



Regional Integration in the Asia Pacific

ISSUES AND PROSPECTS



The Bob Hawke Prime Ministerial Centre
at the University of South Australia

ENERGY
TRANSPORT HEALTH TRADE INVESTMENT ENERGY
INVESTMENT TRADE HEALTH TRANSPORT HEALTH TRADE INVESTMENT
HEALTH TRADE INVESTMENT ENERGY TRANSPORT HEALTH TRADE INVESTMENT
TRADE HEALTH TRANSPORT ENERGY INVESTMENT TRADE HEALTH TRANSPORT
TRADE INVESTMENT ENERGY TRANSPORT HEALTH TRADE INVESTMENT ENERGY
HEALTH TRANSPORT ENERGY INVESTMENT TRADE HEALTH TRANSPORT ENERGY
INVESTMENT ENERGY TRANSPORT HEALTH TRADE INVESTMENT ENERGY TRANSPORT
TRANSPORT ENERGY INVESTMENT TRADE HEALTH TRANSPORT ENERGY INVESTMENT
ENERGY TRANSPORT HEALTH TRADE INVESTMENT ENERGY TRANSPORT HEALTH TRADE
ENERGY INVESTMENT TRADE HEALTH TRANSPORT ENERGY INVESTMENT TRADE
TRANSPORT HEALTH TRADE INVESTMENT ENERGY TRANSPORT

HEALTH TRADE INVESTMENT ENERGY TRADE
INVESTMENT TRADE HEALTH TRANSPORT ENERGY INVESTMENT TRADE HEALTH T
HEALTH TRADE INVESTMENT ENERGY TRANSPORT HEALTH TRADE INVESTMENT ENERGY TRANSPORT HEA
TRADE HEALTH TRANSPORT ENERGY INVESTMENT TRADE HEALTH TRANSPORT EN
TRADE INVESTMENT ENERGY TRANSPORT HEALTH TRADE INVESTMENT ENERGY TRANSPORT HEALTH TR
HEALTH TRANSPORT ENERGY INVESTMENT TRADE HEALTH TRANSPORT ENERGY
INVESTMENT ENERGY TRANSPORT HEALTH TRADE INVESTMENT ENERGY TRANSPORT HEALTH TR
TRANSPORT ENERGY INVESTMENT TRADE HEALTH TRANSPORT HEALTH TRADE INVESTMENT ENER
ENERGY TRANSPORT HEALTH TRADE INVESTMENT ENERGY TRANSPORT HEALTH TRADE INVESTMENT ENER
ENERGY INVESTMENT TRADE HEALTH TRANSPORT ENERGY INVESTMENT TRADE H
TRADE INVESTMENT ENERGY TRANSPORT HEALTH TRADE INVESTMENT ENERGY TRAN
HEALTH TRANSPORT ENERGY INVESTMENT TRADE HEALTH TRANSPORT ENERGY IN



Regional Integration in the Asia Pacific

ISSUES AND PROSPECTS



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT



THE BOB HAWKE PRIME MINISTERIAL CENTRE AT THE UNIVERSITY OF SOUTH AUSTRALIA

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where the governments of 30 democracies work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The Commission of the European Communities takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

This work is published on the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of the Organisation or of the governments of its member countries or The Bob Hawke Prime Ministerial Centre at the University of South Australia.

© OECD, The Bob Hawke Prime Ministerial Centre at the University of South Australia, 2005

No reproduction, copy, transmission or translation of this publication may be made without written permission. Applications should be sent to OECD Publishing: rights@oecd.org or by fax (33 1) 45 24 13 91. Permission to photocopy a portion of this work should be addressed to the Centre français d'exploitation du droit de copie, 20, rue des Grands-Augustins, 75006 Paris, France (contact@efcopies.com).

PREFACE

The Asia Pacific region, with its dynamic economy and rich cultural diversity, is growing rapidly in significance and is set to play a critical and important role in the world as the 21st century unfolds. A key factor in its success will lie in the capacity and willingness of the region's countries to co-operate with one another across a wide range of activities. This book, a joint venture between the OECD's International Futures Programme and the Bob Hawke Prime Ministerial Centre at the University of South Australia, explores the prospects for deeper integration in the region and examines some of the key challenges and opportunities that lie ahead.

Michael W. Osborne

Bob

FOREWORD

For many observers of the world economy, the 21st century will belong to the Asia Pacific region. The sheer dynamism of its peoples and its huge economic and technological potential do indeed bode well for the future. At the same time it is a highly diverse region, and although interdependence has increased in recent years – driven primarily by market forces – there is room for further progress. The pace towards greater interchange may now be gathering speed, as countries in the region show growing interest in, and place greater emphasis on, more formal co-operation.

Against this backdrop, the Bob Hawke Prime Ministerial Centre* at the University of South Australia was intending to host a Symposium on Regional Integration Issues in the Asia Pacific Region in March 2004. It was to be organised in collaboration with the OECD's International Futures Programme. The aim was to bring together the most influential practitioners, policy makers, strategists and thinkers in the region to consider, over two days, the critical issues affecting the outlook for regional integration across a number of broad fronts. The Symposium was to be co-chaired by The Hon Bob Hawke, former Prime Minister of Australia, and Michael Osborne, Director of the OECD International Futures Programme. Generous sponsorship was pledged by both Mitsubishi Australia and the South Australian Government to support the meeting.

Unfortunately, it became clear that the Symposium was ill-timed. A combination of events – SARS, avian flu and terrorist attacks – seriously unsettled the region and made it impossible for a number of critical contributors to attend the meeting. By that time, however, a very substantial set of Symposium presentations had already been prepared, and the decision was taken to publish the papers for the benefit of global scholarship and regional understanding.

This book brings together revised versions of those contributions. They offer valuable insights from well-known international experts into the future

* Further information concerning the Hawke Centre may be found at www.hawkecentre.unisa.edu.au.

trajectory, shape and structure of the integration process in the Asia Pacific region. They describe the huge challenges facing the region, set the global context, and analyse the institutional path towards integration that various key sectors – trade, transport, education, health, environment and security – are likely to take. Many of the contributions have been updated, while others (such as the keynote speech Mike Moore was to have presented) remain largely unaltered so as to provide a sense of the intended atmosphere of the occasion. The book is a joint OECD/Hawke Centre publication, edited by Barrie Stevens and Randall Holden of the OECD International Futures Programme, assisted by the Director of the Hawke Centre, Ms Elizabeth Ho, and prefaced with an executive summary and synthesis by Professor Emeritus Richard Blandy on behalf of the Hawke Centre. The combination of Professor Blandy's unstinting commitment and the efforts of the contributing authors has ensured that these expert papers can now happily inform a broader audience.

The volume is published under the responsibility of the Secretary-General of the OECD.

TABLE OF CONTENTS

Executive Summary and Synthesis <i>by Richard Blandy</i>	9
PART I REGIONAL INTEGRATION: THE BIG PICTURE	25
<i>Chapter 1</i> Regional Integration in Asia: Some Key Issues for the Future <i>by Michael Osborne</i>	27
<i>Chapter 2</i> Integration: "Think Global, Act Regional" <i>by Stephen Grenville</i>	43
<i>Chapter 3</i> Regional Integration: History and Trends <i>by Juan José Ramírez Bonilla</i>	69
<i>Chapter 4</i> Integration: The Way Forward <i>by K. Kesavapany</i>	85
PART II SECTOR-SPECIFIC ISSUES	101
<i>Chapter 5</i> Trade and Economic Integration in the Asia Pacific Region <i>by Homi Kharas</i>	103
<i>Chapter 6</i> The Evolution of Transport Arrangements <i>by T. R. Lakshmanan</i>	137
<i>Chapter 7</i> Education, Health and Culture <i>by Gavin W. Jones</i>	165
<i>Chapter 8</i> Alleviating Environmental Degradation in the Asia Pacific Region: International Co-operation and the Role of Issue-Linkage <i>by Raghendra Jha</i>	191

<i>Chapter 9</i>	Towards a Regional Rapid Response Co-operation Group in the Asia Pacific	
	<i>by</i> Clarita R. Carlos	235
ANNEX	Reflections on Asia Pacific Integration	
	<i>by</i> Mike Moore	281

Executive Summary and Synthesis

by

Richard Blandy

**Director, Centre for Innovation and Development
School of Management, Division of Business
University of South Australia**

The Asia Pacific is the world's most economically dynamic region. Most of its economies are growing persistently, at rates of between 3.5% and 10% p.a. The pace is such that East Asia (excluding Japan) now enjoys an average GDP per capita (in purchasing power parity terms) not far short of Western Europe's in 1950 (Angus Maddison, "World Development and Outlook 1820-2030: A Quantitative Perspective", Revised Note for the Meeting of OECD Economics and Environment Directorates, 25 June 2004, Table 2, p. 5). On present trends, East Asia will reach Western Europe's 1990 GDP per capita in 30 years' time (Maddison). In line with such growth, the region's share of global exports has doubled over the past 25 years, and many regional businesses have become either world market leaders or major links in the global supply chains of Western multinational corporations.

The Asia Pacific is also a region of great diversity, not only economically but politically, culturally and ethnically. Some countries in the region (Australia, Japan, New Zealand, Singapore and South Korea) already enjoy "Western" living standards, while most still have catching up to do. Within most of the latter countries, income inequality is high. Political arrangements range from democratic to authoritarian. Deep-seated conflicts and tensions exist between some countries and peoples. The region is home to large-scale adherence to many important world religions, including Buddhism, Islam, Confucianism, Hinduism and Christianity. China, Japan, India and Indochina have roots in ancient civilisations of world significance, while other countries possess equally dynamic but less globally significant cultures. Many of the peoples were subject to colonial rule or strong influence by European powers in the 19th and 20th centuries. Some still are.

