 per cent of global gross domestic product (GDP) up to 1820, but its share declined to 16 per cent by 1950. Subsequently, it started to regain its position in the world economy, first through Japan's rapid growth, later through the rise of East and South-East Asia's newly industrializing economies, and more recently by the rise of its two most populous countries, China and India. As a result of this dynamism, long-term projections by Goldman Sachs and the Asian Development Bank (ADB) suggest that the region's share in the global economy could exceed 50 per cent by 2050, as it was 200 years ago. Such an optimistic outlook, however, must be viewed with caution in the dramatically altered global context.

B. A new global context

3. The global financial crisis of 2008-2009 and the ensuing recession in the advanced Western economies have created a new more challenging global economic environment for the region. While the short-term outlook continues to be uncertain as a result of the ongoing debt crises in the euro area, the medium-run prospects are not favourable either. In the light of their need to reduce fiscal deficits and increase savings and exports, the advanced Western economies are unlikely to provide rapidly increasing demand for Asia and the Pacific as they did in the decade prior to the global financial crisis. Furthermore, many of these economies face adverse demographic dynamics, with an increasing old-age dependency ratio, which, combined with the limited carbon space available to them in the future, will constrain their economic growth prospects in the long run. Thus, while these countries will remain important markets for the region's exports, they are unlikely to continue playing the role of engine of growth for the region that they played in the past.

¹ *Growing Together: Economic Integration for an Inclusive and Sustainable Asia-Pacific Century* (ST/ESCAP/2629).

4. Unless the Asia-Pacific region finds alternative engines of growth, its growth rate will fall short of what is needed for poverty reduction and the creation of enough decent jobs for its burgeoning young population. Such alternatives can come from the region itself. As is well known, the region has enormous infrastructure gaps between countries, is making slow progress towards the Millennium Development Goals, and is home to nearly a billion people living in poverty (\$1.25 a day). Closing these gaps can be turned into an opportunity as they would need vast investments and could generate considerable aggregate demand. Similarly, investing in health, education, sanitation, and social protection to achieve the Millennium Development Goals and make progress towards eliminating poverty and hunger beyond 2015 could give access to better employment and business opportunities to hundreds of millions, increasing their income and purchasing power. In sum, investing in infrastructure and in the social sectors, apart from leading to a more balanced and inclusive pattern of economic development, could be instrumental in supporting economic growth in the region.

C. Towards an inclusive and sustainable Asia-Pacific century

5. With the region's rapid economic growth, the centre of economic gravity is shifting towards Asia and the Pacific. As a result of the region's economic success, growing incomes and purchasing power, the world's largest and most dynamic markets of the world are now in Asia and the Pacific rather than in the West. The emergence of these rapidly growing markets makes regional economic integration an increasingly viable and desirable development strategy for the region.

6. In particular, stronger connectivity and integration with the region's economic growth poles may boost the lagging countries by offering them access to the most dynamic markets in the world. In addition, regional financial cooperation may assist in closing the infrastructure development gaps by channelling the region's vast savings into investment in infrastructure development. Regional economic integration may also assist in building capabilities in poorer countries. Regional economic integration could also help economies stuck in the middle-income trap by providing them with new business and employment opportunities in large and rapidly growing markets, which could reinvigorate their growth dynamics.

7. Regional economic integration could be beneficial not only to exploit developmental opportunities but also to help the region articulate a more effective response to common threats. In particular, shared vulnerabilities and risks in areas such as energy and food insecurity, disasters, pressures on natural resources, social exclusion and rising inequalities, could lead to conflicts and social tensions and disrupt the growth process itself. In addition, by enhancing regional interdependence and shared prosperity, regional economic integration will provide for greater mutual understanding, resolving conflicts and ushering peace and stability. Finally, regional cooperation and integration are critical for the Asia-Pacific region to exert influence in global economic governance commensurate with its rising economic weight and to shape the emerging economic order according to its developmental requirements.

D. Conditions for fruitful regional economic integration

8. The diversity and heterogeneity that characterize the Asia-Pacific region can make regional economic integration particularly fruitful because they give rise to complementarities between countries. For instance, the

presence in the region of both large energy exporters and large energy importers offers enormous opportunities for mutually beneficial trade in energy products. Similarly, large differences in levels of development between countries give rise to opportunities, for instance, for channelling savings and technological expertise to the least developed countries, which could enhance their productive capacities.

9. Furthermore, the region has a distinct identity shaped by centuries of history, cultural exchanges and trade. Along with trade there was a vibrant exchange of ideas, including religious beliefs. Bagan, Borobudur and Angkor Wat are but a small testimony to the vast trading and cultural network that the region had in ancient times. These shared historical roots provide a strong basis for regional economic integration.

10. Another important factor for the success of regional economic integration is the presence of large and growing markets. The emergence of vast middle classes with growing incomes and purchasing power in the most dynamic Asia-Pacific economies is leading to the creation of the world's largest markets for a growing range of products and services, from mobile telephones to motor cars to jet airplanes. Such increasing demand is already leading to rapid growth in intraregional trade in Asia and the Pacific, making regional economic integration not only increasingly viable but also highly desirable.

E. Lessons from the global experience

11. Regionalism became a dominant trend in the world economy after the formation of the Single European Market in 1992 and the implementation of the North American Free Trade Agreement (NAFTA) in 1994. These regional trade agreements (RTAs) were followed by many others. Currently, some 300 RTAs, including bilateral free trade agreements (FTAs), are in force worldwide, and a significant part of world trade is conducted on a preferential basis rather than on a most-favoured-nation basis.

12. Countries have a strong incentive to become parties to an RTA, as their exports would otherwise face discrimination vis-à-vis those of parties to an existing RTA. In addition, the current trend towards “new regionalism” is motivated by the desire to strengthen competitiveness by facilitating the restructuring or rationalization of industry to increase efficiency and exploit economies of scale and specialization. Furthermore, insofar as it leads to trade liberalization, there is evidence that regionalism is a building block of multilateralism rather than a stumbling block. There is also evidence that the largest beneficiaries of RTAs are their relatively poorer or lesser developed parties.

