



ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

Sixtieth session  
22-28 April 2004  
Shanghai, China

**POLICY ISSUES FOR THE ESCAP REGION: MEETING THE CHALLENGES IN  
AN ERA OF GLOBALIZATION BY STRENGTHENING  
REGIONAL DEVELOPMENT COOPERATION**

(Item 2 (b) of the provisional agenda)

*Note by the secretariat*

**SUMMARY**

Regional development cooperation in trade, transport, ICT and finance is an effective vehicle for enabling Asia-Pacific countries to benefit equitably from globalization. This document, which summarizes the theme study *Meeting the Challenges in an Era of Globalization by Strengthening Regional Development Cooperation*, prepared for the sixtieth session of the Commission, presents the salient features of the analysis of selected regional cooperation agreements in the above four areas to identify ways in which Asia-Pacific countries can achieve this objective.

The analysis identifies three layers of Asia-Pacific cooperation, intergovernmental rules-based, activities-based and transnational corporation-driven, which are part of globalization and promote incremental integration through public-private partnerships. The document identifies a number of areas which require further regional cooperation. Examples are harmonizing the “spaghetti bowl” of bilateral and regional trade arrangements, making the Asian Highway and Trans-Asian Railway the main international trunk routes of the region, harnessing the region’s world-class expertise in ICT to bridge the digital divide between countries and establishing a strong, safe and efficient financial architecture to support economic development. Against this background, the document suggests several specific roles for ESCAP in promoting regional cooperation.

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## I. GLOBALIZATION: OPPORTUNITIES AND CHALLENGES

1. Globalization is a complex, multidimensional and uneven process through which goods and services, capital, people, information and ideas flow across borders, leading to greater integration of economies and societies. The benefits are clearly visible in the increased trade, higher growth and falling poverty of countries fully engaged in the process. However, globalization has become controversial precisely because of the uneven distribution of its benefits and its equally visible negative impacts in countries where it has caused job losses, rising income disparity and environmental challenges.

2. The Asia-Pacific region vividly illustrates this phenomenon. It spans countries which have been among the most vigorous adherents and major beneficiaries of globalization. Many East and South-East Asian countries have experienced high growth rates, better living standards and an impressive drop in poverty. But the region contains many other countries, including least developed, landlocked and small island countries and transitional economies, whose lack of infrastructure, resources and skills leaves them unable to compete in fast-paced world markets or to exploit the opportunities of globalization.

3. In the United Nations Millennium Declaration, Doha Development Agenda, Monterrey Consensus and Johannesburg Plan of Implementation, a global consensus was forged on priorities and policies for a new partnership for development between developed and developing countries aimed at accelerating economic growth, reducing poverty and promoting sustainable development so that the benefits of globalization could be shared by all. The Doha Development Agenda was aimed at establishing a development-friendly multilateral trading system. The Monterrey Consensus pledged action on domestic, international and systemic policy issues, in particular those relating to financing for development. It made a further commitment to enhance the role of regional and subregional agreements and free trade areas consistent with the multilateral trading system. The Johannesburg Plan of Implementation also supported the emergence of stronger regional groupings and alliances to promote regional cooperation, improved international cooperation and sustainable development.

4. At the national level, each country will have to design and implement policies to take advantage of the opportunities provided by globalization and at the same time deal with the risks that it introduces. Some of the challenges which the policy makers face are lack of complete access to product markets caused by both trade barriers and hefty subsidies in developed countries for commodities of interest to agricultural producers; limited access to financial resources, and the constraints on acquiring technology in terms of resources, both human and financial; and inadequate infrastructure.

5. The era of globalization also brings about a closer degree of financial and economic integration between countries in an environment where shocks and crises in one country can easily affect others. This presents special challenges in the conduct of fiscal and monetary policies, particularly in conditions of heightened uncertainty. It is no longer possible to formulate macroeconomic policies independently of international and regional developments. Systemic risk management is becoming an integral element of the economic framework.

6. Within a country, there is the challenge of implementing liberalization policies that lead to greater integration of the domestic economy into the global economy. There are pressures from trade unions, lobby groups and local businesses over the effect of these policies on jobs and the closure of local industries. The issue of national ownership of an adjustment programme thus presents a challenge in its practical application. The responsibility for achieving the right balance and pace of adjustment lies with individual Governments. In practice, the task can be a complex one.

7. The Asia-Pacific region has considerable strengths with which to promote development in poor and marginalized countries and ensure that global development agendas work for them. First, the region's level of savings is the highest in the world. Secondly, the region has a large accumulation of foreign reserves, totalling \$2.05 trillion at the beginning of 2004. Third, the region contains Japan, the world's second-largest economy, and China and India, its two most populous countries, which can stimulate regional growth. The increased income and demand arising within the region are expected to provide a powerful driving force for its growth.

8. In a period of growing global economic interdependence, regional cooperation offers Asia-Pacific countries an effective vehicle for promoting sustainable development. It would enable Asia-Pacific countries, particularly small island economies and least developed countries, to overcome the limited size of their domestic markets, achieve economies of scale in production and diversify exports, reducing their vulnerability to external shocks. More efficient use of financial resources and technology available within the region would also help to shield countries from the kind of economic and financial volatility experienced in the 1997 financial crisis.