Despite the frequent use of the term "Asia Pacific", there is no generally accepted definition of which places belong within the Asia Pacific region and which do not. Inclusion depends on economic, administrative, historical and

political perspectives as much as on the strictly geographical. For example, the Asia Pacific Network Information Centre (APNIC) is a not-for-profit, membership-based organisation, founded in Bangkok in 1995, that deals with Internet resource distribution in the Asia Pacific region. It is one of four regional Internet registries in the world. It covers 62 economies, including the island economies of the Indian Ocean (including Madagascar and the Seychelles to the west), as well as the island economies of the Western Pacific, together with Southeast Asia and Australia and New Zealand in between. It includes South Asia (to Afghanistan and Pakistan in the west) and East Asia (including Mongolia and both Koreas). It does not, however, include the Russian Federation or the Central Asian Republics. APNIC's headquarters used to be in Tokyo but are now located in Brisbane. Clearly, this regional grouping of places is useful in terms of effective global Internet management, but it does not concur with a number of definitions of the Asia Pacific useful for other purposes.

For example, the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) is a regional branch of a global entity: the United Nations Economic and Social Council (ECOSOC). There are five Regional Commissions reporting to ECOSOC; UNESCAP has 53 members and nine associate members. These include Turkey, Armenia, Azerbaijan and Georgia in the west (but not Iraq or Syria – they are part of the United Nations Economic and Social Commission for Western Asia, which also includes Egypt); the Western Pacific island countries in the east; the Russian Federation in the north; Australia and New Zealand in the south; and all the countries of South, Southeast and Central Asia, including the Maldives, Mongolia and both Koreas. It also includes the metropolitan powers (or former metropolitan powers) France, the Netherlands, the United Kingdom and the United States. UNESCAP's Headquarters are in Bangkok. This idea of the Asia Pacific reflects an amalgam of geography, global politics and colonial history.

The International Labour Organization's Regional Office for Asia and the Pacific (also headquartered in Bangkok) has three sub-regional offices – for South Asia (in New Delhi), Southeast Asia and the Pacific (in Manila), and East Asia (again in Bangkok).

As Mike Moore notes in the Annex to this volume, the Asia Pacific Economic Cooperation organisation (APEC) takes a "Pacific Rim" approach to defining the region. APEC was established in 1989 and has 21 member "economies" (solving the political problem of including Hong Kong and Taiwan in the membership along with China). The Pacific Rim concept allows

the inclusion of Canada, the United States, Mexico, Peru and Chile on the Eastern Pacific Rim, as well as all the “economies” on the Western Pacific Rim including the Russian Federation (but excluding North Korea). APEC’s “rim” approach also excludes the island economies in the centre of the Pacific, as well as Myanmar, Brunei, Cambodia and Laos, all of which are members of the Association of Southeast Asian Nations (ASEAN). To some degree, APEC appears to have been intended to be a counterweight to its perceived Asian regional rival, ASEAN. APEC’s inclusion of the two great powers, Russia and the United States, runs contrary to ASEAN’s desire to avoid entanglement in rivalry between those powers. In this sense, APEC is an overtly political interpretation of the Asia Pacific region (as is ASEAN). APEC is headquartered in Singapore.

ASEAN is headquartered in Jakarta. In her chapter on security, Clarita Carlos describes ASEAN as a loose, regional intergovernmental organisation aiming to foster fraternal relations through co-operation in various areas of common interest. It does not have a centralised decision-making structure and takes non-interference in the domestic affairs of member states as an article of faith, preferring to work through processes of consultation and consensual decision making. ASEAN has its origins in a collective effort in 1967 by Indonesia, Malaysia, the Philippines, Singapore and Thailand to avoid becoming enmeshed in conflict between the great powers, as Vietnam had become. Its purpose was also to defuse tensions between Malaysia, the Philippines and Indonesia arising from the formation of Malaysia by the colonial power (the United Kingdom) out of Malaya, North Borneo and Sabah. ASEAN’s unstated political goal was to prevent the “balkanisation” of Southeast Asia. Cambodia, Laos, Myanmar and Vietnam have subsequently become members of ASEAN. Timor-Leste, although formerly part of Indonesia, is not (yet) a member.

Notwithstanding the formation of the ASEAN Free Trade Area (AFTA) in 1993 and the proposal to create an ASEAN Economic Community (AEC) by 2020, ASEAN is not an inward-looking body. The organisation has an annual “dialogue” with China, Japan and the Republic of Korea (ASEAN + 3). As Stephen Grenville notes in his contribution on integration in this volume, ASEAN + 3 may well now be the most important regional arrangement in the Asia Pacific. ASEAN has signed a framework for co-operation with those countries. Free trade agreements are agreed or under discussion with China, Japan, the Republic of Korea, Australia, New Zealand and India. ASEAN has also established the ASEAN Regional Forum (ARF) to intensify its external dialogues in political and security matters. The ARF adds Australia, Canada, the

European Union, India, Japan, Mongolia, New Zealand, Papua New Guinea, the Russian Federation and the United States to ASEAN's own membership.

As Juan Jose Ramirez-Bonilla notes in his chapter on regional integration, ASEAN's evolution represents the most authentic indigenous attempt at regional integration in the Asia Pacific. Its view of the region has widened to take in the big East Asian powers (China, Japan and the Republic of Korea) and more recently to bring Australia and New Zealand into the fold. Its overtures towards India are highly significant. It is clearly aware of the importance of the idea of "open regionalism" in its engagement with other countries through the ASEAN Regional Forum. While its consensual decision-making processes may slow down progress towards achieving its goals and were not very successful in handling the 1997/8 Asian financial crisis, ASEAN does capture an Asian reality in its firmly "regionalistic" outlook, and in its respect for national sensitivities and the important need in Asia to save face. A less nuanced, soft, forgiving and unintrusive stance among the partners may now be more collectively helpful. But the regionalism that "ASEAN + n" projects is not an ersatz model foisted on the Asia Pacific from outside, but a home-grown political creation that has a chance to form the basis of an evolving regional entity with fluid geographical boundaries, areas, forms and degrees of engagement.

ASEAN, however inspiring, is not the whole Asia Pacific. The region is a group of countries surrounding ASEAN with strong and growing trade relationships among themselves and with many other bilateral and regional political, economic and social ties, including membership of many bodies such as the Asian Development Bank in Manila, APEC, and many regional branches of multilateral bodies such as UNECOSOC. Many of these countries also have extensive and important economic, social and political ties with countries outside the region. In this sense, the situation can be described as one of "open regionalism" – and notwithstanding the growing strength of regional arrangements, it seems very unlikely to change. The Asia Pacific is not a fortress, nor does it look likely to become one. It is also very unlikely to follow a path of political and economic union like Europe, even though parts of it – ASEAN, for example – plan to form a union in due course. The Closer Economic Relations (CER) treaty between Australia and New Zealand, while very successful, has not created the slightest impetus towards currency union or political integration (even though Australia's Constitution makes explicit provision for union with New Zealand).

The home-grown Asia Pacific region that does exist can be defined in the following terms. It has a core in East and Southeast Asia with fluid boundaries to the south in Australia and New Zealand, to the west in India, to the north in the Russian Republic, and to the east in the islands of the Western Pacific.

Most of the strong relationships of various kinds among the countries of this region have been driven by market forces rather than by formal frameworks of co-operation *per se*. Relationships outside the region are also significant, both for individual countries and for the region as a whole. But such relationships do not change the true economic, social and political meaning of the region as an independent and interrelated Asia Pacific identity much (if not universally) inspired by the Japanese economic model.

The significance of Japan is that it offered the example of a successful *Asian* development strategy, different from that followed by the Western colonial powers. This model was based on a strong, vertical, paternalistic state, offering widespread social and economic gains (without a class struggle between capital and labour), and built around large industrial conglomerates able to compete with the West. This was the model followed by South Korea, Taiwan, Singapore and Malaysia. In the aftermath of the withdrawal of the colonial powers after the Second World War, this model emphasised the development of inter-regional trade and capital flows and the development of local savings and resources rather than relations with the metropolitan powers. A regional market developed as a result, raising growth and savings rates. Industrialisation was rapid, accelerated particularly by low raw material prices in the 1980s. Japan (and later South Korea and Taiwan) became capital exporters to Southeast Asia, and eventually to China.

The Chinese Diaspora throughout the region may well have played a role in the development of this integrated regional market. In any case, regional economic integration has been the result not only of the internationalisation of the productive activities of Asian enterprises, but also of the global investment and production activities of large multinational corporations. Trade integration *within* the Asia Pacific region is very high, in fact higher than within Europe. The 1997/98 Asian financial crisis swept through the countries of the region in part because of their very economic relatedness and the inadequacy of regional intergovernmental rules and controls at the time. Emphasis is now being given by the governments within the region to constructing a more secure architecture to govern regional intergovernmental co-operation and the regulation of economic affairs. As K. Kesavapany notes in his chapter on Asia Pacific perspectives on regional integration, these developments are partly spurred on

by concerns within ASEAN that Southeast Asia will be overtaken economically by China and India. To avoid this, a redoubling of integration efforts is seen as needed in order to retain the attractiveness of the region as a destination for foreign direct investment, and to reduce transactions costs within the region for multinational corporations.

The economic success of the Asia Pacific also shows the dynamic possibilities of departing from a strictly liberal (static) economic philosophy. While global integration is desirable, it does not necessarily follow that all integration should be based on multilateral arrangements. A layering of bilateral, regional and multilateral arrangements is needed because there is often a bigger payoff to integrating with neighbours, and therefore a stronger motivation to act regionally. Such regional economic gains increase the chances of neighbourly behaviour in political and other areas. That must surely be counted as part of the overall welfare gains from regional integration: the highest priority is always to get along with one's neighbours. After all, a major purpose of, and welfare gain from, European regional integration has been to reduce the likelihood of war between the European states, as well as to build a European political identity capable of taking an course independent from that proposed by the superpower(s).