F. Emerging patterns of regional economic integration and the case for a broader arrangement

13. Despite two early initiatives—the Asia-Pacific Trade Agreement (APTA), signed in 1975, and the Asian Clearing Union, set up in 1974—both under the auspices of ESCAP, the Asia-Pacific region is a late starter in regional economic integration. However, the rise of regionalism as a dominant trend in the world economy in the 1990s and the Asian crisis of 1997, which highlighted the regional economic interdependence, led to a profound rethinking about the importance of regional economic cooperation. Since then, the Chiang Mai Initiative for monetary cooperation and a

number of other initiatives towards regional economic integration have been taken.

14. The implementation of the ASEAN Free Trade Agreement (AFTA) was advanced to 2002 from 2008, and ASEAN moved on to further deepen its economic integration with the establishment of the ASEAN Economic Community planned for 2015. Similarly, the South Asian Association for Regional Cooperation (SAARC) adopted in 2004 the Agreement on South Asian Free Trade (SAFTA), which is to be implemented over 10 years from 2006. Other initiatives include the Economic Cooperation Organization Trade Agreement (ECOTA) of 2003 and the Pacific Island Countries Trade Agreement (PICTA) of 2001. These subregional groupings are complemented by numerous bilateral FTAs.

15. In the context of broader cooperation that brings countries from different subregions together, ASEAN's initiatives are exemplary. ASEAN's policy of engaging key Asian countries as dialogue partners has provided much needed cohesion in the region. China, India, Japan, the Republic of Korea, Australia and New Zealand have all negotiated FTAs (the so-called "+1 FTAs") with ASEAN and are engaging each other as well. For instance, India has signed comprehensive economic partnership agreements with Japan and with the Republic of Korea. This process is also leading to broader groupings. Apart from ASEAN+3 (China, Japan and the Republic of Korea), an important initiative was the launch of the East Asia Summit in December 2005 in Kuala Lumpur, as an annual forum participated by ASEAN and all its dialogue partners. A feasibility study of a Comprehensive Economic Partnership for East Asia (CEPEA) comprising 16 (ASEAN 10+6) countries was completed in 2009. At the Bali Summit in November 2011, two new members—the United States of America and the Russian Federation—were admitted to the East Asia Summit.

16. Another indication of the growing recognition of broader regional economic integration in Asia and the Pacific is the fact that many leaders and statesmen of the region have articulated their visions of a broader Asia-Pacific community. Leaders from India to the Philippines and from Japan to Australia have all spoken of their visions of broader Asia-Pacific communities allowing the exploitation of the region's vast synergies for mutual benefit.

G. Key elements of a regional economic integration scheme

17. To harness the potential of regional economic integration, the study recommends a four-pronged scheme with a long-term vision of building an economic community of Asia and the Pacific:

(a) Coalescing the numerous bilateral and subregional trading arrangements of the region into a broader regional trading and economic cooperation arrangement with built-in safeguards and flexibilities for poorer countries;

(b) Seamless physical connectivity across the region to spread the benefits of economic integration to lagging regions through transport, energy and information and communications technology (ICT) links and the adoption of best practices in trade and transport facilitation;

(c) Financial cooperation for closing the development gaps and to ensure the optimal use of the region's resources for mutual benefit;

(d) Economic cooperation for addressing shared vulnerabilities and risks, such as energy and food insecurity, disasters, pressures on natural resources, social exclusion and rising inequalities.

II. Towards a broader integrated market

18. Asia and the Pacific is the world's most dynamic trading region. Between 2000 and 2010, intraregional trade grew 33 per cent more than global trade, bringing its share up from 48 per cent to 54 per cent. Between 2010 and 2016, intraregional exports are expected to rise from \$3.1 trillion to as much as \$6.8 trillion, depending on facilitation. If current trends continue, Asia and the Pacific would become the world's largest regional market in 2012.

A. Trading opportunities

19. Growing markets provide opportunities for both current and new exporters across the world. In order to assess the prospects and desirability of further trade liberalization within the Asia-Pacific region, a new "export opportunities indicator" developed by ESCAP identifies the markets that countries in the world view as the most promising. China is regarded as being among the top 10 export markets by all countries. The next most promising market is India (44 countries), followed by the Republic of Korea (39 countries), the Russian Federation (32 countries) and Turkey (28 countries). It should be noted that the opportunities within Asia and the Pacific are greater than those in Europe and North America combined. This indicator also shows that, with the exception of East and North-East Asia, Asia-Pacific countries have greater export potential in other subregions than in their own subregion (see table). This observation contrasts with the approach to regional economic integration adopted so far, which remains essentially subregional and fails to recognize the often greater potential of trade expansion across the subregions.

Table

Export opportunities indicator for the average country in Asia-Pacific subregions and selected regions of the world

(Billions of United States dollars per year)

Indicator of opportunities to export from \ To	Asia-Pacific subregions					Asia and the Pacific	Rest of the world		
	East & North-East Asia	South-East Asia	South & South-West Asia	North & Central Asia	Pacific		Europe	North America	Rest of the World
East & North-East Asia	23.3	3.7	5.3	3.6	0.8	36.8	20.8	3.9	11.8
South-East Asia	19.4	2.3	4.1	1.7	0.6	28.1	16.2	5.4	6.9
South & South-West Asia	9.1	2.1	2.8	1.9	0.5	16.5	12.9	3.6	7.0
North & Central Asia	13.5	3.1	6.1	1.0	0.7	24.4	18.1	7.9	6.8
Pacific	5.2	1.4	2.5	0.7	0.3	10.1	7.3	1.8	3.5
Asia and the Pacific	13.0	2.4	3.9	1.6	0.6	21.4	14.1	4.3	6.7
Europe	13.8	3.8	5.6	4.5	1.0	28.6	29.7	6.1	13.7
North America	32.1	6.6	11.1	4.3	1.5	55.6	40.3	10.9	16.5
Rest of the World	9.5	2.2	3.9	1.3	0.6	17.5	12.1	4.9	5.6

Source: ESCAP based on data from United Nations Statistics Division, *Commodity Trade Statistics Database* (COMTRADE).

20. However, according to the ESCAP Trade Cost Database, the costs of trade between Asia-Pacific subregions tend to be substantially higher than those between them and the traditional Western markets. Those between ASEAN and SAARC, for example, are on average nearly double the costs of trade between ASEAN and the United States. It is clear that intraregional trade is not able to exploit the benefits of geographical proximity. The costs vary considerably from country to country, suggesting significant scope for reduction.