9. The present document examines some of the existing regional cooperation mechanisms to identify ways in which Asian and Pacific countries can achieve equitable growth. It summarizes the detailed study *Meeting the Challenges in an Era of Globalization by Strengthening Regional Development Cooperation*, the theme decided on by the Commission at its fifty-ninth session. It focuses on regional cooperation arrangements in trade, transport, finance and ICT and explores how they are facilitated by subregional organizations, including the Association of Southeast Asian Nations (ASEAN), the Economic Cooperation Organization (ECO), the Pacific Islands Forum and the South Asian Association for Regional Cooperation (SAARC). The conclusions derived from this analysis should be valid for any cooperation arrangement in these four areas. The analysis and findings are intended to help national policy makers in facing the challenges of globalization.

## II. REGIONAL COOPERATION IN TRADE AND INVESTMENT

### *(a) International trade and regional cooperation*

10. Trade liberalization efforts are largely a post-Second World War phenomenon. At the multilateral level, they have been promoted through the General Agreement on Tariffs and Trade (GATT) since 1947 and subsequently at the regional level through such arrangements as the European Union and the North American Free Trade Agreement. In Asia and the Pacific, regional trade liberalization started only in the late 1960s.

11. GATT eventually led to the establishment of the World Trade Organization (WTO) in 1995, broadening the agenda of multilateral trade liberalization. However, in Asia and the Pacific, 22 countries (slightly less than half the total number of ESCAP member countries) are not yet members of WTO, implying they have little opportunity to gain from the rules-based multilateral trade liberalization efforts. At the same time, the region has witnessed a surge in bilateral and regional trading arrangements. Many Asia-Pacific countries find these arrangements more focused and easier to abide by than multilateral agreements which aim to achieve many targets at the same time.

12. The Doha Development Agenda of WTO (2001) placed special emphasis on making a positive effort while implementing present agreements to ensure that developing countries, and especially the least developed ones, can secure a share in the growth of world trade commensurate with their development needs. It also recognized the importance of regional trading arrangements (RTAs) in promoting trade liberalization and stressed the need to harmonize regional and multilateral initiatives. However, the multilateral process has slowed owing to the breakdown of the talks at Cancún, Mexico, in 2003.

### *(b) Major regional initiatives*

13. In the Asia-Pacific region, cooperation started in the late 1960s with the formation of ASEAN, but economic and trade cooperation started only later with the adoption of the ASEAN Preferential Trade Agreement (PTA) in 1977. South Asian countries came together and formed SAARC in 1985. Similarly, Pacific island countries established the Pacific Islands Forum in the early 1970s but trade agreements came only later. The Australia and New Zealand Closer Economic Relationship (ANZCER) was initiated in the early 1980s and mutual trade liberalization has been the key element of such cooperation. ECO is a relatively new organization. It was established in 1985 and expanded its membership in 1992. Since the early 1990s, all subregional cooperation efforts promoted wider and faster liberalization by going beyond tariff reductions.

14. The major trading countries of the Asia-Pacific region now belong to one or more regional integration arrangements. Some details are given below:

- The Australia New Zealand Closer Economic Relations Trade Agreement, a bilateral agreement adopted in 1983, is one of the first comprehensive trade agreements in the region. Currently, the focus has shifted to establishing a “single market” and liberalizing the trade in services and trade facilitation and harmonizing customs rules, food standards and quality accreditation.
- ASEAN started modestly with the ASEAN PTA in 1977 and pursued further trade liberalization and the ASEAN Free Trade Area (AFTA) in 1992. AFTA has succeeded in including more than 85 per cent of traded products in its tariff reduction inclusion list. The average tariff rate for products under the list was reduced to 2.7 per cent in 2003 from 12.76 per cent in 1993 after implementation of the Common Effective Preferential Tariff scheme. The complete elimination of tariffs for products in the list is expected by 2010 (2015 for least developed country members). Trade among ASEAN countries grew by almost 11.6 per cent annually in the 1990s.
- The SAARC Preferential Trading Arrangement was signed in 1993 and has so far approved concessions on more than 5,000 products. Members agreed in principle to a South Asian Free Trade Area (SAFTA) during the 10<sup>th</sup> SAARC Summit (1998), but the agreement was only signed in Islamabad during the 12<sup>th</sup> Summit (2004). SAFTA provides a road map for setting up a free trade area in stages, starting in 2006, allowing flexibility for least developed country members.
- The Pacific Island Countries Trade Agreement (PICTA) was signed in 2001 by Pacific Islands Forum countries. PICTA is a major achievement of the Pacific Agreement on Closer Economic Relations, the umbrella regional cooperation arrangement. The Forum is now focusing on implementing (and monitoring) these agreements, providing advice on tariff and tax reforms, compliance with the rules of origin clauses and trade facilitation measures. The South Pacific Regional Trade and Economic Cooperation Agreement is another agreement under which the two developed nations of the South Pacific Forum, Australia and New Zealand, offer duty-free and unrestricted or concessional access for virtually all products originating from the developing island member countries.
- The ECO Trade Agreement was signed by ECO member countries in 2003, focusing on a gradual phasing out of tariffs and other trade barriers among member countries within 8 years, except for Afghanistan, which is allowed 15 years.
- ASEAN and ECO have been able to negotiate agreements on transit trade. SAARC has also accorded priority to this issue but has not yet included it in any agreements. Along with trade, ASEAN has initiated liberalization in investment among its members through the Agreement on the ASEAN Investment Area in 1998, which will accord national treatment to direct investment by ASEAN members by 2010 and to all direct investment by 2020.