Economic integration provides gains not only from trade but – even more importantly – from the fresh access to new ideas. In many ways it is also the *rules* that flow from economic integration that are beneficial to the countries. These are necessarily uniform, forcing countries to improve their own institutions and policy making in order to compete and attract capital. Rules increase efficiency, reduce uncertainty and cut transactions costs. But these rules and institutions must also ensure that an equitable share of benefits flows to all the economically integrating countries. The importance of rules can be seen, for example, in the impact those of the European Union have in bringing about reforms in aspirant member countries. These countries must decide whether the gains they will receive from membership are sufficient to compensate the losses that will usually also be part of the changes flowing from the adoption of new rules.

Global rules are often the best rules because all countries in the world then have to play the same “game”. But global rules are not nearly as well developed (or enforced) as national rules, and political resistance to further extension of truly global rules is now intense (European and Japanese farmers and US shipbuilders, for example). Regionalism offers a potentially easier political opportunity to make progress towards uniform international rules of substance,

combined with regionally focused institutions designed to sustain co-operation and understanding and to share the gains regionally in an acceptable way. The 1997/98 Asian financial crisis created a regional watershed about rules. It is now generally judged that the International Monetary Fund (dominated by the United States and European countries) and other multilateral global institutions failed the region. This has given impetus to the creation and strengthening of regional arrangements (which might also give the region a louder voice in global rule making).

Most of the authors in this volume agree that there is presently scope for major regional collective action in the Asia Pacific. One proposes improving regional trade dispute settlement arrangements. Another proposes regional improvements in the security of international bonds offered by Asia Pacific countries, in foreign investment dispute resolution and in the prudential supervision of international capital flows. A third sees scope for regional action in the liberalisation of agricultural and services trade, as well as in “behind-the-border” institutional and regulatory reforms covering technical barriers and product standards (“trade facilitation”), transport and logistics, intellectual property rights, competition policy, and environment and labour standards. Such “behind-the-border” reforms are as important for welfare gains as trade liberalisation itself.

Changes in the relevant rules affecting these matters requires a commitment by countries in the Asia Pacific to implement many domestic reforms, to strengthen regional bureaucracies (for example in ASEAN), to co-ordinate, implement and enforce the rules, and to establish suitable institutions with supranational powers. Whether there is sufficient political will in the Asia Pacific region to push forward with these difficult changes is not entirely clear at this point. One option is to allow groups of countries to integrate at different rates (*i.e.* to adopt different rules in the short run with a view to achieving convergence in the long run), rather than to hold back for the pace acceptable to the most reluctant integrator.

The next round of integration reforms will be difficult, notes Homi Kharas in his chapter on trade, because many of them address “sensitive sectors” that have been excluded from integration in the past. For example, cutting regional barriers to trade in agricultural commodities is very sensitive politically and socially, but is also especially important economically – particularly for poverty reduction in the region, as the main gainers from agricultural integration will be poor farmers and urban workers. China’s commitment to low protection in agriculture is very fortunate in this respect. Other countries in the region will be

able to export to China, increasing the incomes of poor (agricultural) households in other countries and reducing food prices for urban households in China. China's commitment offers scope for a broad-based regional liberalisation of agriculture that offer great prospective welfare gains for the people of the region (matching the gains from trade liberalisation in manufacturing alone). Further, it is possible that such an initiative may inspire and support emulation in other parts of the world that continue to protect their agricultural sectors, enabling a major global advance in economic welfare and major gains for the poorest in developing countries everywhere.

Service sector liberalisation also offers major gains because competitiveness there affects supply chain efficiencies that impact the competitiveness of agriculture and manufacturing. But reform of the services sector is often regarded as sensitive politically and socially as it offers incomes (albeit low incomes based on low efficiency and productivity) to large numbers of people. While a non-preferential, multilateral approach to service sector reform offers the greatest gains, a regional approach provides “learning by doing” advantages and more “policy space” for regulatory co-operation, for example in harmonisation and mutual recognition of regional neighbours’ domestic regulations in professional and other services.

Trade facilitation is becoming more critical to economic integration. It requires rationalising product standards that have often been used artificially to protect domestic producers, and accelerating customs, quarantine and safety clearances that have often been used for the same purpose. Rationalising product standards in a regional context is a good first step, together with mutual recognition agreements to accept national differences that essentially achieve the same ends.

Transport and logistics improvements also offer a big payoff for the Asia Pacific, as many of the countries move from being resource-based economies to being producers of low- and medium-technology goods and services, to being producers of high-technology goods and services. Time and reliability are essential in international supply chains affecting sophisticated, high-margin, high-volume goods and services, including flowers, fruit, seafood, electronics and international tourism, for example. High internal transport costs and inadequate port logistics are key problems in the path of reaping full gains from economic integration now that the costs of international transport have fallen greatly. High internal transport costs and inadequate logistics also have a particularly bad impact on people living far from coasts; the value of their export products and services (tourism, for example) is eaten up by those costs,

which also add greatly to the prices of incoming goods and services and so reduce real living standards.

Indices of environmental sustainability and labour standards place some countries of the Asia Pacific near the bottom of world ladders. This may be a normal result of economic development following the so-called “environmental Kuznets curve”, which predicts a worsening of standards up to some level of per capita income, after which standards improve. Raghendra Jha, in his chapter on environment, argues that that historical pattern could be advantageously short-circuited in the Asia Pacific. Exports from and investments in pollution- and labour-intensive sectors can be shown to increase when standards are raised (*i.e.* when the rules are changed). The reasons are technological upgrading and skills development that raise productivity, incomes and profits. As incomes rise, domestic demand in the Asia Pacific for better environmental and labour standards also rises; the adoption of Western “triple bottom line” standards globally by large Western multinational corporations is an additional force leading to better environmental and labour rules in the Asia Pacific.

In order to pursue these reform agendas, Asia Pacific policy makers will continue to need popular support. The people must see these next reforms as continuing to reinforce social stability and address inequalities. That is why specific and visible measures are needed in association with integration reforms that directly target restraints affecting the poor – inadequate roads and infrastructure, export taxes, illegal fees, public sector corruption, monopoly buyers (often government agencies), and so on. To succeed, regional integration initiatives must continue to provide a compelling vision of how they can deliver broadly shared growth and prosperity.

These issues can be more forcefully illustrated by exploring a number of areas in greater depth: migration, energy, air transport, education, health and culture, the environment and security.

Coming first to migration, Michael Osborne observes in his chapter that some parts of the Asia Pacific (Japan, China and Korea, for example) have rapidly ageing populations and labour forces, while other parts (*e.g.* Bangladesh, Cambodia and India) do not. The pressures on health and aged care systems in the countries with ageing populations (where “support ratios” are falling) could be eased if there were greater cross-border movement of people from countries whose populations are younger. Short-term and “irregular” migrants are already substantial in some parts of the region (Malaysia and Thailand, for example), while there is a growing demand for highly skilled

workers throughout the Asia Pacific and a falling supply of unskilled workers. There are large potential gains to the people of countries of emigration, as well as to the people of the countries of immigration in the region, provided that the flows of people can be monitored and controlled in ways acceptable to the countries concerned and the social conditions of migrants in countries of destination can be protected.

With regard to energy, demand in the Asia Pacific is increasing faster than supply. Resolution of this imbalance will require not only very large regional investments (one-third of global investments in energy over the next 25 years), but also regional solutions and a high degree of regional co-operation to enable them to happen. Power stations to supply electricity and gas are not necessarily best located in the countries where the energy will be consumed. Trans-border gas, oil, coal, uranium and electricity transportation infrastructures need to be built, including not only pipeline and cable networks, but also ports and logistics systems. Regional environmental problems associated with the Asia Pacific's massive future production of energy also need to be solved.

In air transport, as T.R. Lakshmanan argues in his chapter, many barriers hinder the spread of international and regional competition. These barriers essentially flow from governments' efforts to protect "national flag carriers" from foreign competition by entering into bilateral agreements to share international traffic, by excluding foreign competition on domestic routes, and by intervening in the development of airports in ways that raise the costs of air transport. The barriers are particularly focused on passenger traffic, with the result that passenger airlines are smaller than in the United States, airports are congested, and the hub-and-spoke systems for collecting and distributing passengers are inefficient. Regional airfares are high (adjusted for distance), and airport and airline productivity are low compared with the United States and Europe. The most profitable and flourishing airlines are Singapore Airlines and Cathay Pacific, which operate with much less government protection than other airlines in the region. Air cargo transport is different from air passenger transport because of the need to integrate manufacturing production in the Asia Pacific efficiently into global manufacturing supply chains, especially at the high-value-added end. Protection of national flag carriers and domestic carriers occur less frequently in the cargo operations of airports than in passenger operations. Asia Pacific airports are the equal of United States airports in the volume of cargo handled and, FedEx aside, Asia Pacific airlines are the equal of United States airlines in the volume of cargo transported.

With a dramatic rise in air passenger travel (particularly tourism) expected in the Asia Pacific region over the next decade, reforms in the rules governing air passenger transport are needed if the gains from this increase in demand are to be maximised. The tourism market will require lower fares if it is to meet its potential. Many new domestic airlines have emerged in the region with a desire to expand regionally and internationally. Removing flag carrier rights will see total traffic expand even if the presently designated national flag carriers carry a smaller share of it at lower prices.