B. Trade in services

21. Exports of commercial services are becoming increasingly important for Asia and the Pacific. Between 2000 and 2010, the region increased its contribution to world services exports from 22 per cent to 29 per cent, and its trade deficit in commercial services, measured as a percentage of its exports, dropped from 15.4 per cent in 2000 to 2.8 per cent in 2011. This suggests that the region is enhancing its capabilities to produce and export commercial services.

22. Available data suggest that the region is becoming a major market for itself. This is to be expected, partly, as the result of the increasing purchasing power of the region's emerging middle class, which can increasingly afford, for instance, the expense of travelling to other countries for tourism or study. In fact, recent data show that about two thirds of the arrivals to the top 10 tourism markets in the region originate in the region itself, and the large majority of international students studying in the region's universities also come from the region.

C. Movement of people

23. Another aspect of growing trade in services is migration. Migration flows between countries in the region could be very effective in tackling structural demand-supply imbalances between countries of the region, contributing to economic growth and a reduction in region-wide disparities in the distribution of labour income. International migration also provides a source of income for members of the migrant's household left behind, as well as a source of foreign exchange for the sending countries. In fact, the share of remittances originating in the region itself is significant, averaging about 34 per cent in 2010.

24. Many of the labour flows within the region are irregular, reflecting the absence of adequate legal frameworks to enable migration through formal channels. The absence of such formal channels leads to increases in the costs of migration, for instance through more onerous recruitment processes. In order to regularize migration flows and maximize the benefits of labour migration, a number of countries have concluded bilateral agreements, covering recruitment, conditions of employment and measures to protect the migrants.

D. Foreign direct investment

25. Foreign direct investment (FDI) flows to the Asia-Pacific region have grown tremendously, and the region now accounts for a quarter of global inflows, but FDI outflows from the region have expanded even more impressively with the emergence of China, India, Malaysia, Singapore and Hong Kong, China, joining conventional sources of FDI, such as Australia, Japan and the Republic of Korea.

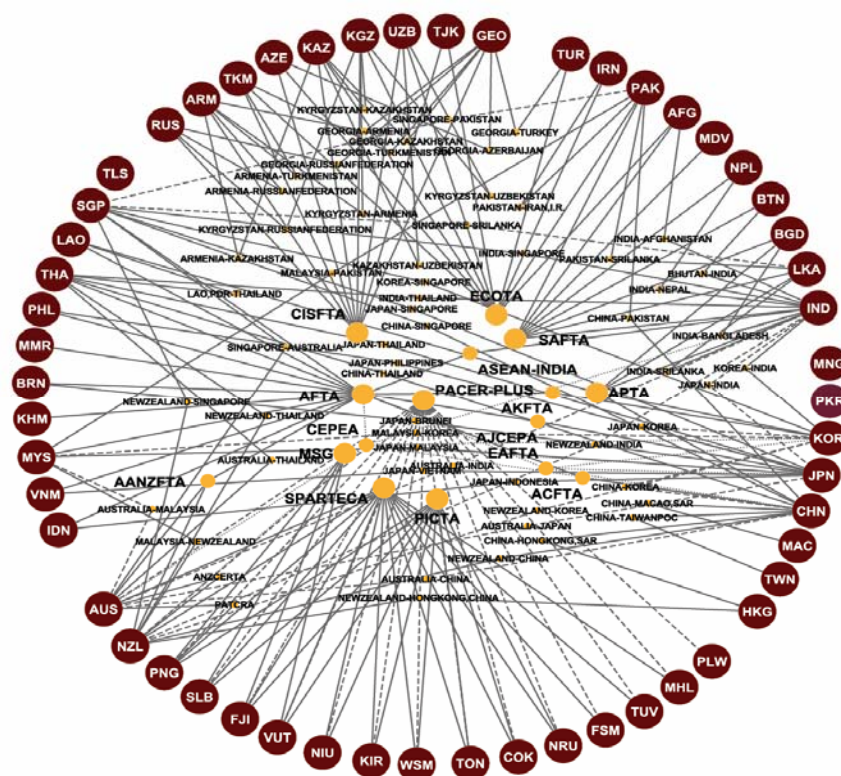
E. A fragmented region

26. The extent of non-tariff and behind-the-border barriers to trade suggests that there is still considerable scope for further trade liberalization in the region, but, in the light of the limited progress in multilateral trade negotiations since the conclusion of the Uruguay Round in 1995, most countries in the region have turned to bilateral or subregional FTAs. Asia-Pacific economies are parties to more than 140 agreements and are contemplating many more. This activism signals a preference for deeper integration among countries in the region. However, the overall effect is a tangle of overlapping agreements which has been likened to a noodle bowl. Its complexity adds to the cost of trade and does not provide a seamless or integrated regional market (figure 1).

27. The scope of FTAs has widened beyond liberalization of trade in goods to cover a range of other areas, including services, investment, trade facilitation, standards and technical regulations, and dispute settlement. Newer agreements have more provisions for economic cooperation. An important element of these agreements should be trade facilitation, including electronic trade data exchange systems and Single Windows for customs processing, such as the pioneering ASEAN Single Window, apart from mutual recognition of standards and conformity assessment procedures. The agreements generally do not specifically cover transit facilitation even though attempts are being made in the framework of subregional groupings, such as the Greater Mekong Subregion. The main problem is a lack of collaboration between trade, transport and customs authorities, and the limited involvement of local public and private stakeholders at early stages of negotiations.

Figure 1

Network of trade agreements between countries in Asia and the Pacific



Source: ESCAP based on APTIAD database of trade agreements and the ASEAN Secretariat website (<http://www.aseansec.org/20182.htm> and <http://www.aseansec.org/22765>).

Note: Solid lines represent concluded agreements. Dashed lines represent both agreements formally under negotiation and two proposed agreements, EAFTA and CEPEA, for which formal negotiations have not started.