15. Countries from East Asia, especially Japan and the Republic of Korea, are forming economic partnership agreements, a much wider concept encompassing trade, investment, financial services, ICT, tourism and human resources development. Asia-Pacific Economic Cooperation (APEC) illustrates another trend based on open regionalism or non-discriminatory liberalization with the common goal of achieving free trade by 2010 (2020 for developing countries). Under open regionalism, tariff preferences that one APEC member accords to other members are also accorded to non-APEC trading partners.

16. A number of cross-subregional cooperation agreements and initiatives have also taken place. The members of Bangladesh-India-Myanmar-Sri Lanka-Thailand Economic Cooperation (BIMST-EC) have agreed on setting up a free trade agreement and aim to achieve free trade by 2017. Trade and investment relations between AFTA and ANZCER took an important step forward with the signing of the Ministerial Declaration on the AFTA-CER Closer Economic Partnership in 2002, aiming to double ASEAN-CER trade and investment by 2010. ASEAN+3 (ASEAN members plus China, Japan and the Republic of Korea) adopted the Joint Statement on East Asia Cooperation in 1999, highlighting closer economic, financial, political and cultural cooperation. ASEAN members held discussions in Bali in 2003 with Japan, the Republic of Korea, China and India and expressed support for further cooperation in economics and business (through free trade agreements), regional financing (establishing an Asian bond market), health (containing and avoiding SARS, HIV/AIDS) and countering terrorism and transnational crime.

*(c) Implications for the region*

17. A recent upsurge of bilateral trade agreements across subregions has created a so-called “spaghetti bowl” of overlapping and multiple trading arrangements, making trade relationships more complex and sometimes confusing.

18. Some concerns of developing countries as well as issues which need attention are listed below:

- The access of agricultural goods to regional markets as an alternative to protected developed country markets requires further consideration.
- Many countries are concerned about their textile exports in a post-Multi-Fibre Arrangement period starting from 2005. Regional efforts are needed to deal with the situation by increasing the productivity and competitiveness of their textile industries.
- Countries need more cooperation to harmonize product standards in order to face non-tariff barriers.
- Trade facilitation, transit trade and regional investment agreements require further attention to make RTAs effective.

*(d) Future cooperation in trade*

19. Asia-Pacific developing countries as a group are growing faster than either the global economy or other groups of developing countries. This is primarily the result of forces within the region, such as intraregional trade and strong domestic demand, although exports to the rest of the world continue to play a significant part in sustaining the overall momentum of growth. China's remarkable performance has been central in sustaining the growth momentum of the region as a whole, with its GDP expanding by 24.9 per cent during 2001-2003 on the basis of strong investment and consumption demand. During this period, China increased its total imports by more than \$160 billion, two thirds of which came from the region. It is now the world's fourth-largest trading nation, helping to stimulate output in the regional economy. Similar trends are visible in several other economies of the region where robust growth has resulted from a combination of higher net exports and domestic demand. The dynamism of the region in the area of trade is reflected in numerous cross-subregional efforts like ASEAN+3, the Bangkok Agreement and BIMST-EC as well as subregional arrangements.

20. The accession of China to the Bangkok Agreement has given the Agreement fresh vitality. It is being further revitalized as the Asia-Pacific Trade Agreement, which is intended to provide a comprehensive trade and investment framework.

21. A consultative system to map and review RTAs and PTAs will assist countries in promoting better reporting and dissemination by ensuring that comprehensive information on the tariffs, regulations and rules of origin of the trade arrangements is publicly and easily available and provided to WTO in a timely and systematic way. This will help in establishing a more effective link between regionalism and multilateralism.

22. To improve the effectiveness of trade agreements, countries may prepare a negative list where only the goods that are excluded from tariff reduction are detailed. Appropriate dispute settlement and enforcement mechanisms are also required to ensure serious commitment. Many countries lack expertise regarding international arbitration and countries of a region can more easily develop a joint system. The same is true for developing a strong patent system and harmonizing product standards. Providing safeguard mechanisms, for example, to deal with a balance-of-payments crisis, can also act as an incentive to countries to participate in RTAs more actively and equitably.

### **III. REGIONAL COOPERATION IN TRANSPORT**

*(a) Cooperation in the region and lessons learned*

23. Until recently, conditions were not conducive to developing intra- and interregional land transport linkages in the Asia-Pacific region. Conflicts in and between countries damaged land transport infrastructure in many areas and created barriers to international land transport. However,

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increasing regional cooperation among countries, especially in trade, has led to a notable increase in transport cooperation among nations in Asia and the Pacific since the early 1990s. Most regional groups like ASEAN, SAARC, the Pacific Islands Forum and ECO have action plans to improve transport in their respective subregions.

24. A number of positive transport cooperation measures are already being taken in the region. Priority is being given to transport networks serving industrial and economic activity in the vicinity of international seaports as well as to improving regional transport networks, emphasizing design, standards and safety. More recently, countries of the region have been paying attention to transit transport at border crossings and subregional groups have signed several agreements, conventions and protocols to facilitate cooperation on this issue. Asia-Pacific countries are also cooperating in maritime transport.