One essential difference between air passenger services in the United States and those in the Asia Pacific is that the former are domestically traded while the latter are internationally traded and can, therefore, be more subject to misguided, mercantilist objectives by national governments. Here is a classic example of how *regional* regulatory reform is needed in order to promote more open regional access so that air passenger services can become cheaper and better for their customers, including the development of an efficient intra-regional and intercontinental hub-and-spoke network. The sorts of reforms required include the multiple designation of permitted carriers on particular routes, removal of capacity and fare restrictions and support of foreign carrier rights to carry domestic passengers to third countries (e.g. Singapore Airlines carrying Australian domestic passengers from Sydney to Los Angeles). Air cargo might be used to spearhead such liberalisation because it is less sensitive. Code-sharing alliances might be encouraged so that particular groups could increase market share without increasing their investment in the network. “Phased multilateralism” could be used, allowing some groups of countries to move to “open skies” policy regimes ahead of other groups, which could join in later.

In education, Gavin Jones argues in his contribution to this volume that the wide differences in educational provision and outcomes that exist in the region offer scope for collaborative arrangements of various kinds to assist the less developed countries to advance faster. While a number of global agencies offer regional and national assistance, a regional agency (the Southeast Asian Ministers of Education Organisation – SEAMEO) is regarded as dominant in the field, largely taking over the role of ASEAN and enjoying the support of advanced country associate members such as Australia, Canada, France, Germany, the Netherlands and New Zealand, as well as a “donor country” – Japan. There are also many bilateral programmes of assistance, not only from advanced to less developed countries but also “South/South” programmes (using advanced country funds) with Thailand assisting Cambodia, Laos, Myanmar and Vietnam, for example.

Non-government educational initiatives have been even more significant, as illustrated by the dramatic “internationalisation” of university programmes in the region. Australia and New Zealand have long offered many thousands of university places to foreign students, mostly from the region, in offshore as well as onshore programmes. But international integration of university education is now spreading throughout the region. Malaysia, for example, hosts campuses of four foreign universities as well as 36 private colleges set up in collaboration with foreign universities. There are now 30 000 foreign students studying in Malaysia, while Thailand and the Philippines have opened post-graduate university programmes in English. The National University of Singapore has operational links with many prestigious foreign (including regional) universities, while Universitas 21 Global was set up in Singapore in 2003 as an online university aiming particularly at Indian and Chinese students and supported by 16 research-intensive universities in Asia, Australia, New Zealand and Canada. There is an ASEAN University Network and an Association of Pacific Rim Universities linking a number of the region’s universities.

Language poses particular issues for the region. English is overwhelmingly dominant as a medium of instruction and communication at the middle and upper levels of education in the region (and is generally required for university graduates seeking work in the largest companies). This raises problems in terms of maintaining national languages and local dialects – a classic cultural issue of globalisation and integration. Singapore and the Philippines are well placed in the region to capitalise on their national capacity in English.

Health has improved markedly in the region over the past 50 years, with life expectancies rising generally by around 25 years, but there are wide differences between countries. Health remains an important area for collaboration and assistance from more advanced to less advanced countries as the region becomes more integrated, not least because of the increasing risks of diseases spreading internationally as a result of increasing international travel, business and trade. The region’s recent problems with SARS (Severe Acute Respiratory Syndrome) and avian flu vividly illustrate the issue. SARS exposed problems over the rights of countries to issue travel warnings to their nationals adversely affecting the economies of destination countries (even those SARS-free), over differing screening of departing passengers, differing arrival health declaration cards, and non-standard border controls in different countries. Eventually, countries in the region agreed not to deport suspected cases of SARS to their country of embarkation, but to treat them in the country of arrival and to follow World Health Organization (WHO) guidelines. WHO played a pivotal leadership and co-ordinating role in the region’s dealing with the SARS

outbreak, including its role in determining when countries could be declared free of SARS.

This is an important example of a *global* multilateral agency playing a key *regional* role in the Asia Pacific, based essentially on the expertise and standing of the WHO in its field and notwithstanding the WHO's unorthodox arrangement of its affairs in the region into two offices, dividing the ASEAN countries between New Delhi and Manila. WHO is more dominant regionally in health than UNESCO is in education. UNICEF is noted for its effective infant and child health programmes in the region. The World Bank and the Asian Development Bank play important roles as lenders. ASEAN is also more directly active in health than in education, particularly in relation to HIV/AIDS and other communicable diseases, and food safety. AusAID is one of the more important bilateral partners in the region. However, more emphasis deserves to be given regionally, through collaborative agreements, to HIV/AIDS, tuberculosis, malaria and drug addiction.

Cultures are always affected by interactions among them. Governments spend a good deal of time sustaining and promoting their cultures in the face of competition from other cultures. ASEAN and the governments of the region support numerous dance, music and theatre festivals, for example. Singapore and Bangkok hold prominent film festivals, supporting regional (as well as non-regional) films. Language issues emerge in cultural matters as well as in the educational ones discussed earlier. Should books, radio, television and films be written (or spoken) in English (in which case there may be a wide regional and even global readership or audience), or should they be written (or spoken) in local languages and dialects? Subtitling offers one solution in films. But what about books, radio and television? MTV Asia, a very popular private sector television group (especially among young people), presents a hybrid mixture of English and local language segments anchored by a mixture of Westernised English-speaking Asians and national language presenters. This innovative approach is typical of the dynamism of the private sector in solving many regional problems in the Asia Pacific.

Environmental problems are among the most significant of the difficulties facing the Asia Pacific (costing perhaps up to 10% of GDP in China and 6% in India), notwithstanding the Agenda 21 and Rio declarations, and 180 issue-specific environmental treaties at global or regional level, including the Kyoto Protocol. The reasons are that the incentives contained in these international proposals are insufficient to induce effective action within the region, and that the main problem in the region is *local* degradation (soil erosion, local air and

water pollution, congestion and open access resources) while the main international focus has been on *international* pollution (such as greenhouse gas emissions and climate change). Notwithstanding this balance in environmental issues, by 2020 the Asia Pacific will be the world's largest producer of greenhouse gases and sulphur dioxide.

The Asia Pacific region is characterised by land and forest degradation, including erosion and desertification, habitat and species loss, alien species proliferation, water scarcity and pollution, marine degradation and pollution, air pollution, floods, droughts, earthquakes, tsunamis and volcanic eruptions. Half the drylands in the Asia Pacific are affected by desertification. The region has the lowest per capita availability of fresh water in the world. Less than half of the population has proper sanitation. Air pollution levels are among the highest in the world. The Asian brown cloud reduces sunlight reaching the surface by 10%. The Asia Pacific's major problems and vulnerability now flow from its environmental problems.

The most effective solution to these problems is to include the costs of environmental degradation and pollution in the costs of production in the Asia Pacific, *i.e.* to "internalise" these "external costs" (or "spillovers"), by imposing appropriate ("Pigou") taxes or introducing effective ("Coasian") bargaining between affected groups. The technology now exists to decouple degradation, pollution and energy use from economic growth, provided relative prices justify its use. The existing scientific standard-driven, declaratory, global environmental regulatory architecture has not dealt effectively with the Asia Pacific's serious environmental issues. A new global (or at least regional, Asia Pacific) agency is needed based on putting together deals between a limited number of parties (groups of countries). Such a process would aim for Asia Pacific countries with major environmental problems, agreeing to address them in exchange for receiving benefits elsewhere. This process would be similar to the World Trade Organisation's bargaining rounds aimed at reducing international trade barriers. What is needed is to ensure that the issues over which bargaining takes place are sufficiently large that there are adequate gains for all participants, for example by including trade and cash payments into the bargaining mix as well as domestic and international environmental issues. Thus, the less developed countries in the Asia Pacific might agree to link a reduction in greenhouse gas emissions and in trade barriers in exchange for foreign assistance for domestic environmental policies, broad-based trade concessions (including in agriculture), and some additional aid contributions. Simulations of such trading show that it could greatly improve environmental

management in the less developed countries (as well as significantly reducing trade barriers worldwide).

In recent years, security has come very much to the forefront of issues over which better regional co-operation is needed. Like everything else, organised crime in the Asia Pacific (*e.g.* drug and people trafficking, money laundering, fraud, goods counterfeiting and cyber crime, including identity theft) is increasingly operating across borders, while armed threats are shifting towards non-state actors, such as sea pirates and international terrorists, who are having a big impact on the region. These developments are fuelled, at least in part, by inequality and poverty, the social, economic and political marginalisation of many social sectors, and the rise of militant Islam. Indonesian waters are the world's most dangerous. Large numbers of attacks against small tankers in the Straits of Malacca even threaten eventual environmental disaster. In addition, the Asia Pacific is home to a disproportionate share of the world's natural disasters (in particular, floods, earthquakes, eruptions and tsunamis) and infectious disease outbreaks (*e.g.* SARS and avian flu), inviting the creation of some form of rapid, co-ordinated regional response.

A number of security initiatives have, of course, been taken in the region. In 1997, ASEAN issued a Declaration on Transnational Crime and, in 1999, established a Centre for Combating Transnational Crime – which intensifies co-operation in information exchange, law enforcement and capacity building. In 2001, ASEAN issued a Declaration on Joint Action to Counter Terrorism, which led to a number of practical measures. In 2003 APEC established a Counter Terrorism Task Force. But despite declarations, plans have been slow to be implemented, regional groupings' response seems to be slower than what is often needed, and counterterrorism remains largely *ad hoc* and bilateral in organisation, because bilateral response is often fastest and best directed. ASEAN has not been able to put its counterterrorism and anti-transnational crime programmes into effect as quickly as needed because it is limited by ASEAN's customary decision-making processes. The so-called "ASEAN Way" puts primacy on national sovereignty and non-interference in members' affairs. This approach limits the implementation of counterterrorism initiatives that entail countries surrendering some of their sovereign rights. The approach has also produced weak co-operation mechanisms and institutions. Further, many issues need highly specialised and technical co-operation and support (for example, explosives investigations, body identification and computer examination) which may only be available from particular sources.