F. Towards broader regionalism

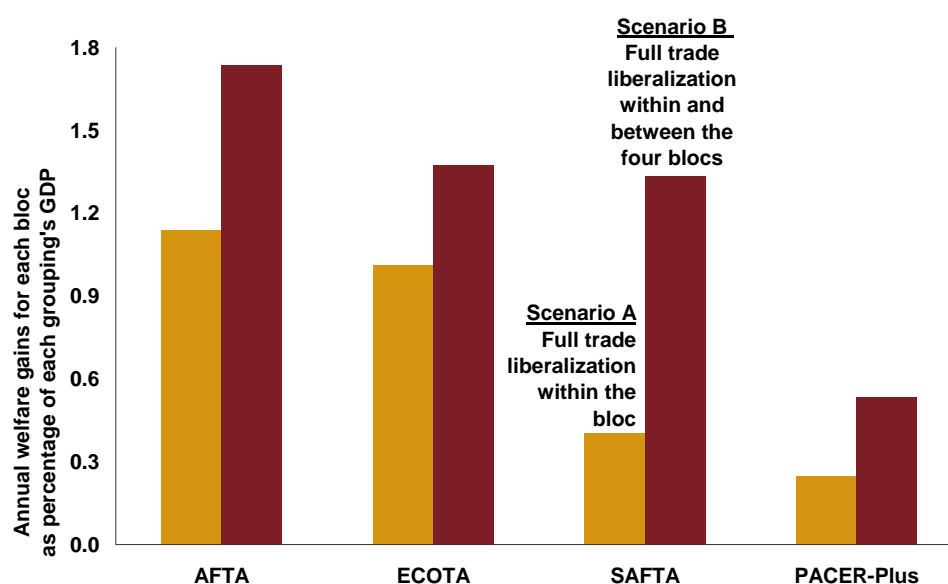
28. Bilateral and subregional agreements help boost trade, but because of their differences in scope, coverage and rules, they do not create a seamless, region-wide market and do not allow synergies between subregions to be exploited. What is needed is not just to deepen integration within subregions but also to foster trade links across subregions.

29. To fully exploit the potential of regional economic integration and for efficiency-seeking industrial restructuring to take place, the Asia-Pacific region needs a trade and economic cooperation arrangement that is broader in coverage, extending to all countries in the ESCAP region, that extends to substantially all trade using a negative list basis (to be consistent with GATT Art. XXIV and GATS Art. V) and that has comprehensive scope to cover trade in services, investment, trade and transit facilitation and cooperation and can be progressively deepened. It should be equitable and provide for special and differential treatment for poorer countries and assistance for lagging regions and vulnerable sections. The study presents three routes to evolving a broader integrated market in the Asia-Pacific region.

30. *An Asia-Pacific Economic Area (APEA)*: The first option is to create APEA as a framework to join existing subregional groupings to exchange trade preferences between members (in the manner of the Agreement on the European Economic Area, which combines the Single Market of the European Union with members of the European Free Trade Association). The major subregional groupings that could be covered in APEA are: (a) ECOTA; (b) the ASEAN Free Trade Area; (c) the South Asian Free Trade Area; and (d) the proposed Pacific Agreement on Closer Economic Relations-Plus, which encompasses PICTA plus Australia and New Zealand. Overall, these four trade agreements include 43 of the 51 Asia-Pacific economies. A modelling exercise conducted by ESCAP suggests that member countries would gain substantially if the four groupings were joined in APEA (figure 2). However, this approach may be complicated by the fact that the four subregional groupings are at different stages of their evolution. Furthermore, a major limitation of this approach is that some of the region's largest markets, such as China, Japan and the Republic of Korea, would remain excluded. In any event, there is a tremendous potential of mutual learning across the subregional groupings of the region and sharing their best practices. Hence, a consultative committee of subregional groupings should be constituted to facilitate that mutual learning.

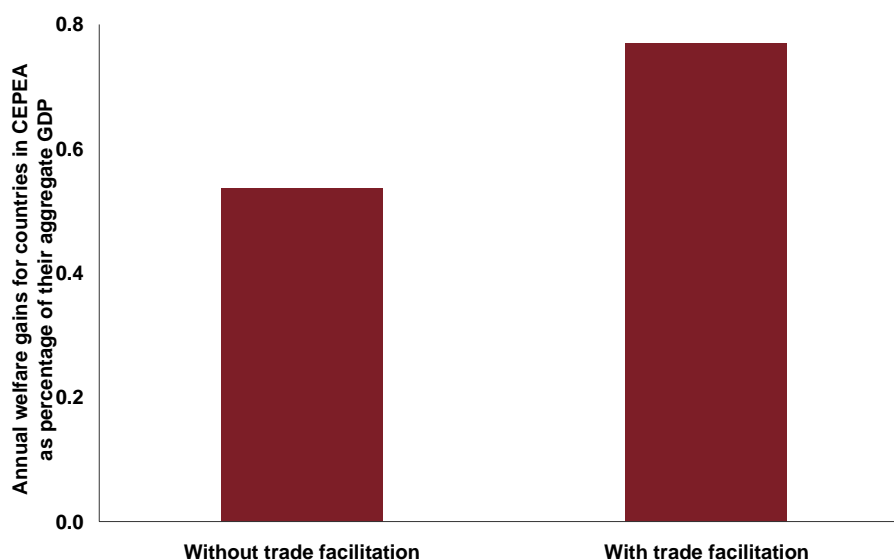
Figure 2

Long-run welfare gains for four subregional agreements, including trade facilitation



