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The Global Economic Crisis and Its Implications for Asian Economic Cooperation

Michael G. Plummer

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East-West Center
1601 East-West Road
Honolulu, Hawai‘i 96848-1601
Tel: 808.944.7111
EWCInfo@EastWestCenter.org
EastWestCenter.org/policystudies

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List of Acronyms

AEC	ASEAN Economic Community
AFTA	ASEAN Free Trade Area
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
CMI	Chiang Mai Initiative
EEC	European Economic Community
EU	European Union
FDI	foreign direct investment
FTA	free-trade area
GDP	gross domestic product
IMF	International Monetary Fund
MNC	multinational corporation
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
WTO	World Trade Organization

Executive Summary

The economic crisis of 2008–09 is the second major crisis in just over a decade that Asia has endured. Unlike the Asian crisis of 1997–98, however, the current crisis originated mainly in the West. Asia's excessive reliance on net exports as the principal driver of economic growth since the 1997–98 crisis rendered it especially vulnerable to external shocks, and most Asian countries have paid dearly. The more open the economy, the more vulnerable it is to such shocks. The newly industrialized Asian economies (Singapore, Hong Kong, South Korea, and Taiwan), which are among the most open and dynamic in the world, are expected to contract by about 6 percent in 2009.

Fortunately, the world economy has showed signs of recovery in the third quarter of 2009 after an extremely difficult first half, when fears of a new Great Depression were widespread. Through aggressive and often unconventional macroeconomic policies adopted by the world's largest economies and most Asian countries, credit markets have been unblocked, bank liquidity has improved, and aggregate demand has picked up or at least stopped falling. Forecasts point to economic recovery in 2010, but expectations are that the region will not revert to its pre-crisis growth trend until 2011. Thus, while the worst of the 2008–09 crisis appears to be over, its effects will likely continue to be felt for at least the next few years.

Asian economic cooperation has been an extremely important aspect of the commercial policies of most Asian countries since 2000, and how the economic crisis will affect the trend toward formal bilateral, subregional, and regional economic agreements is a key question for Asian policymakers and the private sector. To address this question, this paper first looks at regional economic cooperation in Asia and the motivations for it, and then postulates how the crisis is likely to affect the economic and political variables that shape the region's movement toward free-trade areas and financial cooperation.

To understand regionalism in Asia, one must keep in mind the overriding importance of improving competitiveness, which in turn requires a multifaceted approach to economic cooperation. An outward-oriented development strategy has been adopted by virtually all East Asian economies, and integrating effectively with the global economy requires global market access, reductions in barriers to trade and investment, and best practices in commercial policy, as well as macroeconomic and political stability.

Over the past few decades, market-led economic integration ("regionalization") has taken place in Asia largely without formal accords such as free-trade areas and customs unions. This distinguishes it from other regional arrangements such as the European Union and the North American Free Trade Agreement. The rapid pace of globalization and competition from rising giants like China and India, the growing importance of international production chains and fragmented trade, the lack of progress in multilateral trade negotiations under the World Trade Organization, and the discriminatory effects of preferential trade agreements in the region's major markets have created strong incentives for economic cooperation in Asia, whether it be bilateral, subregional (e.g., ASEAN), or regional. But the goal of such cooperation in Asia is to enhance efficiency and economic integration in general, rather than to create an economic fortress or isolate the rest of the world. At its heart, the region is trying to embrace open regionalism—that is, an outward- rather than inward-looking approach to economic cooperation.

Given these motivations, the global economic crisis is likely to enhance the potential gains from regional cooperation and therefore promote support for it. The need to improve market efficiency and competitiveness is even clearer in the context of economic crisis. Economic cooperation through free-trade areas and more liquid, developed, and stable financial markets can effect change in these areas through a variety of channels—such as lower transaction costs, adoption of best practices, economies of scale, lower costs for capital, and inflows of productivity-enhancing foreign direct investment. A trade creation effect that results from more efficient structural change in a free-trade area will also improve efficiency, but such a reallocation of resources will have a significant political cost during a crisis. Trade diversion, on the other hand, which results from discrimination against nonpartner countries in a free-trade area and leads to a less efficient allocation of resources, is actually likely to receive political support, as it could create jobs (albeit in the wrong sectors). Cooperation to improve macroeconomic and financial policies also needs to be a high priority, particularly when a crisis is induced by macroeconomic and financial shocks in an increasingly globalized economy in which the need to redress imbalances and foster greater macroeconomic and financial stability, surveillance, and regulatory issues becomes increasingly compelling.

Hence, most economic variables affected by cooperation are likely to support the regionalism movement in Asia rather than detract from it. There are two political effects that could work against it: nationalism and the political cost of trade creation, the former being perhaps the biggest threat. But other political factors tend to support regional cooperation—including the effect of the global economic crisis on the desire to foster an Asian identity and build stronger and deeper Asian economic institutions.

While there is no unambiguous answer to the question of whether or not the crisis will improve the prospects for deeper and more extensive regional cooperation in Asia, the factors working in favor of it are strong and will likely dominate those working against it. The trade and financial cooperation agreements initiated or finalized during the crisis are prima facie evidence of a positive relationship between crisis and cooperation. At the least, it is evident that the crisis has not turned back the clock on Asian regionalism. More likely, it will do the opposite.

The Global Economic Crisis and Its Implications for Asian Economic Cooperation

Introduction

Asian economic integration has proceeded at an increasingly rapid pace in recent years, in large part driven by market forces. In response to this regionalization, Asian economies have also concluded a large number of free-trade areas (FTAs) with regional and extra-regional partners. Many more are in the works, including the possibility of a Free-Trade Area of the Asia Pacific between member states of APEC (Asia-Pacific Economic Cooperation). There have also been some initiatives in the area of financial cooperation, but these have been far less ambitious than the FTAs.

The financial turmoil that erupted in September 2008 (with the collapse of Lehman Brothers and the nationalization of large parts of the U.S. financial sector) has created significant challenges for Asian economies. The region was not heavily invested in the type of toxic assets that ceased to be sellable and exposed owners to deep losses in the West. But it has been dependent on external demand for economic growth, especially since the Asian crisis

> ***The financial turmoil that erupted in September 2008 has created significant challenges for Asian economies.***

of 1997–1998. As net creditors to the United States and to some other countries in the OECD (Organisation for Economic Co-operation and Development), Asian banks, businesses, and sovereign wealth funds also saw their balance sheets hurt by investments in securities in the developed markets. The crisis created a serious liquidity shortage, especially with respect to trade finance, which has only recently abated. Growth in the United States is picking up—with only an annualized 1 percent contraction in GDP (gross domestic product) in the second quarter of 2009, the best since the crisis hit—and there are signs that the recession in the euro zone and Japan has bottomed out. How rapid and sustainable the recovery will be are open questions. Still, prospects in summer 2009 are far rosier than they were six months earlier, when some doomsayers were predicting a prolonged global recession, perhaps even another depression.

How will this economic crisis affect the trend toward FTAs and various forms of financial cooperation in Asia? Will it bring the region closer together, as was arguably the case with the 1997–98 Asian crisis, or will it make cooperation more difficult and make the region's economies more globalization-shy? Many scenarios can be imagined. Nationalistic responses to the crisis could threaten deeper economic cooperation. But it is likely, given the motivation for regionalism in Asia, that the current crisis will enhance cooperation, both in the financial sector and the real sector (i.e., production outside the financial sector such as in goods or services). Economic cooperation is always complicated by special interests that may oppose it. This is especially true of the financial sector in developing countries, as liberalization and integration of financial markets are often greeted with suspicion. But the current financial shock triggered by the crisis in the United States has sparked a much keener interest in deepening regional cooperation even in financial areas. This effect should combine with the desire to enhance efficiency and competitiveness through FTAs and other forms of real-sector cooperation to overcome political obstacles to regionalism in Asia during the crisis and beyond. Nevertheless, potential risks will need to be addressed.

Will this economic crisis bring the region closer together, or will it make cooperation more difficult?

The next section of this paper gives a brief review of the Asian economy and its likely prospects in the short to medium term. This is followed by a summary of the motivations for regionalism in Asia and a review of the major existing agreements. Next, an exploration of how the current crisis might affect the trend toward regionalism argues that, while there are both positive and negative incentives, the benefits of regional cooperation are likely to win out.

The Global Economic Crisis and Prospects for Asia

The severe economic blow that Asia is enduring at present almost seems unfair. After the 1997–98 crisis, which was mainly homegrown, the region made significant progress in rectifying shortcomings in economic policy, particularly in the financial sector (Adams 2008). Asian banks did not participate in the risky behaviors of banks in the West (particularly in the United States) with their purchases of risky mortgage-backed securities, credit-default swaps, and other toxic assets, which brought down once-mighty U.S. investment banks and forced the United States and other countries to nationalize, de jure or de facto, large portions of their financial sectors.

After the earlier Asian crisis, national current account deficits[1] of 5–8 percent of GDP, considered unsustainable, were replaced by large current account surpluses, and the region became a large capital exporter. Savings rates remained high by global standards, but investment rates fell significantly; this in part reflected a decrease in speculation.[2] Foreign exchange reserves surged to levels that were more than sufficient to cover short-term debt in most countries and to sustain managed—but more flexible—exchange rates (Kawai 2007, Kreinin and Plummer 2008). While Asia had arguably been slower to adopt formal regional cooperation initiatives than other parts of the world, it made up for lost time after the 1997–98 crisis, with 120 bilateral, subregional, or plurilateral agreements under implementation or negotiation as of March 2009.[3] Unlike in most other regions where political imperatives often dominate, these arrangements are being used to enhance the competitiveness of the region's economies, promote best business practices, and make Asia more attractive to global production networks and fragmented trade (ADB 2008). Production networks refer to the organization of production processes within a single firm in the production of a good, and fragmented trade is a term used to describe the cross-border flows of inputs associated with these production networks.

Thus, it seems unjust that a region that returned to values of macroeconomic conservatism and prudence and cautious financial controls, and that adopted pro-market economic reforms in the real sector at various levels, should be sucked into a financial crisis that clearly originated in the West. It has led some to argue that, if this is what globalization entails, who needs it?

Certainly, globalization means that countries will be exposed to negative shocks originating elsewhere. Perhaps it was also not fair that Russia was so seriously affected by the Asian crisis, which it had nothing to do with, or that Thailand was hurt by the Mexican peso crisis (1994–95). Still, the literature is replete with studies showing that the long-run benefits of globalization outweigh the costs, even though these costs may sometimes be significant. The key is for economies to develop systems to adopt to these shocks and resist temptation to turn back the clock: rejecting globalization by adopting isolationist policies would be economically unwise in the short run and devastating in the long run.

In any case, Asian countries did play a part in the current crisis, though no doubt a minor and passive one. While economists did not anticipate the meltdown in its present form, they have drawn attention for many years to imbalances across the globe, with seemingly unsustainable current account deficits in some countries, such as the United States, Spain, and Portugal, and surpluses in others, such as oil-exporting nations, Germany, and most Asian countries.

There was a consensus prior to the financial meltdown that these imbalances could not be sustained indefinitely. While a U.S. current account deficit of 3 percent could be considered sustainable, it has been double that in recent years. How to reduce that deficit was highly controversial. Some authors (e.g., McKinsey Global Institute 2007 and Cline 2005) suggested that exchange-rate changes would be sufficient, while others were concerned about associated effects on income and output that could mitigate against the salutary influence of exchange-rate realignments, rendering the adjustment process extremely difficult (e.g., McKinnon and Schnabl 2006). Nearly everyone agreed that such an adjustment could not take place without commitment on the part of both debtor and creditor countries to engineering a "soft landing."