A new approach based in a new institution may therefore be helpful in improving security in the region. A “functional” body might meet this need – one with a specific mandate to address issues that cross political boundaries and build up expertise and co-operation through undertaking a positive work programme. Building common habits and interests as part of that programme will superimpose an overlay of common activities and administrative units across national frontiers and agencies. Such a regional body (or group of bodies) would undertake an expert work programme designed to contribute to both the prevention and mitigation of security crises in the Asia Pacific.

As this book shows, regional integration in the Asia Pacific is likely to be driven strongly by practical considerations above all else, in the near-term future and perhaps for a long time. Particular issues that can be dealt with more effectively with regional solutions than with other sorts of solutions are likely to become the focus of regional collaboration and integration. Issues not so capable of regional solution are likely to be addressed in other ways. The region’s main problems are probably in the areas of environment and security. To what extent these will be dealt with regionally and to what extent in other ways, only time will tell. In any event, practice with regional approaches in specific areas is likely to increase people’s understanding of each other as well as the region’s skill and confidence in building more bridges across borders in due course. Hence, it seems unlikely that the trend towards regional integration will stop flowing soon. Further, it must be said that the region’s economic success is inspiring for its people. That success helps create the feeling of an important shared objective to which all can contribute and in the rewards from which all can share. Whatever its shortcomings, the Asia Pacific is an optimistic and open place, one unlikely to want to build walls to keep the rest of the world at bay.

PART I

REGIONAL INTEGRATION: THE BIG PICTURE

*Chapter 1***Regional Integration in Asia: Some Key Issues for the Future***by***Michael Osborne****Director, OECD International Futures Programme***

Globalisation trends have dominated much of the news media in the past ten years; many studies have documented the drivers and the process of global economic integration. Understated is the role that regional economies play in relaying globalisation effects, both within and beyond the region. Regional integration has long been on the agenda within the Asia Pacific, but it has advanced at a slower pace than efforts in Europe and North America.

There are now some very good reasons for stepping up policy co-operation and the rate of integration in the region. This is because, looking to the longer-term future, a number of imbalances are emerging that render this a more urgent issue.

Three illustrative examples of such growing imbalances are to be found in the fields of demographic change, industrial development, and health. All call for improved institutional mechanisms for international dialogue and policy improvements in the region.

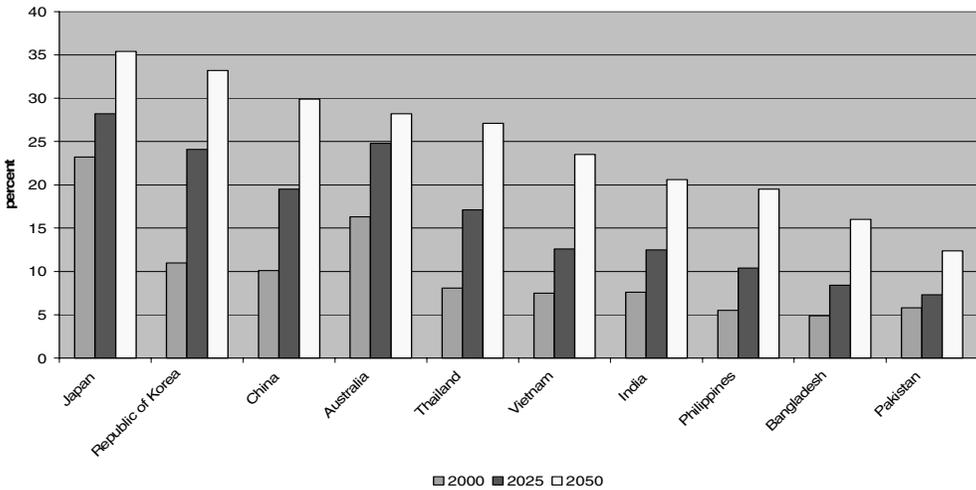
The global ageing process

A first burgeoning imbalance lies in the age structure of the Asian region. Over the next 30-50 years, the share of the elderly (already high in Japan and Korea) will increase significantly in some countries (*e.g.* China) but less so in others. It will be important for growth and dynamism in the region to even these differences out through the movement of people across the region. This will require finding co-operative solutions on a bilateral and regional level.

* Thanks go to Marit Undseth for her excellent research input into this paper.

Worldwide, the number of people aged 60 and over will increase from about 600 million in 2000 to more than 1 billion in 2025 (UN Population Division, 2002, p. 48). Half of these elderly people will be living in Asia. The ageing process will, however, occur at different speeds across the region. The developed countries will be harder hit than the rest. This applies in particular to Japan, where more than one-third of the population will be over 60 years old in 2025 (and more than two-fifths in 2050) (UN Population Division, 2002, p. 286). China finds itself in a similar, but less advanced, situation. Currently, 10% of the Chinese population is 60 years old or more, but this number will grow rapidly to 30% in 2050 (UN Population Division, 2002, p. 178). Korea shows a similar trend.

Figure 2.1. Share of persons aged 60 or more in selected countries, 2000-2050



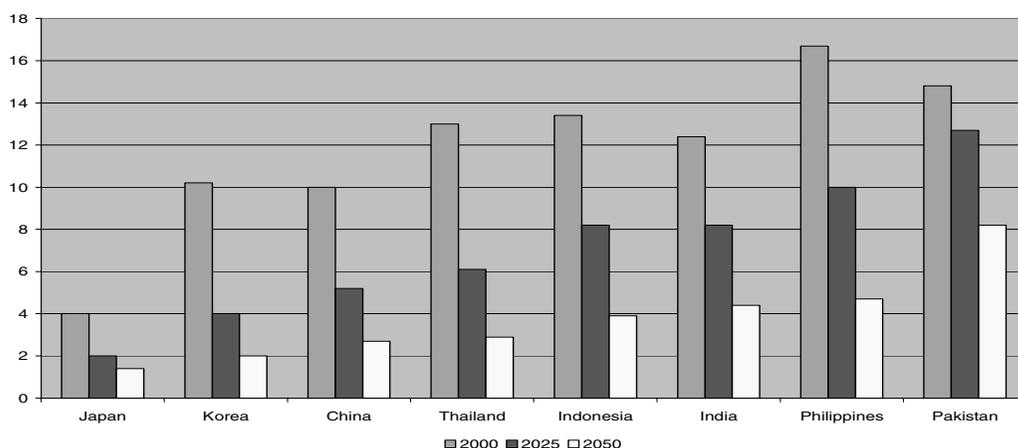
Source: UN Population Division, Department of Economic and Social Affairs, *World Population Ageing 1950-2050*, UN, New York, 2002.

On the other hand, there are countries in South and West Asia with very young populations, in which the share of the elderly is much lower – between 5% and 10%. In India for example, the population share of the elderly is 7.6% (UN Population Division, 2002, p. 270). In Bangladesh and Cambodia, the population shares of the elderly are even below this range, measuring 4.9% and 4.4%, respectively (UN Population Division, 2002, pp. 132 and 162, respectively). Such countries will also nonetheless experience a relative ageing of their populations. Broadly speaking, the share of the elderly is projected to

double in the more developed countries in the Asian region, whereas the ageing process will be slower in the less developed countries.

As in other parts of the world, the ageing process in Asia will have major social repercussions in the years to come. One dimension of such repercussions is the rise in the numbers of elderly that the working population will be called upon to support. Figure 2.2 below shows how many working age people will potentially be available in the future to support each non-active elderly person in a number of Asian countries. This “potential support ratio” is projected to fall significantly over the next 50 years.

Figure 2.2. Potential support ratios in Asia, 2000-2050*



* The potential support ratio is the number of persons in the active working population (aged 15-64) divided by the number of persons aged 65 or more.

Source: UN Population Division, Department of Economic and Social Affairs, *World Population Ageing 1950-2050*, UN, New York, 2002.

The most critical example is Japan. In 2000, there were four working persons for each retired person, while in 2050 this number will have more than halved (to 1.4) (UN Population Division, 2002, p. 286). Although Asian governments have started preparing for the changes in population age composition, economic pressures will inevitably increase, both on state expenditure and on the working population, in terms of social contributions. Furthermore, the ageing population will induce increased demand for health care personnel. Finally, without increased efficiency, shrinking working populations would lead to reduced economic output. Cross-border migration offers one way of partially alleviating the financial problems; this would

provide increased numbers of skilled workers and enable economic output to be maintained at a higher level. However, current migration rates are quite low in Asia, and there are a number of obstacles blocking the further deregulation of cross-border labour movement.

Changing patterns of migration

Asia used to be an exporter of migrants, especially towards the West. However, with the improved performances of the East and Southeast Asian economies from the 1970s onward, Asia itself became a migration destination. It is estimated that in the beginning of the 1980s, East and Southeast Asia had about one million foreign workers (including long-time resident Koreans in Japan and Indonesians in Malaysia). This number had tripled by 1990, and may now amount to more than 5 million, both legal and irregular, according to estimates of ESCAP, the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP, 2001, p. 1). There are regional differences in the types of migration. East Asian governments tend to accept mostly highly skilled migration, whereas unskilled labour is more common in Southeast Asia. It is, however, possible to identify two common features: short-term migration is encouraged, and an important share of the migration is irregular (see Table 2.1 below).