25. Some important subregional cooperation initiatives are listed below:

- The ASEAN Plan of Action in Transport and Communications gives member countries a common level of transport and regulation, enhancing the mobility of goods and passengers. Other initiatives include an ASEAN memorandum of understanding on air freight services (2002) and a ministerial understanding on an ASEAN Highway network project (1999).
- Cooperation in transport is an important issue to ECO as many of its members are landlocked. Currently, the focus is on implementing the Almaty Outline Plan (1993) and the Programme of Action for the ECO Decade of Transport and Communications (1998-2007) and on ratifying the Transit Transport Framework Agreement. However, some members have been slow to ratify the agreements. The Special Programme for the Economies of Central Asia, launched by the Economic Commission for Europe in collaboration with ESCAP and other United Nations partners, focuses on developing transport infrastructure and cross-border facilitation as a regional priority.
- For faster communication, Pacific island countries are emphasizing aviation through forum aviation action plans (1998, 2003) as the islands are remotely located.
- SAARC members recognized the inadequacy of the infrastructure in their subregion at their 9<sup>th</sup> Summit in 1997 but a comprehensive agreement has yet to be concluded. The adoption of SAFTA, however, gives even greater importance to the role of the transport sector. The Islamabad Declaration (2004) emphasized the need to accelerate cooperation and the participation of the private sector through joint ventures in SAARC region.

26. ESCAP's major activity in this area has been the Asian land transport infrastructure development project consisting of the Asian Highway and Trans-Asian Railway projects. These integrated networks demonstrate the commitment of the region's mainland countries to open routes that would facilitate intraregional trade and provide easy access to a massive hinterland, much of

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which remains relatively underdeveloped. These planned transport corridors will also enhance links between Asia and the markets of Europe and North America through integrated land-and-sea routes.

27. The Asian Highway project was conceived in 1959 to achieve coordinated development of international highways in the region and between Asia and Europe. The effort had to overcome many hurdles. After years of negotiation on routes and consensus-building on the modalities for establishing the Highway, the countries adopted an intergovernmental agreement in November 2003 formalizing their commitment to the linkages and aligning over 140,000 km of highway routes connecting 32 countries. The agreement lays down the modalities for proposing new routes and a mechanism for dispute settlement and withdrawal from the agreement. It constitutes a major step towards realizing a massive land transport network linking the region's capital cities, tourism spots, industrial and agricultural centres and sea and river ports. The agreement is ready for signing this year.

**(b) *Future directions in transport cooperation***

28. The ESCAP secretariat is now preparing an intergovernmental agreement on the Trans-Asian Railway network. Rail transport has considerable potential for providing transit transport opportunities, particularly for Asia's landlocked countries, and offers significant advantages for the environment and safety. The challenge is to overcome the technical and institutional barriers which currently hinder the cross-border movement of trains and the smooth transfer of goods across different gauges.

29. As more and more countries look for ways to strengthen their transport sector, there is a growing need for better and more appropriate information on transport developments across the region, as well as the skills for using it. This will help countries to exploit existing capacity efficiently and reduce excess investment in new capacity. It will also help them to give more attention to auxiliary services. ESCAP has taken initiatives to increase the availability of information for forecasting container transport requirements for the major ports of the region. Such information will also help to provide long-term forecasts of transport investment requirements. Emphasis is now being given to collecting similar data and statistics on cross-border road and rail traffic. ESCAP will assist countries in collecting the data along selected transit corridors in order to better monitor movements of goods and identify bottlenecks.

30. Transport facilitation is another challenging area which includes many stakeholders to address legal, regulatory, institutional, operational and technological issues. Indeed, one of the challenges is to harmonize the initiatives undertaken by different subregions, which, in some cases, have led to inconsistent legal commitments, documentary requirements and procedures. ESCAP is analysing facilitation agreements in the region to prepare model framework agreements on transit transport. It is anticipated that this work will lead to a substantial review of Commission resolution

48/11 of 23 April 1992 on road and rail transport modes in relation to facilitation measures and provide a checklist of the important transport-related conventions and other arrangements which need to be put in place to ensure efficient border crossings.

31. The Asian Highway and Trans-Asian Railway networks are expected to become the main international trunk routes linking countries to each other and to other regions. Regional cooperation needs to be promoted so that countries can take the fullest advantage of these networks for international and transit transport and also as the basis for spreading economic development to wider hinterlands. Major stakeholders, particularly Governments and the private sector, need to find ways to communicate better with each other on their needs.

#### **IV. REGIONAL COOPERATION IN ICT**

##### ***(a) Cooperative initiatives and lessons learned***

32. To build an open, empowering information society using ICT is an economic, social and political challenge. The World Summit on the Information Society adopted a Plan of Action to bridge the digital divides between and within countries and communities and make progress towards an information society. It calls for new forms of solidarity, partnership and cooperation among Governments, the private sector, civil society and international organizations and seeks their commitment to the Plan's Digital Solidarity Agenda. Regional dialogue should contribute to national capacity-building to create a critical mass of qualified and skilled ICT personnel and to the alignment of national strategies with the goals set out in the Summit's Declaration of Principles.

33. Subregional cooperation is helping member countries to apply ICT in government operations and services, health care and health information, education and training, business, agriculture, transport, management of natural resources and poverty reduction.