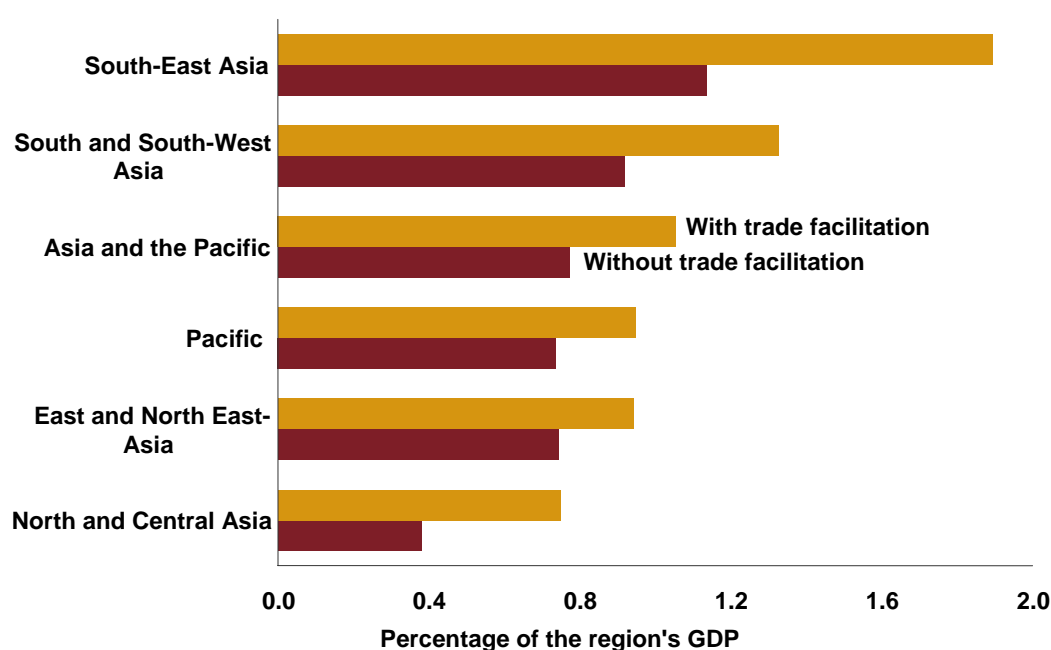
31. *Building on the ASEAN+ approach:* The ASEAN dialogue process has contributed towards a discussion of broader regional arrangements. Two key proposals are the ASEAN framework include an East Asian Free Trade Area (EAFTA) among ASEAN+3 countries, and the Comprehensive Economic Partnership for East Asia (CEPEA) originating in the East Asia Summit, which additionally includes Australia, India and New Zealand (ASEAN+6). CEPEA, the more inclusive of the two approaches, could be treated as the nucleus of an incipient Asia-Pacific RTA to which other countries could accede to. The advantage of this approach is that a feasibility study and some subsequent exploration in ASEAN+ working groups have been completed. All six dialogue partners have concluded ASEAN+1 FTAs that can be easily multilateralized with common rules of origin. Combining the region's growth poles, China and India, with the advanced economies of Japan and Australia, and the Republic of Korea with those of ASEAN, could produce a regional grouping comparable in stature with the European Union and NAFTA but outclassing them in terms of dynamism by a wide margin. The simulation results found substantial welfare gains for CEPEA that could be nearly 0.8 per cent of the GDP of the region when trade facilitation was covered (figure 3).

Figure 3
Potential benefits of expanding ASEAN Free Trade Area to ASEAN+6 (CEPEA)



32. *A new Asia-Pacific Trade Agreement (APTA II)*: The third option is the creation of a new, broader, agreement with a comprehensive scope and open to all countries in the ESCAP region. ESCAP, having sponsored a pioneering RTA in the region—APTA—in 1975, could provide auspices for a region-wide agreement, which could be called the Asia-Pacific Trade Agreement II (APTA II) or Asia-Pacific Trade and Economic Cooperation Agreement (APTEC). As this option would not have any baggage, it would be possible for it to have all the desirable features, including a comprehensive scope, based on a negative list and trade facilitation, investment and economic cooperation, including the flexibilities and special and differential treatment features for the poorer countries to make it a RTA with a human or Asian face and as a model for regional economic integration. Simulation studies indicate that such an agreement would have the potential to generate the largest welfare gains for the region — up to \$140 billion or over 1 per cent of the region's GDP, with broad and comprehensive coverage (figure 4). The additional gains accruing from trade facilitation are largest in North and Central Asia, reflecting the potential benefits for the subregion's landlocked developing countries, but they are also important for South-East Asia, reflecting the potential gains from integration for countries such as Cambodia and Myanmar, whose current trade costs are very large.

Figure 4
Welfare gains from region-wide liberalization



III. Building seamless connectivity

33. Economic integration depends critically on the development of seamless connectivity between countries, which requires investment in transport, energy and ICT infrastructure.

A. Transport

34. Asia's most important maritime liner routes, by volume, still run to Europe and North America. Although almost all the region's coastal countries are now linked by direct shipping services or by transshipment and transit operations through hub ports, shipping connectivity is still poor between many neighbouring countries. Moreover, the Pacific island developing economies have the added disadvantage of being located a long distance from the rapidly growing economies in Asia.

35. Over the past decade, the region has significantly improved air transport. More low-cost carriers have entered the market, flight frequencies have increased, and countries have invested in new and existing airports. Most Asia-Pacific countries are now linked, either directly or through hubs, and have been making air service agreements and liberalizing their air transport markets. Land-based transport infrastructure is needed, however, to link airports to production and population centres.

36. Land transport is important for regional economic integration and for balanced regional development. ESCAP simulation exercises show that improving land transport connectivity has the potential to increase economic growth, especially in relatively poorer areas, and thus reduce development gaps. Land routes are critical for the development of landlocked countries.

37. In recent decades, governments across the region have made considerable efforts to extend national road and railway systems and, in some cases, inland waterways, and to connect to their neighbours. Even so,

given the likely expansion of intra-Asian overland trade, regional road networks are still inadequate.

38. The Asian Highway Network now extends through 32 member States and comprises 142,000 km of highways, 32 per cent of which are classified as primary and Class I standards, the two highest categories of road class. However, there are still 11,500 km of Asian Highway routes that need to be upgraded to meet the minimum standards. Although there are no “missing links” in terms of absence of roads, poor road quality can act as a deterrent for international transport due to increased vehicle operating costs.

39. Regarding railways, some countries are expanding and improving their networks through double tracking, for example, or electric signalling, but the region as a whole has yet to realize its rail potential. The main challenge is the many missing links, which prevent the network from functioning as a continuous system. According to ESCAP estimates, these constitute about 10,500 km of rail track, or 9 per cent of the Trans-Asian Railway Network.

40. Countries can make greater use of the Asian Highway and Trans-Asian Railway routes by improving transport facilitation measures and by investing in intermodal facilities, such as dry ports. Dry ports can build synergies by linking different modes of transport; they can also promote balanced spatial development by helping industrialization extend to the hinterlands. ESCAP is working on an intergovernmental agreement on dry ports to complement those on the Asian Highway and Trans-Asian Railway. In addition, it would be useful to extend initiatives, such as the Istanbul-Tehran-Islamabad container train pioneered under the Economic Cooperation Organization (ECO), to other parts of Asia.