The lack of such cooperation is certainly a reason for today's ongoing "hard landing."

By relying on net exports rather than domestic demand for growth, Asian countries and others made it possible for the deficit countries to finance unsustainable spending binges. Another way of seeing the problem, articulated by Federal Reserve Chairman Ben Bernanke, is that the lack of domestic demand in Asian countries led to a "savings glut" with excess savings being generated due to lack of local investment opportunities and consumption. The excess savings, then, was naturally exported abroad, feeding the imbalance. Did the savings glut drive the process, as Bernanke suggested, or did the United States and other countries drive Asia to finance their over-consumption and investment, as many Asian economists argue? It would be extremely difficult to disentangle the causality, as each argument derives from the same macroeconomic identity—that is, two sides of the same coin—and identities by their very nature do not give information about causality. In any event, reliance on external demand certainly made the region more vulnerable to the current crisis.

By relying on net exports rather than domestic demand for growth, Asian countries and others made it possible for the deficit countries, especially the United States, to finance unsustainable spending binges.

That Asia has been hard hit in real terms is clear. Relatively moderate forecasts at the end of 2008 gave way to gloomier ones in the first quarter of 2009. Recently these forecasts have been revised upward for certain key countries, but the numbers are still fairly bleak. Table 1 summarizes the International Monetary Fund's (IMF's) projections for GDP growth and inflation, two key macro indicators, as of April 2009.[4] Obviously, the real sector has suffered in almost all countries: growth in developing Asia is expected to fall to less than 5 percent in 2009 from almost 8 percent in 2008. The IMF expects that growth will return to its pre-crisis trend only in 2011.

But these averages hide considerable variance across countries, and growth appeared to be rising well beyond expectations as of mid-2009,

Table 1. GDP Growth and Inflation Forecasts to 2011

	GDP Growth (%)[1]				Inflation (%)[2]			
	2008	2009	2010	2011	2008	2009	2010	2011
Country aggregates								
Developing Asia[3]	7.7	4.8	6.1	8.3	7.4	2.8	2.4	2.7
NIAEs[4]	1.6	-5.6	0.8	4.4	4.5	0.4	2.0	2.3
ASEAN-5[5]	4.9	0.0	2.3	4.3	9.2	3.6	4.5	3.6
European Union	1.1	-4.0	-0.3	1.7	3.7	0.8	0.8	1.1
United States	1.1	-2.8	-0.0	3.5	3.8	-0.9	-0.1	0.7
World	3.2	-1.3	1.9	4.3	6.0	2.5	2.4	2.6
Asian countries								
Japan	-0.6	-6.2	0.5	2.2	1.4	-1.0	-0.6	-0.2
China	9.0	6.5	7.5	10.2	5.9	0.1	0.7	1.5
Hong Kong	2.5	-4.5	0.5	3.8	4.3	1.0	1.0	1.5
Taiwan	0.1	-7.5	0.0	3.0	3.5	-2.0	1.0	1.5
South Korea	2.2	-4.0	1.5	5.3	4.7	1.7	3.0	3.0
Singapore	1.1	-10.0	-0.1	4.4	6.5	0.0	1.1	1.9
Brunei Darussalam	-1.5	0.2	0.6	1.3	2.7	1.2	1.2	1.2
Cambodia	6.0	-0.5	3.0	7.2	19.7	5.2	1.4	3.5
Indonesia	6.1	2.5	3.5	4.5	9.8	6.1	5.9	4.2
Lao PDR	7.2	4.4	4.7	7.5	7.6	0.2	2.6	4.0
Malaysia	4.6	-3.5	1.3	4.1	5.4	0.9	2.5	2.5
Myanmar	4.5	5.0	4.0	4.0	26.4	22.0	20.0	20.0
Philippines	4.6	--	1.0	3.8	9.3	3.4	4.5	4.5
Thailand	4.9	2.6	-3.0	1.0	2.2	5.5	0.5	3.4
Vietnam	6.2	3.3	4.0	5.5	23.1	6.0	5.0	5.0

Source: IMF 2009.
[1] Gross domestic product, constant prices (annual percent change).
[2] Inflation, average consumer prices (annual percent change).
[3] Developing Asia = Afghanistan, Bangladesh, Bhutan, Brunei Darussalam, Cambodia, China, Fiji, India, Indonesia, Kiribati, Lao People's Democratic Republic (PDR), Malaysia, Maldives, Myanmar, Nepal, Pakistan, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Thailand and Vietnam.
[4] NIAEs = newly industrialized Asian economies—Hong Kong, South Korea, Singapore, and Taiwan.
[5] ASEAN-5 = Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

suggesting that the IMF's April 2009 forecasts will be revised significantly upward in late 2009. The IMF expected Chinese growth to continue to be relatively strong (given the circumstances) at 6.5 percent in 2009, and this now seems conservative given the 7.8 percent growth rate reported in the second quarter of 2009 and new expectations of strong growth for the rest of the year.[5] Although the newly industrialized Asian economies (Singapore, Taiwan, Hong Kong, and South Korea) continued to endure a recession, in some cases severe, by mid-2009 they were recovering: the South Korean economy grew by an annualized rate of 10 percent in the second quarter, and the Singaporean economy grew by 20 percent; Taiwanese industrial output increased by an amazing 89 percent in the same quarter (Economist 2009). In ASEAN (Association of Southeast Asian Nations), the story is mixed: in mid-2009, Indonesia continued to grow in the 4 percent range, while Philippines growth was close to zero but still positive. However, first-quarter GDP growth estimates for Malaysia and Thailand of negative 6 percent and negative 7 percent, respectively, suggest that these economies are still mired in recession, though expectations are that, even in these economies, the recession has already hit its nadir.

In general, the larger a country's net exports in GDP, the more it has been affected by the global economic crisis. Given the important role played by net exports in the development process in these economies, this is not surprising. This reality has sparked a lively debate in Asia regarding the need to rebalance—that is, to focus more on domestic rather than external demand in national expenditures.[6] Rebalancing at the global level will require Asian and other current account surplus countries to focus more on internal demand (consumption, investment), while current account deficit countries do the opposite.

A lively debate has emerged in Asia regarding the need to rebalance—that is, to focus more on domestic rather than external demand in national expenditures.

On the positive side, Table 1 also reveals that the IMF expects inflation rates, which were uncomfortably high in 2008, to come down significantly for most economies in the region. As conservative monetary policies have been a hallmark of success in Asia, this is good news for the region's monetary authorities. It also will allow more room for monetary policy maneuvers should the recession last longer than anticipated.

The key question is: how long will the crisis last? If the IMF forecast and others are significantly revised every few months, their usefulness in the midst of a recession is questionable. Forecast models tend to rely excessively on recent trends and do a poor job projecting large shocks, let alone business cycles. Nonlinearities are difficult to model, so this shortcoming is understandable, but it is severe.

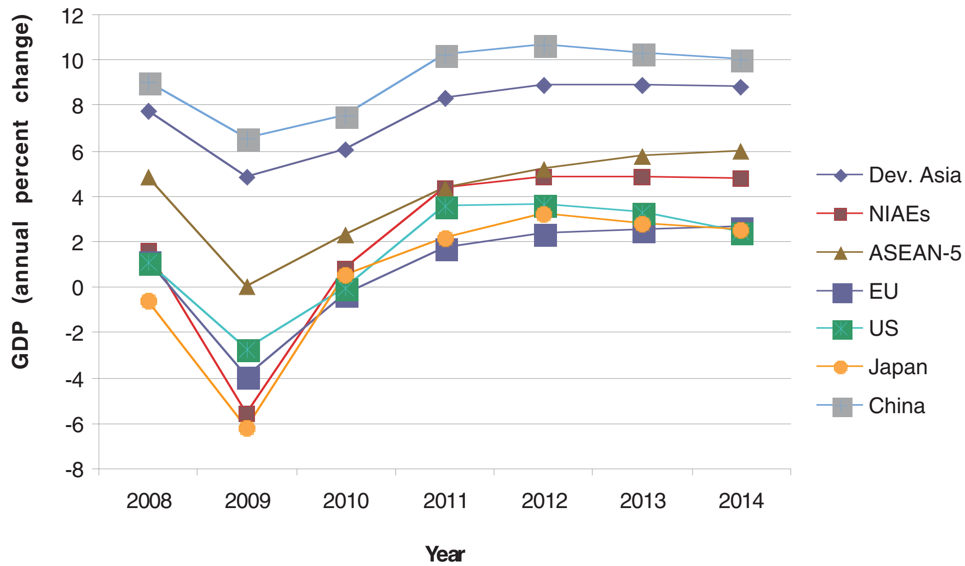
More insight may be gained from historical precedent. According to Claessons et al.'s (2008) IMF study, severe recessions in OECD countries from 1960–2007 had the following characteristics, measured from peak to trough:

1. Real-output contractions lasted about 4¾ quarters (similar to the Asian crisis).
2. Loss in GDP was 5 percent on average.
3. Housing and equity prices took 18 quarters and 12 quarters, respectively.

The U.S. recession began in December 2007 (according to the National Bureau of Economic Research, which tracks business cycles). According to the pattern identified above, it should have reached the trough by mid-2009. Indeed, consensus forecasts (e.g., surveys by the Wall Street Journal) suggest that the U.S. GDP will start to grow in the third quarter of 2009. Estimates for recovery in Japan and OECD countries in Europe are less optimistic. But at the time of this writing the prospect of a return to positive growth at the end of 2009 no longer seems like wishful thinking—2010 is likely to be a year of recovery.

Given recent trends, it is reasonable to conclude that the worst of the current crisis for the region, in terms of GDP growth, was in the fourth quarter of 2008 and the first quarter of 2009, and that the second quarter marked the beginning of the recovery. Reversion to pre-crisis growth trends, however, will likely take some time. The labor market in these economies will also take a long time to turn around; estimates are that unemployment in the United States, for example, will continue to rise into 2010 and could even rise to 10

Figure 1. Global GDP Forecasts to 2014



Source: IMF, World Economic Outlook, April 2009.

percent, though the rate in July 2009 had actually fallen slightly to 9.4 percent. Moreover, the need to rebalance the global economy is receiving greater attention as the immediate crisis becomes less dire. Rebalancing is arguably a necessary condition for sustainable growth, and it will pose significant challenges in terms of macroeconomic adjustments and economic cooperation.

Figure 1 shows a medium-term IMF projection of economic growth in Asia, broken down by regions and compared to the United States and the European Union (EU), through 2014. The IMF paints an optimistic picture of reversion to pre-crisis growth trends, with Asia returning to a steady state in 2012 of 5 percent growth in the newly industrialized Asian economies (Singapore, Taiwan, Hong Kong, South Korea), 6 percent growth in the ASEAN-5 countries (Indonesia, Malaysia, Philippines, Thailand, and Vietnam), and 9 percent growth in developing Asia.

Recovery is not automatic, and the duration of this economic cycle is not likely to be independent of policy choices. For example, if the world's economies were to make the same mistakes that were made during the 1930s, in terms of closing their economies to trade as a way of boosting domestic output, this would no doubt prolong and deepen the recession. Fortunately, the world's leaders have resisted protectionist pressures, though sometimes in trade policy the spirit is willing but the political flesh is weak.[7]

Stimulus packages in the United States and many Asian countries are helping to bring their respective economies out of the recession, with positive spillovers to the rest of the world. But the lack of coordination between these stimulus packages, and the reluctance of some major economies (particularly in Europe) to embrace more than a superficial stimulus, is disappointing given the degree of economic interdependence (Petri and Plummer 2009). Lack of cooperation to no small degree got us into this mess; cooperation will help get us out of it.