34. SAARC member countries are using ICT in a SAARC Audio Visual Exchange Programme to promote awareness on literacy, health, participatory governance and other socio-economic issues. SAARC laid out a plan in 1998 for modernizing telecommunications, including the simplification of regulations and tariffs. Pacific island countries have adopted a Forum Communication Action Plan (1999) and ICT Policy and Strategic Plan (2002) to facilitate construction and expansion of community telecentres to enhance telehealth and distance learning programmes. ASEAN, however, having a relatively high penetration of ICT, attaches more importance to commercial use of the technology, especially in e-commerce, developing an ICT legal framework and promoting private investment and training in this field. Some important initiatives in these areas include the e-ASEAN Initiative (1999), e-ASEAN Framework Agreement (2000) and Manila Declaration (2002). In ECO, some attempts are being made to modernize telecommunication systems. The emphasis is on harmonizing regulatory and technical features and developing the telecommunication network. The ECO secretariat is currently preparing a framework for a ministerial conference on ICT.

35. The region comprises a constellation of countries with surplus capital, world-class expertise in electronics, hardware and software technologies and very good technical institutes. Many developed countries in the world outsource their business processes to countries of the region using ICT. Moreover, hardware and software are major export items in many countries. In spite of this level of sophistication, the region has an acute digital divide. Many countries do not have even basic ICT infrastructure. There are enough regional resources to tackle the problem, the issue is how best to utilize them, developing a proper and coordinated policy framework so that their full potential can be realized. Cooperation among subregional groups in this context could be beneficial.

36. It is important to note that while designing cooperation arrangements, most subregional groups and institutions have paid attention to digital divide issues. However, subregional priorities vary as some countries have still not mainstreamed ICT comprehensively into their development policy framework. This makes regional cooperation in ICT sporadic and sometimes superficial.

37. Many countries are unable to take full advantage of space technologies because of high costs. However, wider application of the technology and rural penetration will significantly reduce the cost through economies of scale. Satellite communication applications programmes can be used extensively to promote education, health and multi-purpose community telecentres in rural and remote areas and to help the self-employed.

**(b) *Future directions in ICT cooperation***

38. ESCAP's vision is to assist countries in creating a regional information society in line with the World Summit's guidelines. The Regional Road Map towards an Information Society in Asia and the Pacific adopted by representatives of 16 member countries at the Regional Interagency Working Group on ICT in August 2003 recommends specific actions at the national and regional levels to create such an information society and mainstream ICT to help to achieve the Millennium Development Goals. It further suggests that since the actions required at the regional level are cross-sectoral in nature, a regional organization like ESCAP is appropriate for taking the lead in cooperating with the International Telecommunication Union, the Asia-Pacific Telecommunity, the United Nations Development Programme, the United Nations Educational, Scientific and Cultural Organization and others. The suggested regional priorities include preparing a regulatory, legal and security framework, facilitating and promoting a regional broadband network, preparing an e-readiness index and developing special programmes for weaker countries.

39. To spread the benefits of space technology and its applications to all countries in the region, the Regional Space Applications Programme for Sustainable Development (RESAP), phase II, is focusing on environmental and natural resource management, food security, capacity-building, human resources development, education, poverty alleviation, natural disaster reduction, health care and hygiene, and sustainable development planning. ESCAP is playing a catalytic role in these areas.

40. ESCAP's contribution to facilitating regional negotiations on technical, institutional and policy-level issues includes:

- (a) Fostering public-private partnerships;
- (b) Building strategic partnerships among stakeholders, including resource countries;
- (c) Strengthening institutional and technical capacity, particularly of least developed countries;
- (d) Developing viable and sustainable ICT service provision;
- (e) Developing the mechanisms for regional and subregional cooperation.

## V. REGIONAL COOPERATION IN FINANCE

41. Financial markets in Asia and the Pacific are unevenly developed, comprising world-renowned financial centres such as Tokyo; Hong Kong, China; and Singapore, and countries without any financial or bond markets. Many existing markets are not geared to cater for the needs of long-term financing or small and medium-sized enterprises (SMEs). Financial systems in most countries in the region are bank-based, often controlled by the State and closed to foreign competition. This restricts cross-border financial transactions. Lack of credible and reliable legal and regulatory systems and loans to relatively less productive sectors in many cases have led to high levels of non-performing loans, making the financial sector inefficient.

42. The lack of a regional financial infrastructure that includes a region-wide system of clearing and settlement, effective regulatory and surveillance mechanisms, regional credit rating and guarantee institutions, and hedging instruments is a major constraint for the development of a proper market for finance in the region. It hinders the development of a regional bond market for long-term finance. This requires the harmonization of legal and regulatory systems, domestic clearing and settlement systems, market practices and withholding taxes on bond coupon payments. Poor-quality institutions and information disclosure and the lack of credit enhancement and guarantee facilities are contributory factors to the slow progress of financial sector development in the region.

43. The lack of financial sophistication in many countries has led to an outflow of savings from the region, much to the disadvantage of its developing countries, which are fiercely competing for financial resources for development in international capital markets. The region's development financing requirements have so far come mainly from the Asian Development Bank and such bilateral donors as Japan and Australia together with multilateral lending agencies such as the World Bank and private capital flows in the form of foreign direct investment and portfolio capital. The International Monetary Fund (IMF) has provided balance-of-payments support for countries in times of crisis.