41. Land transport is still hampered by many non-physical barriers that lead to excessive delays, high costs and uncertainties. These include multiple technical standards, inconsistent and complex border-crossing procedures, and excessive documentation. Rather than simply being inspected at loading or unloading points, goods may also be checked repeatedly at borders by different authorities. ESCAP has been urging member countries to accede to seven international conventions related to land transport facilitation and has prepared a Regional Strategic Framework for the Facilitation of International Road Transport (see E/ESCAP/68/9, chap. I, annex II).

42. There is further scope for strengthening cooperation between ESCAP and ADB in the identification and financing of priority transport infrastructure projects, including the completion of missing links in the Trans-Asian Railway routes and upgrading of routes in the Asian Highway network.

B. Energy connectivity for energy security

43. Given the uneven distribution of energy resources between countries and growing demand, the energy trade in the region has expanded rapidly. The energy connectivity in the region is unevenly developed often preventing countries from accessing even their own domestic resources. There are also geopolitical and security considerations that discourage investors from exploiting potentially profitable opportunities.

44. Enhancing physical connectivity infrastructure across countries is one important objective of regional energy cooperation. There are a large

number of energy infrastructure projects planned or under way in the region. For example, the Russian Federation has launched several pipeline projects to export hydrocarbons from its East Siberian and Sakhalin reserves. There are proposals for ASEAN gas pipelines and power grids and a SAARC energy ring and proposals for Turkmenistan-Afghanistan-Pakistan-India pipeline projects, among many others.

45. A region-wide energy cooperation framework could encourage joint investments by buyers and sellers in the region to create subregional power, gas and oil grids, as important arteries connecting multiple demand and supply sources that could in turn be linked to build regional grids. Cooperation could also be greatly beneficial for undertaking longer-term projects, such as joint research on energy technologies relevant to the region, or for the formation of joint ventures of regional energy companies for joint prospecting and exploration. Further, regional cooperation could play an important role for the development, commercialization and dissemination of energy-efficient technologies.

46. In order to promote energy cooperation and trade in the region, it is also necessary to develop a deep, liquid and transparent market for crude oil, petroleum products and gas. Other fruitful areas include sharing detailed information on demand, supply and inventory positions and building emergency response mechanisms by increasing physical supply security in Asia and the Pacific through strategic reserves. The ministerial-level Asian and Pacific Energy Forum, which is scheduled to be held in Vladivostok, Russian Federation, in May 2013, could provide the basis for a regional framework for energy connectivity and trade.

C. Information and communications technology and digital connectivity

47. The Asia-Pacific region has been a major beneficiary of the information technology revolution, but the digital divide prevails in terms of unequal access and affordability of services across countries. Information technology services tend to be more expensive in the poorest countries. On average, less than 20 per cent of people in Asia and the Pacific have access to the Internet. Internet traffic volumes are expected to continue to increase exponentially both within and between subregions. The region therefore needs to invest in additional terrestrial fibre-optic cable routes and in the capacity of new Internet hub cities. These new Internet hubs need not cluster around Asia's congested mega-cities; thus, they can offer opportunities for more inclusive and geographically balanced development. Overall, the region still lacks infrastructure commensurate with its growing global influence or its expected surges in Internet traffic. This would require more systematic intergovernmental cooperation to provide an organizational framework for expanding ICT connectivity, including through cooperation in satellite technology.

IV. Enhancing regional financial cooperation

48. Asia-Pacific regional cooperation in finance has largely been confined to mechanisms to provide short-term liquidity, but much potential remains unexploited. The Asia-Pacific region boasts vast reserves that are largely invested outside the region in low-yielding securities in advanced economies because of poorly developed regional financial architecture. In addition, there are substantial private savings held outside the region (valued at \$7.4 trillion in 2008, making up 23 per cent of total invested assets worldwide). Only 16 per cent of Asia-Pacific portfolio securities investment

ends up in the region owing to the small size of securities markets. All countries would benefit from the pooling of regional funds to provide liquidity, boost trade financing and increase investment for infrastructure.

49. Apart from the establishment of ADB in the 1960s and the Asian Clearing Union in the 1970s, a number of initiatives have been taken in the region to promote financial cooperation. However, most of them are fairly recent and are at early stages of evolution and need to be scaled up to become more effective. The Chiang Mai Initiative Multilateralization is an important initiative to assist member countries with short-term liquidity support. However, it has hardly been used as yet because of its link with the International Monetary Fund conditionality beyond a 20 per cent threshold. While the size of the fund is being doubled from \$120 billion and a surveillance and monitoring office is being established, its coverage needs to be extended beyond ASEAN+3 countries to other systemically important countries of the region and to create a quick disbursal facility to effectively serve as a regional lender of last resort for dealing with emergencies.

50. The Asian Bond Fund and the Asian Bond Markets Initiative are also important initiatives to develop regional bond markets and mobilize financing for lesser developed countries. However, the scale of these initiatives needs to be expanded, and coverage needs to be extended beyond ASEAN+3 countries. Therefore, it will be some time before Asian bond markets offer substantial sources of financing for infrastructure development.

51. In the area of infrastructure financing, an important recent initiative is the establishment of the ASEAN Infrastructure Fund in Malaysia with an initial equity base of \$485 million with the support of ADB. It hopes to catalyse more than \$13 billion in investments by 2020 through co-financing. In 2010, the SAARC Development Fund was set up in Bhutan with paid-up capital of \$200 million to finance infrastructure projects, including feasibility studies, but it also has social and economic windows.

52. Investing in infrastructure across the Asia-Pacific region promises not only high rates of financial return, but also opportunities to diversify risk. Existing forms of investment, such as lending by ADB, could be complemented with a new and independent large-scale lending facility for infrastructure. This could help coordinate potential financiers, such as multilateral and bilateral development agencies as well as private-sector sources. Its backing for infrastructure projects could also signal opportunities to private investors. As a regional body, the facility could also be in a position to take account of intra-regional spillovers and back cross-border projects. Apart from financing infrastructure, the facility could provide advisory services and technical assistance. Its capital base would be contributed by the central banks, and it could raise bond financing. The ESCAP secretariat is already engaged in elaborating elements of a regional financial architecture for supporting infrastructure investment. One element to consider is the harmonization of listing rules across stock exchanges, which could enable the cross-border listing of equity and bonds by entities in the region.