Lack of cooperation to no small degree got us into this mess; cooperation will help get us out of it.

Table 2 gives the IMF's estimates of fiscal stimulus packages provided by the G-20 in order to fight the economic crisis. Clearly, there is considerable variation across countries. The euro-zone countries have all delivered less than the G-20 average. China, Japan, and South Korea all exceeded the average in 2009, while India and Indonesia offered significantly less. Such a result is to be expected, however, given their respective budget problems and the fact that these two economies continued to grow throughout most of the crisis.

Returning to robust growth has been the highest priority during the crisis, but we now seem to be emerging from the worst of it, and setting the stage for a sustainable recovery needs to be a high priority. This will require global rebalancing, which will require, among other things, greater cooperation and coordination in the areas of monetary policy, exchange-rate policy, prudential and supervisory approaches to global finance, and trade policy. These areas are all characterized by significant policy externalities that make cooperation especially important. The rest of this paper focuses on Asian economic cooperation and how the crisis itself and lessons learned from it are likely to affect the ongoing trend toward regionalism.

Factors Influencing Regionalism in Asia Before the Crisis

The many economic motivations for regionalism in Asia have been discussed extensively (see, for example, ADB 2008 and Plummer 2009

Table 2. Stimulus Packages of G-20 Economies, 2008–2010 (% GDP)

	2008	2009	2010
Argentina	0.0	1.5	—[1]
Australia	0.7	2.1	1.7
Brazil	0.0	0.6	0.8
Canada	0.0	1.9	1.7
China	**0.4**	**3.1**	**2.7**
France	0.0	0.7	0.8
Germany	0.0	1.6	2.0
India[2]	**0.6**	**0.6**	**0.6**
Indonesia	**0.0**	**1.3**	**0.6**
Italy	0.0	0.2	0.1
Japan[3]	**0.3**	**2.4**	**1.8**
Korea	**1.1**	**3.9**	**1.2**
Mexico	0.0	1.5	—[1]
Russia	0.0	4.1	1.3
Saudi Arabia	2.4	3.3	3.5
South Africa[2, 4]	1.7	1.8	-0.6
Turkey[5]	0.0	0.8	0.3
United Kingdom	0.2	1.4	-0.1
United States[6]	1.1	2.0	1.8
G-20 PPP-GDP weighted average	0.5	2.0	1.5
G-20 discretionary impulse[7]	0.5	1.5	-0.5

Source: IMF staff estimates.

Note: Figures reflect the budgetary cost of crisis-related discretionary measures in each year, compared to a 2007 baseline, based on measures announced through mid-April. They do not include "below-the-line" operations that involved acquisition of assets.

[1] No information available.

[2] Fiscal year basis.

[3] Based on preliminary analysis, financial-sector-related measures of 0.1 percent of GDP in 2008, 0.5 percent of GDP in 2009, and 0.2 percent of GDP in 2010 are excluded. These measures cover both subsidies to and capital injections in public fina

[4] Stimulus estimates are based on the FY 2009/2010 budget.

[5] Includes only discretionary measures taken from September 2008 through March 2009. Another fiscal stimulus package is reportedly under preparation.

[6] Excludes cost of financial system support measures (estimated at 1.4 percent of GDP in 2008, 4.5 percent of GDP in 2009 and 0.9 percent of GDP in 2010).

[7] Change from the previous year.

and sources cited therein). Regionalism could be summarized as a function of the perceived need to enhance Asian competitiveness in the global economy. Arguably, such a goal can be reached only through policy initiatives at the national, global, and regional levels. At the national level, macroeconomic conditions conducive to growth, such as sustainable debt and low levels of inflation, are essential, as are policies that remove obstacles to economic interaction, improve competition and transparency, promote best practices in the private sector, and erect appropriate institutions. At the global level, open, fair, and vibrant markets are also essential, a fact that gives the region's economies a strong incentive to support the World Trade Organization (WTO) and its Doha Development Agenda. And at the subregional and regional levels, economic cooperation offers the opportunity to improve competitiveness by lowering obstacles to economic interaction, opening up new markets, and creating a more attractive market for international productive networks and fragmented trade, which have become so important in driving the competitiveness of the region (see, for example, Ernst 2008). Moreover, through closer macroeconomic consultation and coordination, joint approaches to developing local financial markets (e.g., through the Asian Bond Fund initiatives that pool reserves to purchase debt instruments denominated in local currency), regional liquidity facilities that allow countries to tap additional resources in times of crisis (e.g., the multilateralization of the Chiang Mai Initiative), and the creation of regional financial markets that permit cross-border issuance of securities, the region can internalize externalities associated with finance, enhance intermediation, increase stability, and lower the cost of capital. These issues are discussed below.

To understand regionalism in Asia, one must keep in mind the overriding importance of improving competitiveness, which in turn requires a multifaceted approach to economic cooperation. It is possible

To understand regionalism in Asia, one must keep in mind the overriding importance of improving competitiveness, which in turn requires a multifaceted approach to economic cooperation.

to identify both general and Asia-specific economic factors that have influenced the regionalism movement thus far. Political and political-economy-related factors also play a key role.

General Factors

Factors applicable to the FTA movement as a whole include market-restoring and sector-expanding motivations that apply primarily to developed countries, as well as the Doha Development Agenda.

Market-Restoring and Sector-Expanding Motivations

As the twenty-first century began, almost all developed countries were embracing discriminatory trading arrangements with potential trade- and investment-diverting implications for Asia. Europe had been implementing deeper regional initiatives between its member states and former colonies for about a half century. However, European integration deepened substantially beginning in the 1990s—from the Single Market Programme to a monetary union that has grown into a euro zone of 16 members—and has expanded to include transitional economies that could potentially compete with Asia in terms of trade and investment. The United States had few preferential trading arrangements before 2000, but since then bilateral FTAs have become an important part of its commercial policy, and they continue to be a major force today. Menon (2007) suggests that the motivation for this is *market restoring*.

This consideration becomes more important as globalization expands. Consumer-goods demand in developed countries is leading much of the fragmented trade taking place in Asia (ADB 2008, Ernst 2008). If the United States and the EU create FTAs from which Asian economies are excluded, rules of origin exigencies in these accords, for example, could have an important bearing on MNC intermediate-input sourcing strategies. Particularly since the WTO has not yet been able to reach agreement on the Doha Development Agenda, discriminatory trading arrangements giving preferential treatment to Asia's competitors increase the incentive for the latter to use FTAs to preserve their status in the production chain and restore market access.

Another effect of this trend is the perceived success of deeper integration, particularly "behind the border" liberalization and facilitation that can improve competitiveness and reduce transaction costs associated with production fragmentation. This was especially evident in the case of the EU Single Market Programme, but also in the case of the North American Free Trade Agreement (NAFTA), which was only an FTA but had extensive "new age" aspects, including national treatment for investment. Menon (2007) refers to this as sector expanding.

Doha Development Agenda

An incentive for FTAs in Asia is the need for the type of deep integration that the WTO has not been able to deliver (and probably will not in the short to medium term). In order to facilitate the construction of production networks and profit from the process of fragmented trade, obstacles to trade and investment need to be removed, and an FTA between two or more like-minded countries is easier to achieve than agreement in the context of the WTO. While a successful Doha agreement would reduce the potential negative effects of regionalism, generate important welfare benefits,[8] and help to knit the global economy together, it would not stem the growth of FTAs, especially in Asia. East Asian countries have a deeper integration agenda than could ever be expected to emerge out of the WTO. The economic-development strategy of Asia is predicated on outward orientation, and the deep integration measures associated with FTAs appear to be a more effective means of advancing globalization at present.

China has a unique role in regionalism in Asia. Joining the WTO in December 2001 was a major event for that country and for the global trading system as a whole. China has become one of the most important trading countries in the world and has emerged in a relatively short period of time. That, coupled with its sheer size and potential, has created considerable nervousness in developed and developing countries alike. This has important implications for the WTO as well. As a WTO member, China has had to reduce its trade barriers significantly.[9] But its membership has caused some other WTO members to be cautious about offering too much in terms of trade liberalization out of fear of increasing Chinese competitiveness in their domestic markets.

Joining the World Trade Organization in December 2001 was a major event for China and for the global trading system as a whole.

For example, this was explicitly noted as a motivation for Brazil's initiation of FTA negotiations with the EU.[10] This could be one reason why there is less effort being devoted to the Doha negotiations. If this trend becomes significant, it would also be detrimental to future WTO prospects. It would be supremely ironic if, once China was brought into the WTO fold, the WTO itself was obstructed in order to isolate China.

Asia-Specific Factors

Asia-specific factors affecting the FTA movement include bilateral FTAs negotiated by ASEAN member countries leading to the need for deeper cooperation and the emergence of China.

Bilateral FTAs and ASEAN Members

As ASEAN itself is only an FTA (as opposed to a customs union, which would create a common external tariff), individual members have the right to pursue their own FTAs with non-ASEAN partners. This poses a perceived threat to ASEAN integration, since some of these FTAs are even deeper than existing accords within ASEAN itself. Through deeper integration and cooperative initiatives, however, ASEAN can ensure its integrity even in the face of these external ties. In addition, the political economy of FTAs is such that ASEAN as a group can create better outcomes in negotiations than individual countries can. But to negotiate as a group, deep integration is necessary. The idea of an ASEAN customs union has been considered in the past and is gaining more attention as steps to achieve an ASEAN Economic Community (AEC) "single market and production base" by 2015 are implemented based on the 2007 AEC Blueprint.[11]

China and India

Concerns associated with the emergence of China and India have become increasingly acute since the Asian crisis of 1997–98. In fact, a key motivation for creating the AEC is to compete with China and India: an integrated market will be at less of a disadvantage in terms of size and will be able to enjoy economies of scale in production fragmentation, a more efficient regional division of labor, and other "dynamic" features of

A key motivation for creating the AEC is to compete with China and India.

integration that will enhance its attractiveness to foreign investors and its competitiveness in local and third markets.

Political Factors

Policy by its nature is political, and political factors play an important role in regionalism. The selection of FTA partners tends to be political, with economics often having an important but secondary influence. The United States has myriad FTAs with countries that have little importance to it economically but considerable political importance (such as Morocco, Caribbean countries, Jordan, and Bahrain). Mexico is an important economic partner, but the politics behind NAFTA—including immigration, support for domestic economic reform in Mexico, and narcotics issues—were extremely important in the U.S. debate on NAFTA, and the agreement continues to be controversial for political reasons. Indonesia is negotiating a Comprehensive Trade and Economic Partnership agreement with Iran, though it trades little with that country. The Economic Cooperation Organization[12] has a trade agreement in place in spite of the fact that intraregional trade is less than 10 percent of members' total trade. Even the European Economic Community (EEC) and subsequent economic initiatives have had strong political dimensions; the EEC emerged in the late 1950s after efforts at political integration—including a common defense policy—failed. The economic union has served in part to make up for the lack of political union in developing relations with third countries, particularly since it is arguably the only unified policy that the EU has had.

In short, while there are many regional accords in which the economics make less sense than the politics, it would be extremely difficult to find examples of the opposite. No FTA exists between the Northeast Asian economies of Japan, China, and South Korea, though there would certainly be large economic benefits. Politics have imposed constraints that are only now beginning to soften.

While there are many regional accords in which the economics make less sense than the politics, it would be extremely difficult to find examples of the opposite.