Table 2.1. **Estimates of irregular migrants in selected Asian countries, 1997**

Countries/regions of origin	Japan	Korea	Chinese Taipei	Malaysia	Thailand
Bangladesh	5 864	9 033		246 400	
Cambodia					68 468
China	38 957	57 722			
Indonesia		2 353	2 700	475 200	
Korea	52 854				
Malaysia	10 926		400		
Myanmar	5 957			25 600	684 676
Pakistan	4 766	5 935		12 000	
Philippines	42 627	13 909	5 150	9 600	
Chinese Taipei	9 403				
Thailand	38 191	8 200	6 000	8 000	
Vietnam		6 389			
Other	72 242	43 448	5 750	23 200	92 135
Total	281 157	148 048	20 000	800 000	845 279

Source: International Organization for Migration (IOM), *Labour Migration in Asia*, IOM, Geneva, 2003, p. 17.

Migratory flows

In the future, there will most likely be a growing demand for highly skilled labour in the region. Shortages have been identified in professional occupations (mechanical engineers, IT); management (production and operations managers); and the trades (toolmakers, electrical mechanics and motor vehicle mechanics) (UNESCAP, 2001, p. 35). Ageing will exacerbate labour shortages in the health sector. In addition, demand for unskilled migrant labour is also likely to rise, following increases in living standards in countries of destination that could be expected to make people in those countries less willing to undertake low-wage, unskilled jobs.

There are strong economic arguments for increased migration in the region, as in other parts of the world. Improvement in economic circumstances for the migrants themselves is, of course, a major factor. Potential support ratios could be improved and economic output sustained in the destination countries. Migration could also imply economic gains for the countries of origin. Unemployment rates could fall and remittance payments would increase, as well as the chances of technology transfer and skills formation. The Central Bank of the Philippines reported that remittances amounted to USD 7.6 billion in 2003, equivalent to 10% of the country's GDP (Central Bank of the Philippines, 2004).

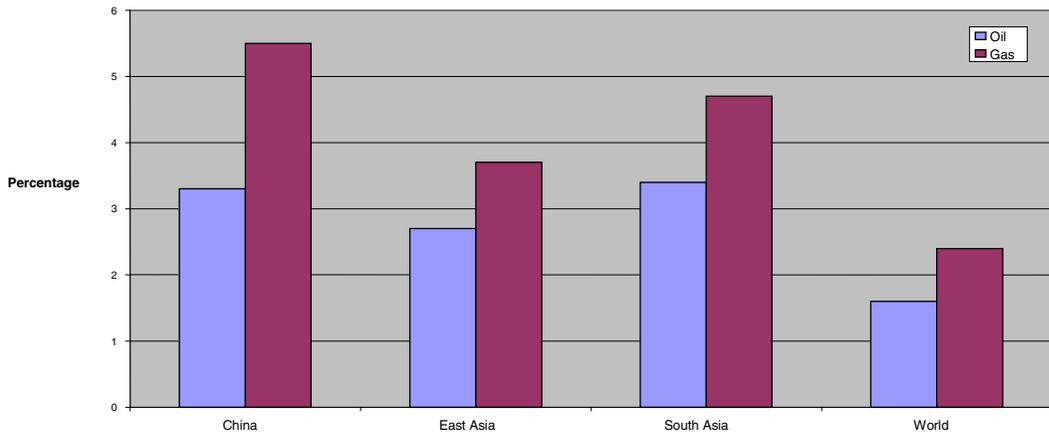
These positive economic arguments, of course, have to be weighed against possible negative effects of increased migration. There are important issues relating to the social conditions and rights of unskilled immigrant labour, equal treatment of highly skilled and less-skilled migrant workers, the implications of a brain drain from countries of origin, and illegal immigration.

Energy demand in Asia

A second example of long-term imbalances in the Asian region is the increasing mismatch in many countries between the needs of their growing populations and each country's capacity to meet such needs through its own industrial development. Energy is a case in point. Massive investments in energy infrastructures will be required in the next 50 years to sustain economic growth – but these will likely prove difficult given the amount of regional co-operation it will take to raise and channel the finance to where it is needed, build the necessary trans-border infrastructures, and find solutions to the regional environmental questions that higher energy consumption is almost certain to create.

The combination of population growth, urbanisation and economic growth is putting huge pressure on existing distribution patterns of energy, including fossil fuels. In the years to come, Asia is expected to account for the largest share of the increase in world energy demand. Oil demand in China alone is expected to rise by 7 million barrels per day (mb/d), from 4.9 mb/d in 2000 to 12 mb/d in 2030 (IEA, 2001, p. 63). Asian emerging economies would account for about one-third of total global demand increase (IEA, 2003a, p. 3).

Figure 2.3. **Oil and natural gas demand, average annual percentage growth, 2000-2030**



Source: IEA, *World Energy Outlook 2002*, IEA, Paris, 2001.

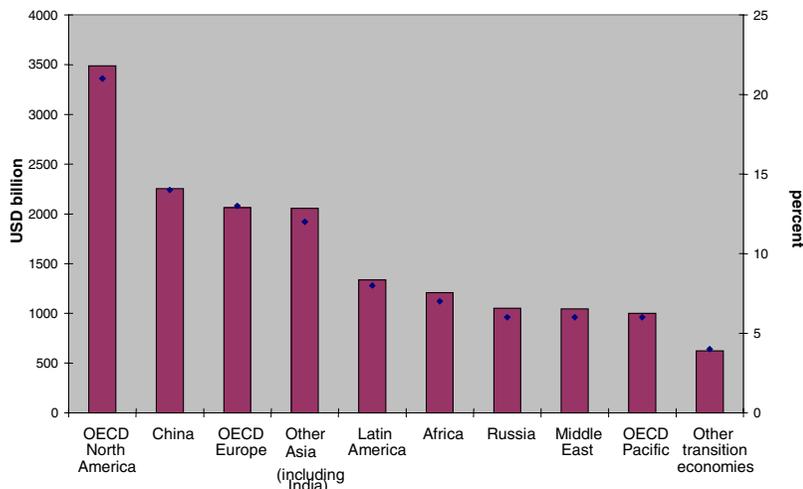
Demand for natural gas is projected to grow faster than that for oil over the next three decades, mainly driven by increased power generation. Gas is competitively priced, and relatively environmentally friendly. However, here – as with oil – there are problems of import dependency. The main short-term natural gas supply will be liquefied natural gas (LNG) from the Middle East. Import dependency on Middle East LNG will increase substantially over the next three decades.

The necessary investment

The International Energy Agency (IEA) projects total investment requirements for energy supply worldwide at USD 16 trillion over the next 30 years. While the OECD Pacific countries (Japan, Korea, Australia and New Zealand) are expected to account for about USD 1 trillion, China and other Asian countries (including India) will need some USD 4.3 trillion of

investments. Asia, taken as a whole, will therefore account for about one-third of the world's energy investments through to 2030 (IEA, 2003b, p. 47).

Figure 4: **Cumulative Energy Investment by Region, 2001-2030**



Source: IEA (2003), *World Energy Investment Outlook*

Energy investments will take up a substantial share of GDP in all regions. In China and India, they will amount to 2.2-2.4% of GDP according to the IEA's projections, but somewhat less in other Asian countries. What seems clear is that in the years to come more of the capital needed for energy projects will have to come from foreign sources – and from private sources – than in the past, making closer regional co-operation imperative.

Regional supply networks

In order to diversify energy sources and ease dependency on Middle East oil, there will be a need to shift from oil to other energy sources (*e.g.* gas) – and to find other energy suppliers. Several studies have been made of the potential of connecting Russian, Chinese, Korean and North Korean electricity grids (IEA, 2003a, p. 4). The plans include the utilisation of hydropower and natural gas in Siberia to supply electricity to China, Korea and North Korea. However, a solution to East Asia's long-term energy needs based on electricity supply from Russia is subject to a series of uncertainties: economic, structural and political.

Gas networks in Asia are poorly developed. Both China and Japan lack fundamental infrastructure for domestic gas usage (IEA, 2003a, p. 5). Japan lacks a domestic gas pipeline network because of regionally segregated gas markets. China lacks adequate gas transportation and distribution networks. This deficiency could be a disincentive for the development of international gas supply networks. To remedy this, the Chinese government has put a lot of emphasis on developing a gas network in its current five-year plan. This network would particularly serve Beijing. Another 4 000 km pipeline linking Shanghai with the West is also planned (IEA, 2003c, p. 15).

There is also a lack of supply infrastructure in Russia. The gas network in East Siberia has yet to be built (IEA, 2003a, p. 6). The Russian producer Gazprom is not only short of funds for its own new investments, but also opposed to third party access. This opposition is one of the factors blocking the ratification of the European Energy Charter. It will be important to attract foreign direct investment to speed development of the Russian gas industry.

Several difficult political problems also hinder regional energy co-operation. This applies in particular to the Korean peninsula. The energy shortages of North Korea have been interlocked with nuclear issues affecting that country. So far no solution has been found. There is also doubt whether gas pipelines from Irkutsk and Sakhalin will be allowed to pass through North Korea (IEA, 2003a, p. 6). Furthermore, political relations need to be improved between Japan and Russia and between Japan and North Korea, if regional energy co-operation is to reach its full potential (IEA, 2003c, pp. 15-16).