V. Economic cooperation for addressing shared vulnerabilities and risks

53. Not only can greater regional integration help countries capitalize on their strengths, but it can also help them address shared vulnerabilities,

notably food insecurity, disasters, pressures on natural resources, social exclusion and rising inequalities.

A. Food security

54. In the past half-century, the Asia-Pacific region has made tremendous progress in food security. Nevertheless, the region still faces persistent poverty and hunger and is home to about 65 per cent of the world's hungry people. Of particular concern is the situation in South Asia, where nearly 43 per cent of children are malnourished.

55. The main obstacle is not an overall lack of food. The problem is that many people are not consuming enough of that food. They are prevented from doing so by many factors, including poverty, disasters, conflict and war, poor access to resources, lack of employment opportunities, lack of education, and underinvestment in agriculture, as well as instability in the world's food and financial systems.

56. Given that neighbouring countries share many resources critical to the production and distribution of food, food security also has strong regional dimensions. The High-level Task Force on the Global Food Security Crisis indicated potential areas of cooperation: regional food reserves; sharing information; managing transboundary resources; and building regional food markets.

57. In the area of regional food reserves, the greatest progress has been among the ASEAN+3 countries. Based on a successful pilot, they have established the ASEAN Plus Three Emergency Rice Reserve. There have also been efforts to establish a SAARC food bank. Regional cooperation on agricultural research is also critical when countries face common risks, such as climatic variability, reduced water supplies, loss of biodiversity, and the effects of mycotoxins and microbial hazards on food quality. One of the key organizations for sharing scientific information and knowledge is the Asia-Pacific Association of Agricultural Research Institutions.

58. Managing transboundary resources, such as rivers, is another fruitful area of cooperation. Ensuring stability is more difficult when resources are spread across different countries; thus, countries can benefit greatly from regional cooperation. Building regional agricultural markets could also help as countries are less likely to take defensive measures, such as restricting exports, if they have established joint systems to assure free cross-border flows of food during crises.

B. Dealing with disasters

59. Although, over the last 20 years, the Asia-Pacific region has experienced an improvement in its resilience to disasters, the region's exposure to disasters has been on the rise because of growing populations living in disaster-prone areas. As a result, the number of people affected by disasters, which includes the poorest and most vulnerable segments of the population, has increased. The greatest damage in Asia and the Pacific has been provoked by floods and earthquakes, which have caused about \$30 billion in damage annually from 1990 to 2010. The figure for 2011 is expected to be significantly higher, with the Great East Japan Earthquake and Tsunami alone causing \$210 billion in damage and floods in South-East Asia causing over \$46 billion in damage.

60. Some disasters have a regional impact simply because natural phenomena extend across wide geographical areas, but the cross-country impact of disasters is being amplified by growing economic interdependence. For instance, the earthquake in Japan and the floods in Thailand caused severe disruption in regional and global supply chains, particularly for industrial and manufacturing products.

61. Most countries in the region have established national policies, legislation, frameworks, strategies, or plans to prepare for and cope with disasters. Much less attention has been paid to the opportunities for regional responses. Asia and the Pacific would benefit, however, from more comprehensive regional agreements and cooperation. Better management of transboundary river basins, for example, can prevent floods in riparian countries. The response to tsunamis also calls for regional cooperation to develop effective early-warning and communication systems. Some important initiatives have been taken in the area of regional cooperation: (a) the ASEAN Agreement for Disaster Management and Emergency Response; (b) the South Asian Disaster Knowledge Network and SAARC Disaster Management Centre, New Delhi; (c) the creation of the ESCAP/WMO Typhoon Committee and the WMO/ESCAP Panel on Tropical Cyclones; (d) the Pacific Disaster Net; and (e) the Regional Integrated Multi-hazard Early Warning System (RIMES), which is supported by ESCAP. Areas for cooperation include strengthening regional centres for capacity-building and research, producing regional baseline assessments and periodic reviews, and satellite technology for disaster risk reduction. One important forum for cooperation is the biennial Asian Ministerial Conference on Disaster Risk Reduction within the framework of the Hyogo Framework for Action.

C. Pressures on natural resources and sustainability

62. Rapid economic growth in Asia and the Pacific has placed increasing pressure on natural resources. With limited per capita endowments of natural resources, the region is particularly vulnerable to disruptions associated with volatile energy and resource prices, land use changes and climate change, which are becoming increasingly interconnected.

63. Some of the most significant pressures arise from rising demand for energy, which is projected to increase by about 34 per cent over the next decade. In addition, there are threats to biodiversity, sulphur dioxide emissions, the rapid accumulation of solid waste, and the increasing prices of many natural resources. Indeed, by 2005, Asia and the Pacific had become the world's largest resource user, consuming 35 billion tons per annum of key materials, such as biomass, fossil fuels, metal ores and industrial and construction materials—amounting to 58 per cent of the global resource use of about 60 billion tons.

64. Recognizing that these and many other environmental problems pose threats to economic growth and poverty reduction, the region's leaders have been developing regional responses, such as the Kitakyushu Initiative for a Clean Environment and the Seoul Initiative on Green Growth. Key elements of these responses include research and development and technological innovations. The need for regional cooperation to "facilitate technological innovation and transfer and promote access to green technologies at affordable costs" was emphasized at the Asia-Pacific Regional Preparatory Meeting for the United Nations Conference on Sustainable Development. In this context, ESCAP has been supporting the widespread sharing of knowledge and transfer, adaptation and replication of environmentally sound technologies, with the support of its regional institutions, such as the Asian

and Pacific Centre for Transfer of Technology. Much more needs to be done, however, in order to address the challenge, including the development, commercialization and transfer of material and carbon-efficient technologies and the promotion of associated lifestyle changes to reduce the material- and carbon-intensity of consumption.

D. Addressing sustainability risks

65. The three challenges of food insecurity, disasters and pressures on natural resources are fundamental aspects of sustainability and are interrelated. The concept of sustainability implies that, at a minimum, the same degree of access to food, protection from disasters, and natural resources must be ensured for future generations. To meet this enormous challenge, it is critical to build capacities and promote technological innovations and research and development to improve eco- and resource efficiency. Technological innovations are also needed to ensure food security through the development of sustainable agricultural practices and to enhance the effectiveness of monitoring and early warning systems to reduce disaster risks.