ASEAN began as a political organization. It was founded in 1967, as the Chinese Cultural Revolution and the war in Indochina created a need for closer political cooperation. No summit meeting was held until 1975, when the North Vietnamese army captured Saigon and fears of Communist expansion were common throughout the region. ASEAN succeeded in presenting a united front at that time, particularly in its opposition to Vietnam's 1978 invasion and occupation of Cambodia. The ASEAN meeting of foreign ministers has always been the most important regional body.

When the Cold War ended in the late 1980s, some predicted the end of ASEAN, saying that without an external threat to provide political glue it would not hold together. But the region moved forward on economic cooperation—beginning with ASEAN Free Trade Area (AFTA) in 1992—arguably to no small degree because of the need to support political relations and sustain the integrity of ASEAN. The ASEAN Charter went into effect in December 2008. The Treaty of Amity and Cooperation, signed in 1976 and amended several times since then, now even has 16 signatories from outside ASEAN (including the United States, which joined in July 2009). And two out of the three pillars of the ASEAN Community—the ASEAN Security Community and the ASEAN Socio-Cultural Community—are essentially noneconomic in nature.

Mainly due to political considerations, ASEAN forms the core of regional cooperation efforts in Asia. The ASEAN Regional Forum, established in 1993 to foster dialogue on political and security matters, includes among others the ASEAN member states, the EU, the United States, Russia, and Northeast Asian states (including North Korea), and constitutes the region's premier consultative forum.[13] All expressions of ambitious pan-Asian cooperation schemes, including the ASEAN+3 and ASEAN+6/East Asian Summit, have ASEAN at their core. Although China and Japan dwarf ASEAN in terms of size, there exist only ASEAN+1 FTAs between ASEAN and the two Northeast Asian giants and no FTA between the latter.

In sum, it would be difficult if not impossible to explain the growth in Asian regional accords without reference to the key political role played by ASEAN. But like in the case of the EU Single Market Programme, economic incentives are being used to overcome political constraints to economic cooperation. Given the potential benefits of economic cooperation, the cost of these political constraints has been rising.

It seems likely that political relations in Asia will constrain the growth of regional cooperation agreements, but that the economic demands of the modern, globalized economy will help the region to relax these constraints. In fact, the growth in economic cooperative forums, even those that have yet to deliver significant results—e.g., the ASEAN+3 and ASEAN+6 processes—are no doubt helping to reduce resistance to deeper economic cooperation, including in Northeast Asia. Five years ago, it would have been difficult to envision any FTA between China, Japan, and South Korea, regardless of the potential economic benefits. Today, it is far more probable, though it will likely still require a good deal of time before there are "+3" FTAs. Under a new administration, even Taiwan is considering the possibility of an FTA with China. Changes in Asia are improving the prospects for deep, comprehensive regional economic cooperation accords throughout the region.

Real- and Financial-Sector Cooperation in East Asia

An in-depth review of the many FTAs in Asia is beyond the scope of this paper, and many excellent surveys already exist.[14] But it is clear that the pace of Asian integration has quickened considerably over the past decade. ASEAN cooperation, for example, took off with AFTA and is being implemented at the same time that its member-countries are establishing FTAs with non-ASEAN partners. ASEAN itself is implementing an FTA with China and has recently signed agreements with Japan, Australia and New Zealand, South Korea, and, most recently (August 14, 2009), India.

Real-Sector Cooperation

The deepest accords that have been negotiated by Asian countries tend to be with developed countries, in particular the United States and Japan. The U.S.-Singapore FTA, for example, is being used as a model for other FTAs with ASEAN member states under the Enterprise for ASEAN Initiative. It has the usual characteristics of a "new age" FTA, including chapters stipulating WTO-plus features in IPR and FDI; government procurement; e-commerce; technical barriers to trade; environment and labor; and financial services, telecommunications, and cross-border services.[15]

Moreover, given that bilateral and regional FTAs in Asia are outward-oriented in nature, it is only natural that attempts to integrate them at the regional level would emerge. This is beginning to happen in the fledgling ASEAN+3 meetings and the East Asian summits. While little concrete progress has been made, the fact that these forums are being established is significant. Such initiatives may even extend outside of Asia to include the Asia-Pacific region as a whole, either under the rubric of APEC or independently. Indeed, there have been recent proposals to establish a Free-Trade Area of the Asia-Pacific, a concept that is advocated by the APEC Business Advisory Council among others. The EU began setting the stage to launch FTA negotiations with ASEAN and other regional economies in 2007 and is currently in formal negotiations with ASEAN.

In East Asia, as noted above, all accords revolve around ASEAN; agreements between East Asian countries all include ASEAN member states or ASEAN itself. Table 3 enumerates the FTAs that East Asian ecomonies have concluded or are negotiating or that have been proposed as of August 2009.

Almost none of these agreements were in existence prior to 2000; clearly, ASEAN member states have been active in the regionalism movement. Singapore has been the most active, with 13 agreements at various phases of implementation, followed by Thailand with eight. In addition, Singapore has by far the most FTAs with extraregional countries (five), whereas Brunei Darussalam, Indonesia and Malaysia each have one and the others do not have any. ASEAN itself has three accords in place (all within the Asia-Pacific) and four are under negotiation. Northeast Asia has also been quite active, particularly Japan and China. In addition, India and South Korea have several accords in place. The most important agreement that South Korea has signed is with the United States, but the ratification of that accord was still delayed as of this writing in the new U.S. Congress. South Korea is also at an advanced stage of negotiations with the EU.

Clearly, ASEAN member states have been active in the regionalism movement.

The fact that the more developed ASEAN members, such as Singapore and Thailand, are more active in negotiating FTAs is no doubt linked to their superior trade-negotiation capacity and pressures from their outward-oriented private sectors. Less developed ASEAN

Table 3. Major FTAs Including Countries in East Asia as of August 2009

	Implemented (year)	**Signed (year)**	**Under Negotiation**	**Under Consideration**
ASEAN	China (2005)	India (2009)	Australia	ASEAN+3
	Japan		New Zealand	ASEAN+6
	Korea (2007)		EU	
China	ASEAN (2005)	Singapore (2008)	Australia	Costa Rica
	APTA		GCC	India
	New Zealand		Iceland	Japan and Korea
	Chile (2006)			Korea
	Hong Kong (2004)			Norway
	Macao (2006)			Peru
	Pakistan			South Africa
	Thailand			
Korea	ASEAN (2007)	United States (2007)	Australia	GCC
	APTA		India	Mercosur
	Chile (2002)		Japan	Peru
	EFTA (2006)		Canada	South Africa
	Singapore (2006)		EU	Thailand
			Mexico	Malaysia
			New Zealand	China and Japan
				China
Japan	ASEAN	Vietnm (2008)	Australia	Canada
	Brunei Darussalam		GCC	China and Korea
	Chile		India	
	Indonesia		Korea	
	Malaysia (2006)		Switzerland	
	Mexico			
	Philippines			
	Singapore (2002)			
	Thailand			

Table 3. Continued

	Implemented (year)	Signed (year)	Under Negotiation	Under Consideration
Philippines	ASEAN			Pakistan
	Japan			United States
Thailand	ASEAN		India	Korea
	Japan		Bay of Bengal	Pakistan
	Lao PDR		Bahrain	Chile
	China		Peru	Mercosur
	Australia (2006)		EFTA	
	New Zealand (2005)		United States	
			Peru	
Singapore	ASEAN	China (2008)	Canada	Sri Lanka
	EFTA (2003)	GCC (2008)	Pakistan	United Arab Emirates
	India (2005)	Peru (2008)	Egypt	
	Japan (2002)		Kuwait	
	Korea (2006)		Mexico	
	New Zealand		Qatar	
	Australia (2003)		Ukraine	
	Jordan (2005)			
	Panama (2006)			
	United States (2004)			
	Trans-Pacific			
Malaysia	ASEAN	G-8 (2008)	Australia	Korea
	Japan (2006)		Chile	
	Pakistan		India	
			New Zealand	
			United States	
			Islamic Conference	
Indonesia	ASEAN	G-8 (2008)	Pakistan	India
	Japan			Australia

Table 3. Continued

	Implemented (year)	Signed (year)	Under Negotiation	Under Consideration
Indonesia *continued*				EU
				United States
Taiwan	Taiwan		Dominican Republic	United States
	Guatemala		Paraguay	
	Nicaragua			
	Panama			
	El Salvador			
	Honduras			
India	APTA	Afghanistan (2008)	ASEAN	Australia
	Bhutan	Chile (2006)	Bay of Bengal	Colombia
	Singapore (2005)	Mercosur (2005)	Egypt	Indonesia
	Sri Lanka		EU	Israel
	Nepal		GCC	Russian
	South Asian		Korea	Uruguay
			Mauritius	Venezuela
			Japan	New Zealand
			Malaysia	China
			South Africa	
			Thailand	
Vietnam	ASEAN	Japan (2008)	Chile	
Hong Kong	China (2004)		New Zealand	
Cambodia	ASEAN			
Myanmar	ASEAN		Bay of Bengal	
Lao PDR	ASEAN			
	APTA			
	Thailand			

Source: Asia Regional Integration Center.

Notes: APTA = Asia-Pacific Trade Agreement; GCC = Gulf Cooperation Council; EFTA = European Free Trade Association; ASEAN+3 = ASEAN plus China, Japan, and Korea; ASEAN+6 = ASEAN+3 plus Australia, New Zealand, and India; G-8 = Group of Eight; Mercosur = Mercado Común del Sur; Islamic Conference = Organization of the Islamic Conference. Trans-Pacific Strategic Economic Partnership Agreement (2005). Countries (in addition to Singapore) are: New Zealand, Brunei, and Chile.

members, especially the transitional members, tend to rely on AFTA- and ASEAN-negotiated FTAs (e.g., the ASEAN-China and ASEAN-Korea FTAs).

Financial-Sector Cooperation

Until recently, the literature on regionalism in Asia has focused much more on trade cooperation than financial and monetary cooperation. However, since the 1997–98 crisis, the latter issues have received a higher priority. For example, in December 1999, the ASEAN heads of government concentrated on the need to move toward greater regional cohesion and economic integration, as expressed in the ASEAN Vision 2020 statement. In this document they pledged, among other things, to maintain regional macroeconomic and financial stability through closer cooperation on monetary and financial policies. The next year in Vietnam they agreed to the Hanoi Plan of Action, which calls for (1) maintenance of financial and macroeconomic stability; (2) strengthening of the financial systems; (3) liberalization of financial services; (4) intensification of cooperative efforts in monetary, tax, and insurance matters; and (5) development of ASEAN capital markets.

The perceived need for closer financial cooperation will no doubt rise given the nature of the global economic crisis.

The perceived need for closer financial cooperation will no doubt rise given the nature of the global economic crisis. Emerging initiatives can be divided into two categories: exchange-rate management and financial and monetary cooperation.