44. Since the financial crisis in 1997-1998, East Asia has amassed over \$2 trillion in foreign exchange reserves to build a war chest for fighting future financial crises. Some of these reserve holdings could have been deployed in other countries for productive investment. However, there are few channels to facilitate such lending. Regional cooperation can pave the way for efficient use of these resources, minimizing the downside risks.

*(a) Existing regional cooperation and lessons learned*

45. Regional development cooperation in finance is relatively new in Asia and the Pacific. The regional or subregional cooperation arrangements that existed prior to the Asian financial crisis in 1997 were confined primarily to cooperation in the areas of research and training among central banks, clearing and settlement, reinsurance and small-scale development financing and swap arrangements.

46. The initiatives taken by the South East Asia, New Zealand and Australia Group and the South East Asian Central Banks aim at collaboration in research and training of central bank staff on several policy and operational aspects of central banking. The Asian Clearing Union, set up in 1973, is an arrangement to settle payments for intraregional transactions among the participating central banks on a multilateral basis. The Asian Reinsurance Corporation, set up in 1979, works to reduce leakage of foreign exchange from the region in the form of insurance and reinsurance premiums. Both organizations have moved slowly and require renewed attention to achieve their potential for facilitating regional financial transactions.

47. The regional initiatives on finance that emerged after the crisis include the ASEAN Surveillance Process, the Manila Framework Group, the Chiang Mai Initiative (CMI), the ASEAN Framework Agreement on Services, which also covers financial services, and the Asian bond initiative (ABI) under the Asian bond market development programme. CMI was designed to provide liquidity support for member countries that experience short-run balance-of-payments deficits in order to prevent future crises, while ABI is expected to lead to a basket of dollar-denominated bonds issued by Asian sovereign and quasi-sovereign issuers. To facilitate trade and other regional financial requirements, ECO and SAARC are also making attempts to mobilize regional and external resources through the ECO Trade and Development Bank, South Asian Development Fund and SAARC-Japan Special Fund.

48. However, recent regional financial initiatives and their perceived benefits have been concentrated mainly in the East Asian region. Many developing countries in the Asia-Pacific region have yet to benefit from such initiatives or make use of the sophistication and innovations in financial services elsewhere owing to their underdeveloped domestic financial systems. There is a need in the Asia-Pacific region to consolidate the region's institutional architecture, improve quality and efficiency and intensify financial restructuring and cooperation.

*(b) Future directions in financial cooperation*

49. In a world economy that is being rapidly globalized, Asia-Pacific economies cannot remain outside of the integrated world financial system much longer. Therefore, one possible vision for the future of the financial sector of Asia and the Pacific is: financial modernization and integration through financial reform, institution-building and cooperation.

50. What can developing member countries do to modernize their financial systems? Member countries may wish to consider the following suggestions as part of a long-term strategy to create a strong foundation for financial cooperation.

*(a) Financial modernization and integration*

- ❖ Sustain extensive financial reform and institution-building efforts: member countries may adopt different financial reform plans with different speeds of implementation tailored to their reform capacities.
- ❖ Develop the banking sector and capital markets simultaneously: recent studies show that banking development and capital market development are complementary. Credible and reliable legal and regulatory systems are prerequisites to develop efficient banking and capital markets.
- ❖ Adopt emerging international standards for accounting, disclosure, corporate governance, risk management and capital adequacy of financial institutions. However, the introduction of these standards may encounter formidable obstacles in many countries. Indigenization rather than the grafting of these standards is the preferred strategy.
- ❖ At a certain stage of financial development, emerging market economies of Asia should gradually deregulate capital account transactions and open financial services industries. Here again, different countries may consider different forms and speeds of financial opening that fit their institutional capacities.
- ❖ There is no one-size-fits-all exchange rate regime for emerging market economies. Most of the countries, which are not active participants in the global capital market, may decide what is in their best interest.
- ❖ If monetary integration is the ultimate objective of the countries participating in regional arrangements, they will find it expedient to accept a collective exchange rate regime and tighten up policy coordination.
- ❖ Experience has shown that financial reform is often derailed by the opposition mounted by vested interest groups. One possibility of diffusing this domestic political resistance is to exert peer pressure on individual member countries by

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“collectivizing” financial reform within a regional financial arrangement organized by a group of like-minded countries. For example, ASEAN+3, ECO, SAARC and other similar regional arrangements were able to construct a common framework of financial reform for the participating countries. Member countries could then devise their own reform plans based on the common framework. To be effective, the “collectivization” scheme will have to be supported by monitoring the implementation of reform in each country. A self-enforcement mechanism can be introduced, and a review process instituted at the regional level.

*(b) Mobilization of domestic and international resources for development*

51. The study proposes an extension of ABI to cover the entire region as a mechanism for mobilizing domestic and international resources for financing for development. This does not mean, however, that all countries in the Asia-Pacific region should automatically become members of ABI. The architects of the existing ABI could develop a set of convergence criteria for eligibility as in the case of the Euro common currency area. Countries which satisfy these conditions could become members and benefit from the initiative. This would not only make the existing ABI more efficient and large enough to meet the bond-financing needs of Asia and the Pacific but would also provide an opportunity to those having limited access to international capital markets to raise funds for development within the region. This initiative could also be extended to financing SMEs in the region by providing guarantees and securitizing SME bonds.