The environmental implications

Finally, associated with its huge prospective increase in energy consumption, Asia faces enormous environmental challenges in the years to come. This applies in particular to China and India, whose main fossil fuel is coal. China is already the world's second largest emitter of CO₂, and will, according to IEA projections, produce 18% of world emissions of CO₂ in 2030 (IEA, 2001, p. 268). Coal will eventually be replaced by other energy sources, first by oil and subsequently by natural gas. Demand for renewable energies will also increase. However, even if coal is replaced by less polluting energy sources, environmental problems will persist. CO₂ emissions per capita are currently very low in the emerging economies of the region. Per capita emissions will rise with continued economic and industrial growth and with urbanisation. When allied with a growing population, rising per capita emissions imply significant future outputs of CO₂. This and other environmental

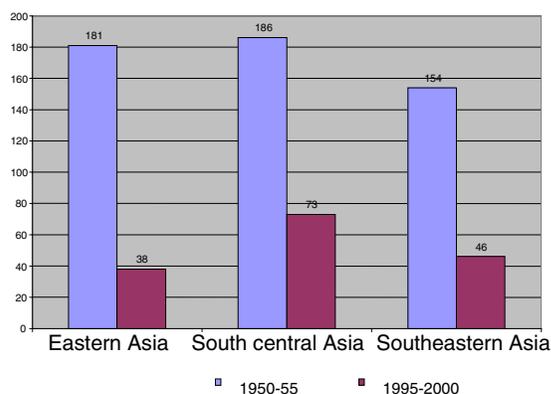
challenges in Asia can only be met successfully if efforts to do so are founded on fruitful co-operation between countries in the region.

Health standards

A third key imbalance involves significant variations in health standards in the Asian region. Combined with increased intra-regional migration and economic interdependence, these differences may pose a threat to health and economic progress in other parts of the region, as exemplified by recent outbreaks of SARS and avian influenza. Better regional co-operation is necessary in order to develop and reinforce surveillance routines so as to be able to avert such health crises in the future, to provide aid to populations in need, and to share the economic burden of future infectious disease outbreaks.

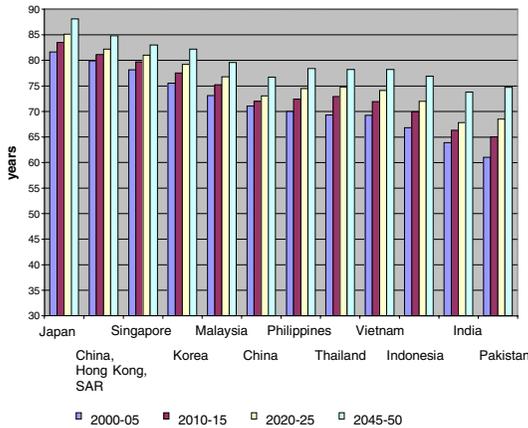
The health situation in Asia has improved considerably over the past 50 years. As Figures 2.5 and 2.6 show, infant mortality has dropped dramatically and life expectancy at birth will continue to grow in the next 50 years.

Figure 2.5. **Infant mortality rate, per thousand, 1950-2000**



Source: J.C. Caldwell, "Good Health for Many: The ESCAP Region, 1950-2000", *Asia Pacific Population Journal*, Vol. 14, No. 4, UNESCAP, 1999, www.unescap.org/pop/journal/1999/v14n4a3.htm, accessed 18 March 2004.

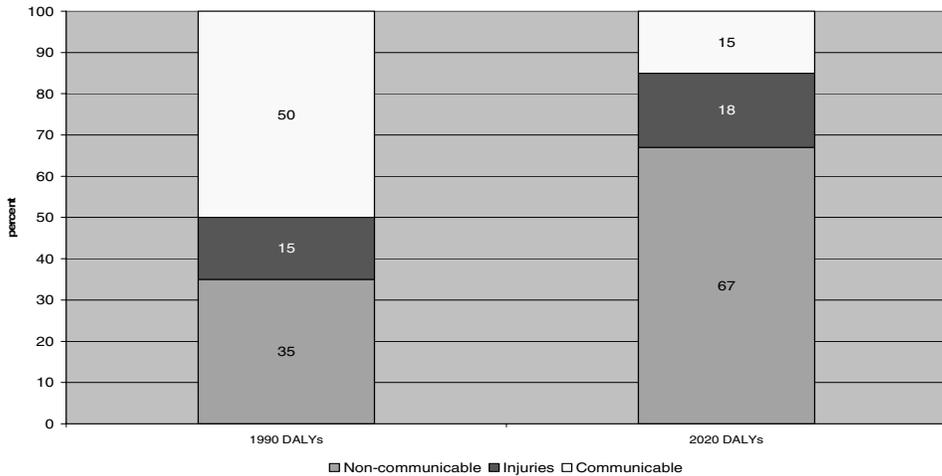
Figure 2.6. Life expectancy at birth in selected countries, 2000-2050



Source: Adapted from UN, *World Population Prospects: The 2002 Revision*, UN, New York, 2003.

With continuing improvements in health and living standards in the region, attention will continue to shift away from infectious diseases towards non-communicable diseases, such as cardiovascular illnesses and cancer. Smoking will be an increasing health problem in the coming years. Currently, more than 50% of Korean and Japanese males smoke.

Figure 2.7. **Burden of disease in the Asia Pacific, measured in DALYs,* 1990 and 2020**



* DALY (disability-adjusted life year) is the common measure of the burden of the disease. It combines mortality, morbidity and disability.

Source: Asian Development Bank (ADB), *Policy for the Health Sector*, Policy Paper, ADB, Manila, February 1999, p. 15.

Nevertheless, although Asia as a whole has improved its general health levels, there remain huge differences in health standards between Asian countries, as illustrated in Table 2.2. In particular, some countries in South and Southeast Asia lag behind. Countries such as Bangladesh and Lao DPR have among the highest child mortality rates in the world.

Table 2.2. **Health status in selected countries***

Region and country	Hospital beds per 10 000 population	Physicians per 10 000 population	Infant mortality rate per 1 000 live births
East Asia			
Japan	-	20.1	3.22
China	25.1	3.64	32.2
Korea	61.3	17.8	7.7
Southeast Asia			
Myanmar	6.29	2.98	59.8
Vietnam	-	5.29	35
Lao PDR	-	1.97	93
Philippines	-	11.9	31
Malaysia	-	6.7	7.9
Indonesia	6.03	1.1	41.4

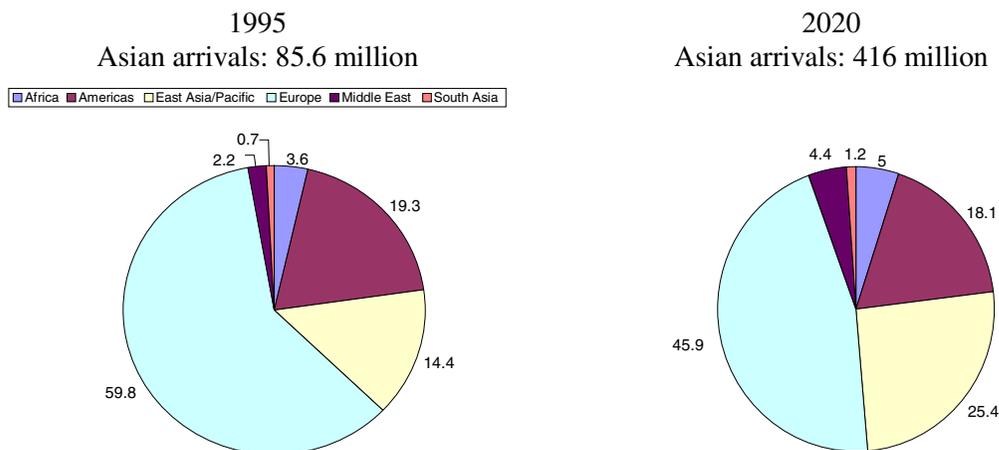
* These data have been collected between 1994 and 2001.

Source: WHO, regional offices' websites, <http://w3.who.sea.org/cntryhlth/> and www.wpro.who.int, accessed 16-22 March 2004.

There are, furthermore, big differences within countries and between occupational groups. Rural regions are increasingly disadvantaged. Only 24% of the rural population in China has access to adequate sanitary facilities, compared to 68% in urban areas (WHO Regional Office for the Western Pacific Region [WPRO], n.d.). In Myanmar, maternal mortality rates are almost twice as high in rural areas as in urban areas (WHO Regional Office for the Southeast Asia Region [WHOSEA], n.d.). Communicable diseases are still a main cause of death in these areas. Low education levels make the population vulnerable to new health threats, such as SARS and HIV/AIDS. Given the relative ease with which contagious diseases cross borders, such diseases threaten the health situation in all of Asia.

Health security

Asia stands before one of the greatest migration waves in its history. Rural to urban migration is likely to involve 150 million people in China alone. Cross-border migration is also expected to increase. Furthermore, projections of international tourist arrivals by region see Asia's share growing rapidly between 1995 and 2020, implying an annual growth rate of 6%.

Figure 2.8. **International tourist arrivals by region, percentage share**

Source: Adapted from World Tourism Organization (2003), "Tourism 2020 Vision", *Tourism Highlights*, 2003 edition, Madrid.

Such interconnectedness offers ideal conditions for transporting health problems from one place to another. The rapid spread of SARS provides a salutary lesson on how vulnerable the region is to infectious diseases. The economic impact of SARS is difficult to assess, but according to the Asian Development Bank, costs amounted to about USD 12 billion, or a 0.5% reduction in annual GDP growth for one year for East and Southeast Asia (Fan, 2003, p. 4).

Conclusion

In conclusion, Asia faces a wide range of economic, social, technological and environmental challenges over the coming decades, the responses to which will require considerably higher levels of regional policy co-operation than at present. But in intensifying regional co-operation, it is equally important that broader, global considerations be borne in mind so as to ensure that regional solutions do not serve to undermine increasingly important multilateral efforts in those same fields.