Exchange-Rate Management

Exchange-rate regimes in Asia differ widely, from various degrees of managed floats (e.g., most ASEAN countries, Japan, and South Korea) to hard pegs (e.g., China and Hong Kong).[16] However, they all have one common characteristic: the U.S. dollar is the explicit or implicit reference currency or anchor. In reviewing the evolution of the roles of the U.S. dollar, yen, and euro in East Asia, Kawai (2002) notes that the U.S. dollar was either the de facto or de jure anchor in the region's economies prior to the 1997–98 crisis. This role declined during the crisis but was generally resumed afterward. Still, its importance diminished in certain countries (e.g., Indonesia), and there has been greater flexibility in exchange-rate management. Today the role of the dollar continues to be prevalent, but there have been indications over the past few years, as its value plummeted, of certain strains. A desire to diversify is clearly evident. Some countries (e.g., China) have announced explicit reserve diversification strategies. Thailand in December 2006 even briefly imposed capital controls in order to prevent further appreciation of the baht against the dollar, reflecting problems associated with continued sterilization[17] of foreign exchange interventions over a long period of time. (Holdings of U.S. dollars by the region's central banks are at historic highs.) The current crisis will no doubt increase the motivation for diversification; while the dollar is seen as a safe haven for the time being, once the crisis begins to turn around, there will be a strong incentive in Asia to reduce reliance on it (as well as on the U.S. market in general).

While the dollar is seen as a safe haven for the time being, once the crisis begins to turn around, there will be a strong incentive in Asia to reduce reliance on it.

There continues to be a strong appetite in the region for proposals regarding exchange-rate management and cooperative arrangements, even if there has been little or no concrete progress in this regard at the policy level. Arguably, this desire relates to problems associated with the Asian crisis of 1997–98. The "contagion effect" of the crisis, which began in Thailand on July 2, 1997, and quickly spread to Malaysia, Indonesia, Philippines, South Korea, and even Hong Kong, took the region by surprise. Such contagion had been considered unlikely, given the relatively low levels of trade integration between the affected economies at the time, but it was devastating.

Kim, Kose, and Plummer (2001) separate types of contagion into several categories, with bilateral real integration just being one (and a small part of it).[18] Others include competition in third markets;[19] *financial contagion*, which relates to international investors' behavior during a crisis; and *pure contagion*, involving herd behavior, and the like. Kim et al. (2001) argue that all these factors played a role in the

1997–98 crisis. Arguably, these same contagion factors have been instrumental in the current crisis as well.

For Asian policymakers, this contagion clearly underscored the externalities associated with macroeconomic and financial policies in an increasingly integrated region. This understanding has given birth to a variety of approaches, discussed below, intended to endogenize at least in part these externalities. The presence of contagion at higher levels of integration reinforces arguments in favor of monetary union, a topic discussed elsewhere in the literature.[20]

Financial and Monetary Cooperation

The first initiative toward financial and monetary cooperation in East Asia was the original Miyazawa Plan, initiated by Japan during the Asian crisis to create an Asian Monetary Fund to supplement the IMF. It was opposed by the IMF and the United States, but eventually led to the establishment of currency swap arrangements among East Asian countries (basically bilateral swaps between Japan and other individual countries) during the annual meeting of the Asian Development Bank in May 2000 (the Chiang Mai Initiative).[21] These swaps have grown in terms of nominal values to about $85 billion in 2008. In May 2009, the Chiang Mai Initiative was formally multilateralized and expanded to $120 billion as the Asia Fund.

There have also been proposals to integrate capital markets in the region, from closer coordination of existing national capital markets to more ambitious suggestions such as the creation of supranational regional bond and stock exchanges. The main issues relate to cooperation as opposed to capital market development more generally, although one motivation for integration is typically to foster development of the market.

Interest in stock market integration arises primarily because financial theory suggests that an integrated regional stock market is more efficient than segmented national capital markets. Capital market efficiency in Southeast Asia has become even more important since the Asian crisis, as Southeast Asian countries have sought to reduce the traditional dependence of firms on bank loans rather than bond and stock issuances.

With an integrated regional stock market, investors from all member countries would be able to allocate capital to the locations in the region where it can be the most productive. With more cross-border flows of funds, additional trading in individual securities would improve the liquidity of the stock markets, which would in turn lower the cost of capital and the transaction costs of investments, thus allowing a more efficient allocation of capital within the region. It would also help in rebalancing Asian economies by stimulating investment and consumer spending by lowering interest rates.

From the perspective of an investor outside the region, stock market integration would bring separate markets closer together and give them high correlations of stock-price movements, so there would be less benefit from portfolio diversification across countries. However, it would make investment in the region easier and more justifiable. As shares become more liquid and transaction costs fall, fund managers become increasingly willing to buy stocks. In addition, some outside investors might take notice of a regional stock exchange when they would have dismissed a collection of small national exchanges—the whole might be greater than the sum of its parts. Click and Plummer (2005) find evidence of a trend toward closer integration of the original ASEAN-5 stock markets, which would bode well for the creation of a regional market. Candelon, Piplack, and Straetmans (2006) come to the same conclusion; they consider five different Asian economies (Malaysia, Thailand, Taiwan, Singapore, and South Korea) and find increased joint movements of these stock markets during periods of boom and bust, with a common break in 1997 (which can only be interpreted as an effect of the Asian crisis).

With an integrated regional stock market, investors from all member countries would be able to allocate capital to the locations in the region where it can be the most productive.

The development of bond markets is a natural priority in the region—given the need to finance growing government deficits, robust demand for infrastructure projects, and ambitious business plans by many private-sector companies—but also a major challenge. Bonds are important as an additional financial vehicle; firms may wish to raise medium- and long-term financial capital without relinquishing more control of the firm. Bonds can also function as a complement to stocks (or vice versa). ASEAN governments in particular have recognized that a stronger and larger local bond market can be strong protection against maturity and currency "mismatches."[22] While ASEAN launched a study on the possibility of creating an ASEAN bond market in 2002–2003, the idea was essentially put on the back burner in favor of the ASEAN+3 framework, which would include the major financial players in Asia. For example, the December 2002 Asian Bond Markets Initiative established a small but growing bond pool under the auspices of the Bank for International Settlements (BIS) (discussed below).

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Financial Cooperation Initiatives

Until the current financial crisis, financial and monetary cooperation in Asia had nonetheless remained at the conceptual stage. Even the most successful cooperative effect, the Chiang Mai Initiative (CMI), is relatively lacking in ambition if one considers that the multilateralized version of the CMI (discussed above) totals $120 billion (as of May 2009) and will be drawn from reserves that are currently at about $4 trillion. But the economics seem to support such initiatives, and the outbreak of the financial crisis in September 2008 has prodded Asian leaders to move more gingerly in this area. The Asian finance ministers reportedly also want to create a multilateral stabilization fund, which could grow to $350 billion, or 10 percent of current regional reserves (Head 2008). This is far more than the IMF has at its disposal. Still, many questions remain about how such a fund would be technically managed, what type of conditionality (i.e., policy and other conditions required for the loan) would be involved, who would be the leaders, and how it would relate to the IMF.

Several other forums in the region deal with financial and monetary cooperation. The Executives' Meeting of the East Asia and Pacific Central Banks (EMEAP) is a forum of regional central banks whose goal might be characterized as developing an "Asian Bank of International Settlements BIS" (Hamanaka 2009). It meets semiannually and is mainly a forum for dialogue, exchange of information, and other technical matters. It does not have a formal secretariat.

Under the aupices of the EMEAP, the first Asian Bond Market Fund was launched in June 2003 with an investment of $1 billion in Asian bonds (de Brower 2005). This was followed by a second Asian Bond Market Fund, which was created in 2005 and invested in local-currency-denominated bonds with initial funding of $2 billion. The Asian Bond Market Funds are managed by the BIS and are funded by the central banks that are members of the EMEAP. While its value is small compared to the foreign-exchange reserves in the region, this fledgling process constitutes an interesting initiative particularly in its purchasing of local-denominated bonds and its attempt to mitigate problems inherent in developing countries having to borrow money denominated in foreign currency (known in international finance as the "original sin" problem).

The ASEAN+3 and APEC Finance Ministers' Meetings have also emerged in recent years. Established in the wake of the Asian crisis, the ASEAN+3 Finance Ministers' Meeting focuses on financial-sector cooperation, surveillance (including monitoring of capital flows), and policy dialogue. The CMI was developed as part of these meetings, as was the Asian Bond Market Initiative. The CMI framework was integrated in May 2005 with the Economic Review and Policy Dialogue, which had been developed mainly to strengthen cooperation in the area of regional surveillance and to foster dialogue on global, regional, and national economic developments.

The APEC Finance Ministers' Meeting was first convened in 1994; it has since been renamed the APEC Finance Ministers' Process. It provides an annual forum for APEC member economies to exchange views and information on regional macroeconomic and financial developments and on national and regional policy priorities. Partners include the Asian Development Bank, the Inter-American Development Bank, the World Bank, and the APEC Business Advisory Council.

In short, there exist a number of forums in the Asia Pacific region dedicated to dialogue, exchange of information, and technical interaction. However, concrete initiatives in the form of applied financial cooperation are less impressive, with the exception of the CMI. With the global economic crisis, a greater demand for cooperation and coordination, including in the areas of financial surveillance and regulatory cooperation, has emerged. For example, an Asian Financial Security Dialogue, which would include finance ministry and central bank officials, financial regulators and supervisors, and market participants, was proposed by Asian Development Bank President Haruhiko Kuroda in September 2008. While its details have not yet been worked out, current thinking is that it would develop an early warning system for the region's financial markets.

ASEAN and the ASEAN Economic Community

The ASEAN economic cooperation experience in many ways reflects the movement from market-led regional integration (or "regionalization") to regionalism in Asia. While economic deepening has been gradual, its pace has quickened and has been focused on the need to use regionalism as a means of supporting market-led integration.

Founded in 1967, ASEAN is the most advanced institution of regional cooperation in Asia and one of the oldest. At first, its goals were mainly political. In particular, it sought to promote peace in what was then a volatile region. While the early diplomatic initiatives did not directly promote economic cooperation, the peace and security they achieved paved the way for economic growth and development throughout Southeast Asia. It also allowed for a stable environment in which to promote economic reform.

ASEAN did not attempt any significant economic cooperation initiatives until the new, post–Cold War political environment emerged at the end of the 1980s, as discussed briefly above. Its first major initiative was AFTA, which was established in 1992 and originally only called for trade in manufactured goods to be liberalized over a 15-year period. But its scope was subsequently broadened and the implementation period shortened so that it was technically in full effect at the beginning of 2004 for the original five ASEAN countries and Brunei Darussalam (ASEAN-6), although there are transitional periods for some products that are on temporary exclusion lists. The transitional ASEAN countries

(Cambodia, Lao PDR, Myanmar and Vietnam) have been given additional time to implement their respective AFTA commitments.

ASEAN has also made important strides in the area of investment cooperation, e.g., in the form of ASEAN "one-stop investment centers," that is, streamlined bureaucracy and all required permits obtainable under the same roof, the ASEAN Investment Area (AIA), and most recently (March 2009) the ASEAN Comprehensive Investment Area (ACIA). As part of the AEC process, the ACIA will supercede other existing FDI-related agreements (including the AIA). It will do the following: (1) offer benefits to both ASEAN and non-ASEAN MNCs based in ASEAN countries on the same timeline (rather than giving an advantage to ASEAN investors), underscoring the accord's focus on "open regionalism";[23] (2) reduce costs associated with transborder FDI in ASEAN; (3) solicit more (and more regular) input from the private sector; and (4) provide an Investor-to-State Dispute Settlement process. As most MNCs in ASEAN are from nonmember countries, and ASEAN countries are actively courting FDI, legislation is emerging or in place in a number of member countries that would treat all investors as national companies. Singapore, for example, already has such legislation in place.

In November 2002 in Phnom Penh, the ASEAN heads of government proposed that the region should consider the possibility of creating the ASEAN Economic Community (AEC) by 2020. In the 2007 Cebu Declaration, the ASEAN leaders not only formalized this commitment but pushed up the deadline to 2015. The action plan for implementation was published as the AEC Blueprint in November 2007. The ASEAN Charter, which went into effect in December 2008, makes ASEAN an international legal entity—arguably a necessary step in order to deepen integration as substantially as the AEC requires.