*(c) Addressing systemic issues*

52. Extending CMI to cover the entire region is another option to consider. At present, CMI is at an embryonic stage of development and needs to be greatly expanded and consolidated before it can serve as an efficient regional liquidity support system. Given the relatively small amount of liquidity available through CMI, doubts have been raised as to whether the bilateral swap arrangements (BSA) system in its present form could serve as a credible and effective defence against speculative attacks. Participants in international financial markets are not likely to be impressed by the amount of liquidity available and will therefore ignore CMI unless ASEAN+3 is prepared to increase the number of BSAs and increase the swap amount of each BSA.

53. An extension of CMI to cover a large section of the Asia-Pacific region would raise liquidity and make the initiative an effective line of defence against speculative attacks. Convergence criteria similar to those proposed for the Asian bond market could be developed for the extended CMI. Further organizational and operational details would have to be worked out before it could serve as a fully-fledged regional financial mechanism comparable to the European Monetary System.



(d) *An Asian monetary fund: can the region justify the case for it?*

54. The proposal has gained some support lately from early opponents since an Asian monetary fund (AMF) and could play a complementary role to IMF by providing funds required in a crisis, which IMF alone would not be able to mobilize. It could also engage in crisis surveillance and prevention at the regional level. However, setting up an AMF would depend on the region's ability to integrate with the international financial system. An extended CMI could be a stepping-stone in establishing an AMF. The linkages between AMF and IMF would need to be spelled out to ensure that they are complementary and not competing arrangements.

(e) *Currency union: a long-term vision?*

55. Although the region by no means constitutes an ideal group for an optimum currency area, compared with today's Europe, some subregions, in particular East Asia, are as qualified for a common currency as the members of the European Union were in the 1970s and 1980s. Empirical studies invariably point to the large increase in intraregional trade in East Asia in recent years as a development conducive to financial and monetary integration.

56. Financial liberalization throughout the region has led many countries to establish closer linkages with international financial markets than before, but not with the markets of other neighbouring countries in the region. In contrast, however, the financial markets of European countries were much more integrated with one another in the 1970s and 1980s than the markets of Asian countries are at present. With the increasing tendency for regional cooperation in trade in the Asia-Pacific region, better currency management and monetary and financial integration will become necessary.

(c) *The role of ESCAP*

57. As a regional arm of the United Nations for the Asian and Pacific region, ESCAP's mandate is to promote economic and social development through regional and subregional cooperation and integration. Over the years, ESCAP has supported regional movements for trade liberalization and integration and participated in numerous projects for social development, including poverty reduction in Asia and the Pacific.

58. ESCAP was instrumental in establishing the Asian Development Bank in 1965 to provide development finance and technical support to developing countries in the region and the Asian Clearing Union in 1973, for which ESCAP continues to provide advisory services. Reinvigorating ESCAP's role in facilitating financial cooperation would be in keeping with the mandate given by the Monterrey Consensus for promoting the role of regional commissions in supporting policy dialogue on macroeconomic, financial, trade and development issues.

59. The study notes there are separate tracks of regional economic cooperation, particularly in the fields of trade and finance. For instance, ASEAN is forging its own arrangements and with other regional partners in ASEAN+3 and ASEAN+1. Similarly, SAARC is pursuing its own initiatives. The Pacific Islands Forum and ECO also have their own tracks. There is some merit in bringing these initiatives together, at least by starting with a deeper understanding of the cooperation mechanisms and ways that intersubregional cooperation can advance.

60. A possible way to proceed could be for ESCAP to be granted observer status in various forums such as ASEAN, ASEAN+3, SAARC and ECO on a mutually agreed basis with those subregional organizations. At present, ESCAP has observer status at Forum Secretariat ministers meetings in the Pacific Islands Forum Secretariat. This will enable ESCAP to forge intersubregional awareness of regional developments in trade and finance and facilitate policy dialogue between different subregional groupings on macroeconomic and financial issues.

61. With its region-wide membership and wide experience in areas such as trade and investment, transport and ICT, ESCAP is well placed to facilitate financial cooperation in the Asia-Pacific region and serve as a regional knowledge centre.

## **VI. REGIONAL COOPERATION: A STEPPING STONE TO GLOBAL INTEGRATION**

62. Is regional cooperation the “middle path” or the “second-best approach” for responding to globalization in the Asia-Pacific region? Can regional cooperation be disentangled as a separate step in building consensus on a global multilateral framework? This is not likely to be the case as the two processes are intertwined. Economic and financial liberalization and rapid application of ICT are pushing economic, trade and financial relations in the region closer. Rather than being contrasting trends, globalization and regional cooperation can and should proceed simultaneously. Better management of globalization requires better management of regional cooperation, with national policies aligned to these processes to maximize benefits.

63. What is the Asia-Pacific framework for regional cooperation? The increasing globalization and rapid cross-border exchanges brought about by technological changes require an approach that blends in with Asia-Pacific’s heterogeneous and complex economic environment and is based on felt needs and perceived benefits. Today’s global framework, including the Asia-Pacific region, involves open and competitive market-based economies in which the design of various trade, finance and transport agreements are emerging and have contributed to a fundamental change in the way regional integration is taking place. The process now demands both intraregional and interregional agreements.