66. To maximize the effectiveness of the region's response to these interlinked challenges, the creation of a region-wide body, named "Asia-Pacific Technology Development Council" (APTECH), could be considered. APTECH would serve as a regional apex body of national innovation institutions. Its main functions would entail fostering innovation that addresses shared problems and promoting cooperation in pre-competitive research and development. For that purpose, it could establish a regional innovation fund to finance joint innovation proposals, the intellectual property of which would be owned by APTECH and shared among members. Such intellectual property could be subsequently made available to national and regional enterprises for competitive research.

E. Addressing social risks

67. Despite the region's economic dynamism, the number of people living in extreme poverty, suffering from hunger and lacking sufficient access to sanitation, education, health and financial services is still enormous. In addition, income inequality has increased, with the population-weighted mean Gini coefficient for the entire region increasing from 32.5 per cent in the 1990s to 37.5 per cent more recently.

68. The phenomena of social exclusion and rising inequalities are related for a number of reasons. First, economic growth in the twenty-first century places a premium on educated individuals who are not only literate but also able to take advantage of modern ICTs effectively. When professionals and skilled workers are scarce in rapidly growing economies, their real wages tend to increase at a rate significantly higher than average, contributing to increased income inequality. Second, there is much evidence that poverty and social deprivations, such as little or no access to basic sanitation, education or health services, play a large role in determining health outcomes — and, thus, the potential to engage fully in employment activities — across the population. In sum, economic growth is not necessarily the tide that lifts all boats.

69. A key aspiration of regional economic integration schemes is to narrow development gaps and bring about convergence in the levels of economic development of different participants through the optimal deployment of the region's resources. A regional development approach that

is balanced and equitable would appeal to all potential partners in a regional integration scheme, including those with limited productive capacities. Some studies suggest that increased trade by itself, even if balanced, does not ensure economic development. Thus, to ensure balance growth, expansion of trade must be accompanied by complementary development policies, including investment, especially in infrastructure and other public goods, such as education and research and development, and regional and sectoral programmes.

70. Many existing regional trading arrangements include balanced regional development and social cohesion policies. Apart from special and differential treatment provisions in favour of developing and least developed countries, which are normally incorporated in any trade liberalization scheme, the regional trade and economic cooperation arrangements for Asia and the Pacific as proposed above should be accompanied by the creation of regional development funds for promoting balanced regional development, the enhancement of infrastructure and connectivity and technological capability-building in the relatively poorer areas. With these steps accompanying regional economic integration programmes, regionalism in Asia and the Pacific would hopefully become a model for an inclusive, balanced, equitable and participatory development process that other regions could emulate.

VI. Towards a broader and comprehensive framework

71. In summation, a compelling case exists for deepening and broadening economic cooperation in the Asia-Pacific region and moving forward towards the formation of an Asia-Pacific economic community as a long-term goal. It would be critical for achieving an Asia-Pacific century and avoiding the risk of falling into a middle-income trap, especially with the inability of advanced economies to provide growth stimulus. The preceding paragraphs have given the contours of a new action agenda that may help the Asia-Pacific region not only sustain its dynamism but also make it more inclusive and sustainable and bolster the region's resilience to disasters and financial shocks. The four-pronged plan envisions: (a) the formation of a broader integrated regional market; (b) seamless physical connectivity across the region; (c) financial cooperation for closing development gaps; and (d) economic cooperation for addressing shared vulnerabilities and risks. This agenda may assist in the realization of an inclusive and sustainable Asia-Pacific century in which the region will not only be free from poverty and hunger but also continue to prosper in a sustainable manner, meeting its needs without compromising the interests of future generations. It would also help the region play its rightful role in shaping global economic governance according to its developmental needs apart from fostering peace.

72. An ambitious agenda for regional economic integration, as outlined above, would need the support of a comprehensive institutional architecture. Based on the experience of other regions of the world, such an architecture could include the following elements:

(a) A supreme body, the Asia-Pacific Economic Summit (APES): This body would be in charge of setting the region's agenda and provide direction for its implementation among member countries. Meeting annually, it would articulate a long-term vision for an Asia-Pacific economic community and its contours, reflect on global challenges and global affairs as well as the region's response, and effect cooperation with other agencies and international organizations;

(b) Ministerial councils on trade and investment, finance, transport, energy, food security and agriculture, environment, disaster risk reduction, and technology: They would develop specific agendas for the work of their respective sectors. In a number of cases, the ministerial councils would actually replace the ad hoc ministerial conferences that ESCAP organizes in some sectors, such as environment (every five years), transport (every two years) and disaster risk reduction (every two years). These ministerial councils would be able to give direction and operative instructions to respective senior officials meetings;

(c) Consultative Committee of Subregional Associations: It will bring together all subregional bodies, such as ASEAN, SAARC, ECO and the Pacific Islands Forum, to facilitate mutual learning. It would meet annually along the sidelines of APES;

(d) People-to-people contacts: The programme for regional economic integration would never exploit its full potential without the people of the region coming together with their peers. Regional professional associations would be needed to organize such interactions for all professions. Two of them would be critical namely an Asia-Pacific business advisory council, which would help mobilize the business community to exploit the full potential of regional economic integration, and an Asia-Pacific network of think tanks, which would assist in building public opinion in support of fostering regional economic integration as well as formulating new proposals. These groups would meet annually along the sidelines of APES;

(e) The elaborate institutional architecture proposed above would need a secretariat to service it. The ESCAP secretariat, in view of its multidisciplinary nature, could play that role and should be strengthened for that purpose. The ESCAP secretariat would work closely with ADB, which is another regional development organization with overlapping membership and which is committed to regional economic integration, especially in such areas as financial cooperation, infrastructure development and connectivity, trade facilitation, environment and technology development.

73. In December 1963, the First Ministerial Conference on Asian Economic Cooperation, held in Manila under the auspices of the Economic Commission for Asia and the Far East (ECAFE), as ESCAP was known then, endorsed a proposal to establish a regional development bank for Asia to supplement World Bank activities in the area. Three years later, ADB was born. To celebrate the fiftieth anniversary of that conference, it is proposed that ESCAP convene the Asia-Pacific Ministerial Conference on Regional Economic Cooperation and Integration in 2013. This conference would review and discuss possible ways to implement the recommendations contained in the present document and elaborated in the publication *Growing Together: Economic Integration for an Inclusive and Sustainable Asia-Pacific Century* and take steps to implement them as appropriate.