The primary goal of economic integration in ASEAN is to reduce transaction costs associated with economic interchanges and to make the region more attractive to multinational corporations.

The primary goal of economic integration in ASEAN, as articulated by its leaders, is to reduce transaction costs associated with economic interchanges and to make the region more attractive to MNCs wishing to take advantage of its diversity and openness in rationalizing production networks. In this sense, it both determines and is determined by the new wave of outward-oriented regionalism in Asia.

Setting the Stage for Cooperation During and After the Crisis

The unfolding of economic integration in Asia demonstrates that market-led regional integration is supporting regional cooperation, rather than vice versa (as is the case, for example, in the EU). For this reason, as will be argued in more detail below, it is likely that the current crisis has a better chance of reinforcing the trend toward regionalism in Asia than it has elsewhere. Theoretically, the region could either see the logic of deeper integration in order to internalize policy externalities and ensure larger markets, or it could resist and concentrate instead on national emergency measures. But in Asia, current trends favor the former outcome.

This is arguably already in evidence, though it is difficult to generalize. For example, the CMI multilateralized was adopted as an explicit reaction to the current crisis, as was the idea for an Asian Financial Security Dialogue. In the real sector, at the APEC meeting in Lima, Peru, in November 2008, the APEC leaders reiterated their interest in possibly creating the Free Trade Area of the Asia Pacific (FTAAP). The EU and South Korea are expected to sign an FTA in fall 2009. The ASEAN-India FTA was approved by the ASEAN economic ministers in August 2009. Many cynics believed that AFTA would never get off the ground; today, it is almost complete and ASEAN has launched an effort to create a unified market through the AEC. Arguably the global economic crisis has slowed the implementation of the AEC somewhat, but the region should still be on track for completion

> ***The global economic crisis forced Asian economic ministers to focus temporarily on domestic issues rather than regional cooperation. However, it is likely that it will serve as a catalyst for closer economic cooperation in the near future.***

by the 2015 deadline, though some delays are likely (as was the case in the implementation of the European Single Market Programme). ASEAN continues to consider deeper approaches to integration during the global economic crisis: as noted above, in 2009 it also began to consider informally the creation of a customs union.

The global economic crisis naturally forced Asian economic ministers to focus temporarily on domestic issues rather than regional cooperation. However, it is likely that it will serve as a catalyst for closer economic cooperation in the near future, and the regional frameworks that have already been established have dampened the protectionist impulses that often arise during deep global recessions.[24] How much further it will go is another issue, but, as will be seen below, there is strong reason to be optimistic.

How Will the Current Crisis Affect Economic Cooperation in Asia?

Three main conclusions from the above analysis are that: (1) the current crisis has significantly affected Asia, but there is a rebound in evidence; (2) Asian regionalism is unique in that it is market-driven and seeks to support the process of regional economic integration by reducing barriers to economic interaction and promoting a stable macroeconomic environment; and (3) the region has been increasingly aggressive in forming FTAs and other forms of deep integration since 2000, albeit perhaps with a brief slowdown during the current crisis. The rest of this paper will consider whether this crisis, or future crises, will likely promote or discourage economic cooperation. There is very little attempt in the economic literature to identify the likely effect of economic crisis on economic cooperation, though anecdotal evidence exists. The theoretical framework developed below considers, for each element in a matrix of crisis and cooperation factors, what the likely implications are for regional cooperation.

This taxonomy is based on a priori expectations rather than empirical tests. This is inevitable, since the regionalism movement in Asia is new and there has not been a significant global downturn since it became an important force. It is impossible to extrapolate from experience in other regions because the Asian experience with regionalism is unique and, in any case, no empirical discussion of the links between crisis and cooperation exists for other regions. It is often argued

Table 4. Effect of the Crisis on Motivations for Economic Cooperation

Motivation	Real Sector	Financial Sector	Effect of Crisis
Market efficiency and competitiveness			
• Micro efficiency in real sector	√	√	+
• Economies of scale	√	√	+
• FDI/technology/new markets	√	√	+
• Trade creation	√	0	-
• Trade diversion	√	0	+
• Micro efficiency in financial sector	0	√	+
Policy considerations			
• Macro stability and support	0	√	+
• Rebalancing	√	√	+
• Regional or national protection and self-sufficiency	√	√	+/-

that the EU Single Market Programme was made possible due to slow growth in Europe (sometimes called Eurosclerosis), but this argument would be difficult to test empirically (and has not been). Hence, the current discussion is limited to hypothesizing, though in a few years, interesting data for case studies should emerge.

To understand how the current crisis is likely to affect Asian economic cooperation, it is necessary to focus on how it will influence the various incentives to cooperation reviewed in previous sections. Table 4 summarizes those incentives and predicts whether the economic crisis is likely to strengthen or weaken them and whether it is likely to affect real- or financial-sector cooperation or both. Note that it is only possible to identify the direction of the likely effects on the motivation for cooperation; assigning magnitudes to these effects would be difficult if not impossible in most cases. Nevertheless, it is clear that some of these effects are more important than others, and an attempt has been made to capture these differences in the analysis.

Table 4 separates incentives related to market efficiency and competitiveness from policy considerations, mainly because microeconomic and macroeconomic issues are traditionally treated separately. Each issue is discussed in more detail below.

Market Efficiency and Competitiveness

Micro Efficiency in the Real Sector

The need to strengthen competitiveness by reducing transaction costs and adopting more efficient policy measures should increase the demand for closer cooperation.

Severe economic crises are devastating: they take a terrible social toll, as well as leading to macroeconomic inefficiencies through the creation of output gaps. Yet, in the context of outward-oriented economies, they do force policymakers to place a strong priority on boosting economic efficiency as a means of combating the crisis. The incentive to adopt microeconomic measures to improve economic efficiency therefore becomes stronger during economic crises. This is clear from the political-economy literature: during upswings in the business cycle, there is little incentive to change, but during downturns there is a much greater opportunity to embrace even politically difficult economic reforms. The restructuring of the financial sector in the countries affected by the Asian crisis would have been extremely difficult, if not impossible, without a major shock. The oft-cited saying that "a good crisis shouldn't be wasted" refers to this potential opportunity for change.

The restructuring of the financial sector in the countries affected by the Asian crisis would have been extremely difficult, if not impossible, without a major shock.

As discussed above, Asia has been using regional cooperation, especially in the form of FTAs, to boost competitiveness. With the crisis, one could expect that the tendency to promulgate necessary microeconomic reforms at the national level would also be applicable in the context of bilateral, subregional, and regional arrangements. As also mentioned above, Asian economic cooperation was regionalism in support of regionalization, that is, to improve competitiveness. Therefore, it seems likely that that the crisis would reinforce incentives to create new regional trading agreements and deepen existing ones.

It also seems likely that this would have a positive impact on financial cooperation for a variety of reasons. First, trade and financial links are evident; one major reason for the current slowdown in exports of Asian developing countries is lack of trade finance. Second, imprudent macroeconomic policies are the enemy of export promotion (Bhagwati 2004), and with closer real-sector links, one would expect that the rising potential for negative externalities associated with imprudent macroeconomic policies would strengthen the case for financial cooperation at several levels.

Economies of Scale

Cost savings attendant in expanded markets also favor regional economic cooperation, particularly in the modern global economy.

Economies of scale have always been recognized as a key rationale for FTAs and customs unions.[25] By creating a larger market for goods produced in industries characterized by economies of scale (that is, where average costs decline as output increases), regional trading arrangements enhance micro efficiency and global competitiveness. Industries in which there are high fixed costs tend to be subject to economies of scale, but this is a sufficient rather than a necessary condition. Industries include steel, automobiles and automotive parts, other transport equipment, machine tools, electronic components such as microchip production, among others. A strong motivation for the Single Market Programme in Europe, as well as for monetary union, was the perceived need to compete with the United States in economies-of-scale industries. In part, this would apply to the AEC: individually, ASEAN markets are disadvantaged compared to China and India because they are small. Together, however, they constitute a market of over a half billion people, with a combined

A strong motivation for the Single Market Programme in Europe, as well as for monetary union, was the perceived need to compete with the United States in economies-of-scale industries.

GDP even greater than India's. The deeper the integration program, the easier it is for firms to benefit from economies of scale. Hence, with the crisis, the need to increase global competitiveness suggests a strong incentive to break down barriers to intraregional trade and exploit scale economies. Financial and macroeconomic cooperation could also be applicable for the reasons given above in terms of their relevance in supporting competitiveness. In addition, as economies-of-scale industries tend to require more capital layouts than other industries, improving financial markets and facilitating cross-border capital flows would be another incentive for financial cooperation.

FDI, Technology, and New Markets

The crisis should induce countries to liberalize more aggressively in order to attract FDI and reap its attendant economic benefits.

Along with economies of scale, the positive effects of regional economic cooperation, both real and financial, on FDI and technology transfer constitute "dynamic" incentives for FTAs and deeper forms of integration.[26] Attracting larger flows of FDI has been a salient goal of regionalism among developing economies in Asia. For example, AFTA has been referred to as more of an agreement to attract FDI than a trade agreement, and luring greater FDI figures prominently in the AEC. While it is beyond the scope of this paper to delineate the economic virtues of FDI,[27] it is possible to note that FDI brings in new technologies, risk-sharing capital, foreign exchange, and connections to international markets. Lowering barriers to regional economic interchange provides a strong incentive to FDI, as it allows MNCs to use partner countries efficiently in creating a regional division of labor. It is an essential ingredient in attracting the production networks that are so important to the future of economic growth and development in Asia (ADB 2008).

Hence, liberalization of intraregional trade barriers has the potential to have a strong effect on attracting FDI. In addition, FDI-specific measures, such as national treatment, various best practices in treating the private sector, and investment protection can be included in FTAs and customs unions as a means of luring FDI. Indeed, most FTAs that include Asian economies have some sections on FDI. Arguably, the need to bring in FDI is even more important in the context of a financial crisis, as liquidity and other financial problems can sometimes be overcome by foreign investment inflows. There has been a pronounced decrease in global FDI since the third quarter of 2008. Moreover, FDI—particularly in manufacturing and high-value-added services like finance—shies away from countries without strong macroeconomic stability and facilitating institutions. And, given that production networks require these to be present in all regional economies, the need for financial and macroeconomic cooperation in order to encourage network-building FDI is evident.

Trade Creation

While trade creation is efficiency-enhancing, associated adjustment costs could lead to a political aversion to deep economic cooperation in the short run.

Trade creation, a term introduced by economist Jacob Viner (1950), refers to the reduction in inefficient domestic production in favor of more efficient partner-country production. As trade creation increases efficiency in any given trade area, it is considered by economists to be a key positive feature of FTAs and customs unions. However, greater efficiency is linked to underlying assumptions, such as full employment, which do not hold during a crisis. For example, if a country experiences trade creation in textiles due to an FTA, the outcome is guaranteed to be more efficient if and only if these resources are successfully integrated into other sectors in which the country has a comparative regional advantage. If there is a crisis, however, these resources may not be quickly reallocated into the efficient sectors. The longer it takes to reintegrate these resources, the more costly the structural adjustment will be. And such costs are often borne by the most vulnerable.