64. The study has noted the three layers of regional cooperation
- Intergovernmental forms of subregional cooperation with formal institutions, such as ASEAN, ECO, the Pacific Islands Forum and SAARC, that forge “rules-based” cooperation among members and selected outsiders as in ASEAN+3.
  - Activities-based regional cooperation through such organizations as the Greater Mekong Subregion, which promotes cross-border projects such as roads and power. Included in this layer are private sector-driven “growth triangles”.
  - Transnational corporation-driven initiatives in the form of international integrated production networks and outsourcing arrangements, often with public sector backing and incentives.

All these layers are interconnected and are part and parcel of the globalization process and represent the Asia-Pacific way of promoting incremental economic integration. They are driven by both Governments and the private sector.

65. The emerging principles of regional cooperation in Asia-Pacific may be summarized as follows:

- (a) While respecting the region’s diversity of culture, politics and religion and stages of economic development, it strengthens interdependence in forms that promote stability and prosperity;
- (b) Regional cooperation should build upon and strengthen the various interlocking frameworks of cooperation in the region;
- (c) It should be consistent with the broader multilateral consensus enshrined in the Millennium Declaration and other agreed international development goals.

Underlying these principles is the objective that regional cooperation will contribute to both regional and national shared interests and prosperity, consistent with multilateral frameworks.

66. The study examines regional cooperation taking these principles into account in the four selected areas of trade, transport, ICT and finance. Areas which require further development cooperation include:

#### **Trade**

- Promoting harmony among the bilateral and regional trading arrangements in the region’s “spaghetti bowl” to make them consistent with the rules-based multilateral trading system and the spirit of the Doha Development Agenda.
- Focusing trade cooperation efforts so as to harmonize product standards to face non-tariff barriers.

- Expanding cooperation in areas such as trade facilitation, transit trade and regional investment agreements to harness the full potential of expanding trade.

### **Transport**

- Making the Asian Highway network and the Trans-Asian Railway the main international trunk routes in the region with substantial emphasis on building intermodal connections to meet increasing traffic demands.
- Promoting the use of logistics and supply chain methodologies and full integration of ICT by means of favourable investment regimes and cooperative ventures in order to reduce transport costs and substantially improve the competitiveness of the region's products.
- Assisting countries in building infrastructure, and especially feeder roads that link major highways, railways and ports, so that the benefits can be dispersed to a wider hinterland, in particular remote rural areas.

### **ICT**

- Converting the digital divide into a digital opportunity for all, particularly marginalized countries, through regional cooperation that harnesses the Asia-Pacific region's surplus capital, world-class expertise in electronics, hardware, software and space technologies and its outstanding technical institutes.
- Building an Asia-Pacific information society by developing new forms of partnership and cooperation among Governments and other stakeholders, such as the private sector, civil society and regional research and training institutes.
- Garnering commitment from all stakeholders to implement the Digital Solidarity Agenda set out in the Plan of Action adopted by the World Summit on the Information Society.

### **Finance**

- Establishing a strong, safe and efficient financial architecture to support economic development and strengthening existing cooperative arrangements such as CMI and ABI to take account of the needs of disadvantaged economies.
- Developing a regional cooperation road map to greater financial integration and more efficient financial markets in the light of the Monterrey Consensus.
- Promoting arrangements to enable SMEs to access regional capital markets, helping them to achieve economies of scale and compete in a growing regional market.

*ESCAP's role in promoting regional cooperation*

67. Global agreements, including the Monterrey Consensus, the Johannesburg Plan of Implementation, the Almaty Programme of Action for landlocked developing countries and the Plan of Action of the World Summit on the Information Society provide emphatic acknowledgement of the need for regional cooperation to achieve their goals. They articulate clearly the role that regional commissions can play in assisting implementation at the national, subregional and regional levels. With more than five decades of experience in forging regional cooperation, ESCAP will continue to play an important role in supporting economic and social development through regional and subregional cooperation. The study provides illustrations of ESCAP's significant achievements fostering regional cooperation through such initiatives as setting up the Asian Development Bank, promoting trade arrangements such as BIMST-EC and the Bangkok Agreement and supporting the development of the Asian Highway, the Trans-Asian Railway and, more recently, the use of ICT.

68. ESCAP is uniquely positioned to assist countries in forging greater integration in the region and in particular promoting greater linkages among subregional institutions. There are separate tracks of regional economic cooperation being forged in the fields of trade, transport and finance, for instance. ASEAN is building arrangements among its members and with other regional partners in the context of ASEAN+3 and ASEAN+1. ECO, the Pacific Islands Forum and SAARC similarly have their own tracks. There is a need to bring these initiatives together to create a fuller understanding and tap synergies among them. To promote greater regional integration, ESCAP could be mandated to play a coordinating role in bringing these initiatives together. ESCAP, whose membership spans the entire region, could play the role of facilitator to promote greater awareness among the various subregional groups of the other cooperation mechanisms that are being pursued and their linkages to the multilateral processes.

69. As pointed out earlier, one way to proceed would be for ESCAP to be granted observer status in various forums such as ASEAN, ASEAN+3, SAARC and ECO on a mutually agreed basis. This would enable ESCAP to increase awareness of developments in trade, finance and other fields that are rapidly changing. In the spirit of the Monterrey Consensus and other global agreements, ESCAP could facilitate policy dialogues between different subregional groupings on selected issues and at the same time become a "knowledge centre" for the Asia-Pacific region in areas where it has wide experience. ESCAP's capacity and resources would have to be built up to enable it to assist the region in such an endeavour.

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