Even in good times, such restructuring is politically difficult: the United States, for example, has not done a good job of facilitating trade creation in efficient sectors like textiles, even though it has had decades, mostly prosperous, to do so. In bad times, it is even more difficult. Hence, the existence of a trade creation effect in regional trading agreements could actually serve as a drag on regional cooperation in Asia. Worse, it could create the incentive to devise FTAs that minimize trade creation, which would be highly detrimental to the efficiency of the agreement.

Trade Diversion

Though economically costly, discrimination against non-partner countries could create political advantages for certain firms within the region, creating greater demand for regional cooperation.

Trade diversion, another Vinerian concept, is the other side of the traction creation effect: it is the potential for a country to import less from the most globally efficient sources in favor of a partner country that has preferential access within an FTA. This discrimination has negative economic implications and is the key reason why some economists argue against preferential trading arrangements. However, from a political point of view, it obviously has its attractions. While Asian policymakers would arguably do well to always and everywhere minimize trade diversion because of its negative economic implications, the fact that it would be politically attractive for FTA partner countries cannot be ignored.

Micro Efficiency in the Financial Sector

Asian financial markets tend to be underdeveloped and financial intermediation takes place disproportionately outside the region from where the crisis hit. Both of these factors will support a movement toward closer financial cooperation.

As is evident from the current crisis, erecting a strong financial system is essential for economic efficiency and stability. As already discussed at length, the Asian crisis demonstrated the problems associated with lagging development of necessary financial institutions. Adams (2008) suggests that regional economies have by and large been successful in addressing many of the most important financial shortcomings that led to the crisis, but they still have much to do. Most of these issues must be addressed at the national level; even the AEC Blueprint's sections on financial cooperation stress the need to bolster national markets. Still, much can be done in terms of regional financial cooperation in order to support such national development strategies. Moreover, cooperative efforts, such as facilitating cross-issuance of securities, developing efficient integrated clearance and settlement systems, and even creating regional credit-rating agencies, could increase the potential for greater depth, liquidity, and diversification across regional markets.

Erecting a strong financial system is essential for economic efficiency and stability.

The Asian crisis prompted leaders in the region to consider closer cooperation in this area, as part of either formal agreements such as ASEAN or ad hoc arrangements such as the Asian Bond Pool. The Asian Bond Markets Initiative stresses the promotion of local-currency-denominated bonds as well as demand for these bonds, strengthening of legal frameworks, and improvement of infrastructure. The above discussion of financial cooperation thus far demonstrates this demand for greater financial deepening in the region. Since the current crisis derives from financial shocks originating outside the region, it is different in substance from the 1997–98 crisis. However, it can be argued that the current crisis is also likely to prompt greater cooperation in this area. Asian commentators often lament the fact that, while the region as a whole supplies significant net savings to the rest of the world, these savings are usually invested ("intermediated") outside the region. The reason for this is basically economic: the West enjoys economies of scale in financial services and can thus provide cheaper services and better returns. But the current crisis may well drive home the fact that relying on intermediation outside the region is risky. This would increase the incentive to work toward deepening and expanding regional markets.

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Policy Considerations

Macro Stability

The crisis has driven home the need to support global macroeconomic stability at all levels.

Particularly compared to the rest of the world, Asian developing countries have distinguished themselves in terms of their macroeconomic management and prudence. Tables 5A–5D summarize key macroeconomic indicators—inflation rates, interest rates, ratio of deficit to GDP, and ratio of public debt to GDP—for selected recent years. The performance of regional economies is well within the range of

Table 5A. Average Inflation Rates

Country	1990–1999 (%)	2000–2006 (%)	2007 (%)
Thailand	4.3	2.6	2.3
Singapore	1.5	0.6	2.1
Philippines	9.5	5.4	2.8
Malaysia	3.7	3.4	2.0
Indonesia	15.6	11.8	6.4
Cambodia	NA	2.4	5.9
Vietnam	6.7	5.7	8.3
Myanmar	7.8	NA	36.9
Korea	8.9	2	2.5
China		3.1	4.8
India		4	4.4

Source: IMF, International Financial Statistics online, www.imf.org; ADB, Asian Development Outlook, 2008.

Table 5B. Average Interest Rates and Money Market Rates

Country	2000–2006 (%)	2006 (%)
Thailand	2.2	4.6
Singapore	1.9	3.5
Philippines	8.1	7.8
Malaysia	2.8	3.4
Indonesia	9.7	9.1
Vietnam	*	*
Cambodia	*	*
Myanmar	*	*
Korea	4.2	4.2
China	*	*
India	*	*

Source: IMF, International Financial Statistics online, www.imf.org.

* Data not available.

Table 5C. Average Ratio of Deficit to GDP

Country	1990–1999 (%)	2000–2006 (%)	2007 (%)
Thailand	1.26	-0.72	-1.7
Singapore	11.01	5.69	12.2
Philippines	-1.20	-3.67	-0.2
Malaysia	-0.42	-4.80	-2.8
Indonesia	-0.27	-1.45	-1.2
Cambodia	-3.98	-2.39	-3.2
Vietnam	-2.22	-2.81	-4.9
Myanmar	-1.75	0.71	*
Korea	-0.90	1.21	-2.3
China	-2.59	-2.15	0.7
India	-5.91	-5.06	-5.5

Source: ADB, Asian Development Outlook, 2006b, 2007.
* Data not available.

Table 5D. Average Ratio of Public Debt to GDP

Country	1990–1999 (%)	2000–2005 (%)	2005 (%)
Thailand	8.57	26.45	25.83
Singapore	*	*	*
Philippines	57.33	63.17	67.69
Malaysia	50.27	44.19	45.61
Indonesia	42.77	76.02	57.40
Cambodia	*	*	*
Vietnam	*	*	*
Myanmar	*	*	*
Korea	11.74	17.89	16.40
China	11.48	24.18	22.30
India	50.57	61.61	64.10

Source: IMF, International Financial Statistics online, www.imf.org.
* Data not available.

global norms, with few exceptions. However, as the region becomes more integrated, the need for policy convergence will likely become more important, in order to internalize any possible negative externalities associated with deviations from accepted conservative standards.

A country wishing to adopt the euro must meet the EU's Maastricht criteria—domestic inflation rates and interest rates must not be more than 1.5 percent above the average of the three best-performing countries; the ratio of annual government deficit to GDP must not exceed 3 percent; the ratio of public debt to GDP must not exceed 60 percent; and the country's currency must have experienced a long period of stability. Judged by the Maastricht criteria, Asia performs fairly well; countries that have especially similar macroeconomic indicators include South Korea, Singapore, Thailand, Philippines, and Malaysia. There are some problem cases for each of the indicators. But given that there are no formal cooperative mechanisms in place at the regional level, this situation could change easily enough. ASEAN does have the ASEAN Surveillance Mechanism, supported by the Asian Development Bank and put in place in order to give early warning signs, which is a response to this need to foster macroeconomic stability. However, it is an informal arrangement. Arguably, closer cooperation in this area is important in order to preserve stability. The Asian Financial Security Dialogue proposal is indicative of this perceived need.

Asian countries differ widely in terms of their size, wealth, openness, economic structure, and levels of institutional development.

Such cooperation is particularly important in a region as diverse as Asia. As Table 6 shows, Asian countries differ widely in terms of their size, wealth, openness, and economic structure. Likewise, their levels of institutional development, including financial and monetary-policy-related institutions, also diverge considerably. This distinguishes the region from the EU; the founding countries of the euro area all had developed financial and other economic institutions before unifying their monetary policy under the European Central Bank and adopting the euro.

Table 6. Diversity in East Asia

	GDP Growth (annual average)		GDP per Capita (constant US$ base-year 2000)	Openness[1] (% of GDP)	Manufacturing Value Added (% of GDP)	Poverty Head-Count[2]	
	1990–2000	2001–2007				Ratio	Latest Available Data
Japan	1.6	1.5	40,655.7	27.3[4]	21.0[4]	—[3]	
China	9.8	10.2	1,791.3	72.0[5]	33.5[4]	9.9	2004
Hong Kong	4.0	4.9	34,036.5	404.1	3.2[5]	—[3]	
South Korea	6.5	4.7	14,540.3	90.4	27.9	—[3]	
Brunei Darussalam	2.2	2.6	18,304.4[5]	96.2[5]	10.5	—[3]	
Cambodia	7.5	9.7	482.3	144.6[5]	18.6[5]	66.0	2004
Indonesia	4.8	5.1	1,033.6	54.7	27.0	7.5	2002
Lao PDR	6.3	6.6	461.5	78.25	20.9[5]	27.0	2002
Malaysia	7.4	4.8	4,715.2	210.0	29.8[5]	2.0	1997
Myanmar	6.5	9.0	—[3]	—[3]	—[3]	—[3]	
Philippines	3.1	5.0	1,216.2	83.3	22.0	14.8	2003
Singapore	7.8	5.3	28,964.2	433.0	25.5	—[3]	
Thailand	5.2	5.1	2,712.7	132.5	34.5	2.0	
Vietnam	7.4	7.7	617.0	159.3	21.3[5]	—[3]	

Source: World Bank, World Development Indicators, accessed November 2008, www.worldbank.org.
[1] Exports and imports of goods and services as percentage of GDP (current $).
[2] Purchasing power parity, at US$1/day, percentage of population.
[3] No data from World Development Indicators.
[4] 2005 data.
[5] 2006 data.

The current crisis is magnifying the significance of these differences. Countries with weaker financial institutions, for example, were hit disproportionately by the international liquidity crisis, particularly when it came to trade finance. To the extent that these countries play a role in various production networks, this could propagate contagion to other markets. Moreover, the least-developed countries have fewer automatic stabilizers and macroeconomic levers to help them deal with the crisis. A "free fall" in one country, even if it is small, could easily affect other countries in East Asia. This is no doubt one reason why Asian leaders agreed to the Asian Fund as a contingent financial resource.

Rebalancing

Global imbalances, to which Asian countries contributed, were in part responsible for the crisis. Economic cooperation can help remedy this problem.

As noted above, global economic imbalances played their role in the global economic crisis. Trying to rebalance the global macroeconomy is already emerging as an important theme in academic circles and in the media. Net national savings will have to rise in the United States in order to reduce the magnitude of current account deficits that existed prior to the global economic crisis. Ultimately, this will mean that the world will have to reduce its reliance on the U.S. consumer (and U.S. government overconsumption) as an engine of growth. Doing so will help rebalance the global economy and reduce the potential for crises in the future. But if this is true, what will be the new engines of growth?

Net national savings will have to rise in the United States in order to reduce the magnitude of current account deficits that existed prior to the global economic crisis.

Economic theory does not suggest that every country should have balanced trade; in fact, it suggests the opposite. For example, the persistent current account surplus of Japan could be explained in part by demographics and anticipation of increasingly lower national savings as the country continues to age. However, for Asian developing countries in which the demographics are favorable and the return on capital is expected to be high, being net capital exporters seems inadvisable, particularly when capital exports exceed a significant proportion of GDP. Rebalancing, therefore, will be a question of stimulating domestic demand, which has been relatively lackluster since the Asian financial crisis, at least outside of China.

Improved financial markets and greater financial cooperation could help stimulate domestic demand, as they will help lower the cost of capital, which in turn should stimulate domestic investment and consumption and make long-term investments, e.g., in infrastructure, cheaper. Exchange-rate cooperation could allow the region to effect concerted revaluations or devaluations in times of exchange-rate misalignments, as in the case of the U.S. dollar prior to the global economic crisis. Moreover, real-sector cooperation will stimulate trade and FDI, which should also help in the rebalancing process.

Protection and Self-Sufficiency

The crisis has persuaded Asian leaders of the need to create a greater Asian identity through cooperation, but mitigating nationalistic tendencies are always also present during crises.

The perceived lack of support from the West during the Asian crisis led many policymakers to believe that the West could not be counted on in future crises. Hence, it was deemed necessary to begin the process of economic cooperation at all levels in order to ensure that such a crisis would never happen again, or if it did, that institutions would be in place to provide mutual support and combat it effectively together. The idea of creating an Asian identity came to the fore. In this sense, the crisis was vital in setting the stage for Asian regionalism. Thus, regionalism could be called a defensive reaction. While cooperative institutions were still in a fledgling stage when the current crisis hit, some did exist: the CMI is one (albeit minor) example of progress in this regard. Certainly the creation of FTAs across the region has improved bilateral relations and trust among the parties involved, including in Northeast Asia. Asian countries have been uniform in their condemnation of protectionism as a response to the current crisis, and Asian WTO members have joined the chorus of support for a successful conclusion to the Doha Development Agenda. The AEC is indicative of the desire in ASEAN to build a more closely-knit identity as well as cooperative institutions.

Much work needs to be done in these areas. But as was the case with the Asian crisis, it is likely that the current crisis will spur the region to develop deeper cooperative institutions and continue to build the Asian identity, whether through ASEAN, ASEAN+3, or ASEAN+6. Of course, the region will do so without seeking to antagonize nonpartner countries or to build an inward-looking bloc: as was noted at length above, Asian regionalism is predicated on openness to the world, not just the region, and FTAs with nonpartner countries continue to be popular. These new cooperative institutions will be nested in the global system.

Thus, in this sense, the crisis is likely to have a positive effect on regional cooperation. However, crisis creates incentives for nationalistic responses as well. For example, in early 2008 when commodity prices were rising so rapidly as to provoke some leaders to consider that a crisis was imminent, the response was nationalistic: exports of some important commodities were banned. The Thai government even floated the idea of an OPEC-like organization for rice exporters.[28] Throughout the West, public opinion has cried out for nationalistic responses to the crisis—e.g., through higher barriers to trade, "buy USA" policies, preferential financing of national actors, and the like. Even in the EU the reaction has not been promising: European governments are giving preferences to national agents, in blatant conflict with EU rules. (The French government has been particularly criticized for these types of reactions, but it is not alone.) To the extent that the crisis inspires nationalistic responses, it will mitigate against regional economic cooperation.

To the extent that the crisis inspires nationalistic responses, it will mitigate against regional economic cooperation.

Conclusions

The global economic crisis has had a severe negative effect on Asian economies, though the extent of the damage differs significantly from country to country. It will no doubt register as the worst crisis to face world capitalism since the Great Depression of the 1930s. It has also underscored many weaknesses in the international system of economic governance. The world has become increasingly interdependent, but cooperative institutions have not grown to deal with the associated externalities. Moreover, the large macroeconomic imbalances that fed the current crisis are a clear indication of the dangers of not paying enough attention to global cooperative issues.

The depth of the crisis ostensibly is strengthening the international resolve to build a solid foundation for the future. The G-20 group is committed to creating the means for better macroeconomic cooperation and financial regulation, though it is not clear yet how successful it will be. The worst of the crisis appears to be behind us; with recovery will come a reluctance to make the hard decisions that would place the global economy on a more sustainable development course. Still, the world understands the need to avoid the mistakes of the past, and closer economic cooperation at all levels will need to be part of any effective solution.

The trend toward regionalism has been gathering strength in Asia, particularly since 2000. This can be attributed to the incentives for cooperation—in particular, the need to enhance global competitiveness.

Given the motivations behind Asian regionalism, the global economic crisis is likely to enhance the potential gains from regional cooperation and therefore promote support for it. The need to improve market efficiency and competitiveness is even clearer in the context of economic crisis, and real- and financial-sector cooperation can effect change in these areas through a variety of channels. Improving macroeconomic and financial policies also needs to be a high priority, particularly when crisis is induced by macroeconomic and financial shocks in the context of an increasingly globalized economy, in which the need to redress imbalances and foster greater macroeconomic and financial stability, surveillance, and regulatory issues becomes increasingly compelling.

On the other hand, two political factors could work in the opposite direction: resistance to trade creation and nationalism, the latter being perhaps the biggest threat. But other political factors tend to support regional cooperation—including the global economic crisis's effect on the desire to foster an Asian identity and build stronger and deeper Asian economic institutions, given that OECD economic governance and best practices have revealed themselves to fall short of expectations.

There is no unambiguous answer to the question of whether or not the crisis will improve the prospects for deeper and more extensive regional cooperation in Asia. Still, the factors working in favor of regionalism are strong and will likely dominate those working against it. As these countervailing factors (trade diversion, nationalism) are also detrimental to growth in the longer term, they shouldn't be significant. The trade and financial-cooperation agreements initiated or finalized during the global economic crisis are prima facie evidence of a positive relationship between crisis and cooperation. At the least, it is clear that the global economic crisis has not turned back the clock on Asian regionalism. More likely, it will do the opposite.

A number of examples reveal that the trend toward regionalism has continued in Asia, albeit at a slower pace, throughout the global economic crisis. Northeast Asian economic cooperation is improving, if slowly, both intraregionally and with outside countries. ASEAN economic integration is proceeding apace, and new initiatives are being considered, including the possibility of a customs union. And China and India continue to actively pursue regional economic cooperation. The region has expanded the CMI and made it multilateral, tabled proposals for a more ambitious Asian Fund, and begun considering the possibility of an Asian Financial Stability Board to be nested within global financial cooperative frameworks such as the newly created (June 2009) Financial Stability Board. In short, it seems possible to be confident that, in the aftermath of the global economic crisis, Asia will continue its trend toward deeper economic cooperation.

A number of examples reveal that the trend toward regionalism has continued in Asia, albeit at a slower pace, throughout the global economic crisis.

Endnotes

1. The current account represents the balance of trade in goods and services and "unilateral transfers" (e.g., development assistance, remittances) in a given country's balance of payments. A current account deficit means that the value of a country's expenditures on imports exceeds that of its export receipts.
2. A main reason for the Asian crisis was speculation, particularly in real estate, a dangerous trend that showed up in the data as high investment rates. This does not mean that low investment rates are necessarily good, as they can result in a savings glut, the opposite type of savings-investment imbalance.
3. For updates on agreements signed by Asian economies, see the ADB's Asia Regional Integration Center's website (www.aric.adb.org).
4. We use the end-April 2009 IMF *World Economic Outlook* data because this is a semi-annual publication and the next issue is due out in October 2009.
5. Chinese growth is mainly driven by rapid domestic investment growth, the result of one of the largest surges in credit growth in the nation's history. This has led to some uneasiness about the durability of the Chinese rebound and the possibility of the early emergence of financial bubbles.
6. The Asian Development Bank Institute has been particularly active in convening conferences on rebalancing.
7. There have been several highly publicized recent cases of protectionism, including the U.S. anti-dumping duties levied against China for lowering the domestic price of iron ore and artificially lowering prices for screw exports to the EU. However, such cases were in evidence before the global economic crisis as well, and whether the crisis has significantly increased protectionism is highly debatable.
8. The Asian Development Bank (2006a, Part I) put the potential global gains of a "deep" Doha scenario at $155 billion in 2001 prices.
9. See, for example, the WTO Tariff Profiles at www.wto.org.
10. Wall Street Journal Online, July 5, 2007.

11. For an early analysis of the potential for an ASEAN customs union, see Plummer (2006).
12. Member states include Afghanistan, Azerbaijan, Turkmenistan, Kyrgyzstan, Tajikistan, Kazakhstan, Uzbekistan, Turkey, Iran, and Pakistan.
13. The forum's website is www.aseanregionalforum.org.
14. Examples include Kawai and Wignaraja (2009), ADB (2006a), Feridhanusatyawan (2005), and Kawai (2005). The ADB's Asia Regional Integration Center website gives up-to-date information on the bilateral and regional FTA agreements (http://aric.adb.org/).
15. For details, see Naya and Plummer (2005), chapter 4.
16. There are many excellent reviews of these regimes (for example, ADB 2006a).
17. When a country manages or pegs its exchange rate, intervention to keep the international price of the currency stable affects its money supply. "Sterilization" refers to the central bank's neutralizing the monetary effect of the intervention.
18. Glick and Rose (1999), for example, examine five currency crises and find that countries subsequently affected by a crisis have strong trade relations with the country that was the first victim of the crisis. But this effect is not important relative to other factors such as those described in the rest of this paragraph. Thailand, where the Asian crisis began, accounted for only between 1 percent and 4.5 percent of the exports of the affected Asian economies.
19. For example, if a crisis hits Thailand and Malaysia, and Thailand competes significantly in the U.S. market, a strong devaluation of the Thai baht would impact the competitiveness of Malaysia, which would lead investors to sell Malaysian ringgit short.
20. For sources pertinent to integration and contagion, see Candelon, Piplack and Straetmans 2006 and Dungey et al., 2004. For arguments in favor of monetary union, see, for example, Kreinin and Plummer (2009) and Plummer and Wignaraja (2006).
21. These currency swaps involved an agreement between the parties to swap U.S. dollars for domestic currency over a short time horizon and bearing a low interest rate.
22. A common problem during financial crises in developing countries, and the Asian crisis in particular, is that bank liabilities are short-term and assets long-term in maturity ("maturity mismatch") and loans from abroad as denominated in foreign currency whereas assets are denominated in local currency ("currency mismatch").
23. Regionalism by its very nature is discriminatory. However, "open regionalism" is an approach designed to minimize any discrimination through more inclusive policies, for example, extending intra-regional cuts in tariffs to non-partner countries.
24. The statement issued at the November 2008 G-20 Meeting in Washington, DC, also stressed the importance of avoiding protectionism and instructed countries' economic ministers to work toward a successful conclusion to the Doha Development Agenda.

25. Corden (1972) develops the classic theoretical model of the economic effects of economies of scale in the context of regional trading agreements.
26. "Dynamic" in this context refers to changes that grow over time, as opposed to "static" which are one-time effects (such as price changes).
27. Many studies consider these effects; ADB (2008) gives an excellent survey of the issues.
28. ASEAN opposition to this idea is one reason that it was withdrawn.

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The economic crisis of 2008–09 has had a highly damaging effect on Asian economies. While it appears in the second half of 2009 that the worst of the crisis is over, expectations are that the region will revert to its pre-crisis growth trend only in 2011, and many uncertainties remain.

This monograph considers the implications of the crisis for the regionalism movement in Asia, which essentially began in 2000 and was going strong when the crisis hit. Regionalism in Asia has grown out of the desire to integrate more effectively with the global economy, boost competitiveness, and improve efficiency, as well as to prevent discrimination by preferential trading agreements elsewhere. Given these motivations, most relevant economic variables affected by the crisis are likely to foster regionalism in Asia rather than obstruct it. But two political effects could work against it: nationalism and the political cost of trade creation, the former being perhaps the biggest threat. Still, other political factors tend to support regional cooperation—including the effect of the global economic crisis on the desire to foster an Asian identity and build stronger and deeper Asian economic institutions. Hence, it is likely that the crisis will support the trend toward regionalism rather than detract from it.

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About the Author

Michael G. Plummer is Eni Professor of International Economics at the Johns Hopkins University, SAIS-Bologna, and a nonresident senior fellow of the East-West Center. He is editor in chief of the *Journal of Asian Economics* and director of the American Committee for Asian Economic Studies. His main academic interests are international trade, international finance, and economic integration, especially in the Asian context.

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