BIBLIOGRAPHY

- Asian Development Bank (1999), “Policy for the Health Sector”, Policy Paper, ADB, Manila.
- Caldwell, J.C. (1999), “Good Health for Many: The ESCAP Region, 1950-2000”, *Asia Pacific Population Journal*, Vol. 14, No. 4, UNESCAP, www.unescap.org/pop/journal/1999/v14n4a3.htm, accessed 18 March 2004.
- Central Bank of the Philippines (2004), *OFW Remittances Reach a High of \$7.6 Billion in 2003*, press release, 12 February, www.bsp.gov.ph/news/2004-02/news-02122004b.htm.
- Fan, E. Xiaoqin (2003), “SARS: Economic Impacts and Implications”, ERD Policy Brief, No. 15, Asian Development Bank, Manila.
- IEA (2001), *World Energy Outlook 2002*, OECD, Paris.
- IEA (2003a), “Energy Challenges in Northeast Asia and Project Proposals in 2004”, Note by the Secretariat (internal working document), October, IEA Secretariat, Paris.
- IEA (2003b), *World Energy Investment Outlook*, OECD, Paris.
- IEA (2003c), “Energy Developments in Northeast Asia”, Note by the Secretariat (internal working document), IEA Secretariat, June 2003, Paris.
- IOM (2003), *Labour Migration in Asia*, IOM, Geneva.
- OECD (2003), *Migration and the Labour Market in Asia: Recent Trends and Policies*, OECD, Paris.

UN (2003), *World Population Prospects: The 2002 Revision*, UN, New York.

United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) (2001), “International Migration: An Emerging Opportunity for the Socio-Economic Development of the ESCAP Region”, Social Policy Paper No. 6, UN, New York.

UNESCAP (2002), “Report on the Regional Survey on Ageing”, contribution to Asia Pacific Seminar on Regional Follow Up to the Second World Assembly on Ageing, 23-26 September 2002, Shanghai.

UN Population Division (2002), *World Population Ageing 1950-2050*, Department of Economic and Social Affairs, UN, New York.

World Health Organization (WHO) (2001), *Health Situation in South-East Asia: Basic Indicators 2000*, New Delhi.

WHO Regional Office for Southeast Asia (WHOSEA) (n.d.), “Country Reported Data for Basic Health Indicators”, *Country Health Profile: Myanmar*, <http://w3.whosea.org/cntryhealth/myanmar/myanmar.pdf>, accessed 13 March 2004.

WHO Regional Office for the Western Pacific Region (WPRO) (n.d.), “Country Situation and Trends: China”, www.wpro.who.int/chips/chip02/chn.htm, accessed 13 March 2004.

World Tourism Organization (2003), “Tourism 2020 Vision”, *Tourism Highlights, 2003 edition*, Madrid.

*Chapter 2***Integration: “Think Global, Act Regional”***by****Stephen Grenville***
Australian National University

While this chapter mainly focuses on the economic aspects of regional integration, it will go beyond that brief because much of the benefit of integration comes from the synergies between the narrow economic issues and the broader social and political aspects. The economic ties that tend to be the usual focus of discussion on integration are the skeleton or framework on which other, equally important, issues can be built.

Let us start with a précis of the argument to be made here. Integration in its widest sense – which might be seen as synonymous with globalisation – is largely inevitable and on balance desirable. This might seem to imply that integration can be left to “just happen”, without much policy involvement. But there is, in practice, a big job for policy. If the full benefits are to be realised, international relationships need the same sort of complex set of rules and norms that exist within individual countries, but that are much less well developed internationally. These rules and institutions not only facilitate trade, but also provide the framework for non-economic issues to be interwoven with the economic ones. There is two-way feedback here – unless the political environment is supportive, the economic advantages cannot be fully reaped.

But what is the place of specifically regional integration in this world of globalisation? If globalisation is inevitable and desirable, why should it not be embraced fully and wholeheartedly – in a multilateral worldwide format – leaving no special place for regional integration? A two-part answer is offered here. First, the rule-making and institution-building that are needed to make overall globalisation work well are hard to put in place at a multilateral level. There is a better chance of doing this if there is a mix – or layering – of multilateral and regional arrangements – and, for that matter, bilateral. The second element draws on the argument that non-economic co-operation is built on an economic framework. There is stronger motivation to act and a bigger payoff for neighbours than there is for the international community as a whole. Europe provides some lessons on how economics and politics can interact beneficially. But this non-economic integration does not have to go as far as has

occurred in Europe, where the economic institutions facilitated the growing degree of political integration. It is enough if the economic institutions and arrangements facilitate the same sorts of benefits that we reap through getting along with our neighbours over the fence, without giving up much of our own autonomy of action. Pursuing this framework will provide plenty of opportunities for useful regional integration.

It should also be stated what this chapter will *not* cover. There is a huge amount of literature on the economics of integration. It covers such issues as optimal currency areas and the benefits of a single currency (see Mundell, 1961; McKinnon, 1963; Kenen, 1969; and Rose, 2000). The need for international rules and the relationship between globalisation and sovereignty have been addressed by Rodrik (2000, 2002), Grenville (2000) and Weiss (2003). Integration within the East Asian region and the role of regional union in reducing the impact of financial crises has its own huge literature (see Henning, 2002; Thirlwell, 2003; Adams and Semblat, 2003; Asian Development Bank, 2002; Agarwala and Prakash, 2002; Clarete, Edmonds and Wallack, 2002; and Bergsten and Park, 2002). This chapter does not attempt to cover this territory, partly because it has already been well-worked, but partly because it seems to this author that, while the economic benefits are not negligible, they are the skeleton or framework on which other, more nebulous but perhaps more important relationships should be built. The point that needs to be made to Australians (and specifically directed at them) is that, even if common currency, optimal trade area and pooling of reserves do not seem to be pressing issues in our narrow national interest, the institutional framework which builds up around those issues will be the forum and structure on which regional integration will be built. We may not think these issues are of pressing relevance to us, but if we let them “go through to the keeper”, then we will miss out on the other benefits of regional integration. We may decide, as a nation, that “high fences make good neighbours” – but in the view of this author, that would be a serious mistake.

Inevitable and desirable?

Economic integration happens with the inevitability of water flowing downhill, without any help from policy. The starting point is to examine the driving force of overall economic integration – globalisation.

Thomas Friedman captures the important elements of globalisation in his book *The Lexus and the Olive Tree* (Friedman, 1999). He sees it as both positive and inevitable. For him, the “golden straitjacket” (the rules that are

imposed on countries by their participation in international integration) is clearly and overwhelmingly beneficial. These rules will be enforced by the “electronic herd” – the portfolio managers who decide where international capital (and hence productivity-enhancing, wealth-creating investment) will flow. These rules will be largely uniform among countries and will force countries to improve their institutions and policy making, eliminating inefficient taxes and distortions that would otherwise handicap the country in its international commerce. Let us deconstruct these arguments.

The narrow economic case for international trade is long-standing (think of Hume’s 18th century examples of cloth-for-wine trade) and intuitively clear: self-sufficiency is inefficient. Efficiencies of scale and scope seem very powerful, and these effects do not seem to have any obvious limits. A city like New York has the opportunity for a high degree of specialisation; centres of specialisation seem to develop naturally, driven by their own efficiencies and synergies – e.g. Hollywood for films, Houston for oil. With this specialisation comes extra expertise and refinement of technique (think of Adam Smith’s pin-makers), in turn leading to greater efficiency (and the high incomes that go with this).

But integration brings opportunities beyond trade in goods and services – it brings ideas and new insights which are the drivers of economic improvement. Sometimes this is simply a case of learning by seeing how someone else does the job: Newton saw further than others because he stood on the shoulders of those who came before, and similarly, countries can get a leg-up from seeing how other people do things. We often see examples of ideas that have been brought home from overseas and applied successfully, without this leading in any direct way to more international trade. While it is true that competition from foreign products and techniques provides a powerful incentive for improvement, we should not think of integration simply in terms of opening up markets for trade. Perhaps the most compelling example of this is the impact of Admiral Perry’s black ships in Yokohama in 1851. They may have opened up Japan for trade, but much more importantly, they opened it up for new ideas. The benefits of this “learning by doing” (or quietly stealing other people’s good ideas) are potentially huge. At the policy level, integration can drive the wider reform agenda.

There is a further level of benefit coming from integration – the political dimension. The prime example here is the European Community. Starting with a history of two wars within a generation, the Europeans built a political entity on the fragile basis of economic co-operation. Some might see this as the

demonstration of Tom Friedman’s assertion that countries with McDonald’s don’t go to war. But the refutation is close at hand – England and Germany were so close at the start of the 20th century that they even shared the same royal family. A higher degree of institutional interdependence seems to be needed.

History provides the clearest counter-example to the view that globalisation is inevitable. The levels of international trade and investment in the latter part of the 19th century and early 20th century were not far short of current levels.¹ This gave way to the protectionism of the 1930s. The dismantling of the colonial era after the Second World War created numerous new nations (the UN went from around fifty members to close to two hundred), each sensitive about its sovereignty and responding to previously unempowered vested interests.

One other element of the historical experience might be worth noting. Sovereign states which got together usually stayed together (close to home we have the example of the Australian federation). And yet there seems to be a lot of lethargy or inertia in integration: there is very little apparent tendency for countries to go the full distance and merge their sovereignty (Australia and New Zealand). So some arrangement is required that does not infringe sovereignty too overtly.

- **Lesson 1.** The narrow traditional economic benefits of integration are large, but there are benefits well beyond these, in the form of exchanges of ideas, and the opportunities which these economic linkages create for non-economic co-operation. While there are strong elements of inevitability in the process of globalisation, history reminds us that these linkages can be undone if the climate is not benign. Perhaps the best characterisation of this issue is given by Ferguson (2002), who sees globalisation as inevitable, like death, but subject to beneficial intervention and manipulation.

The counter-currents

If this high degree of integration is such a good idea, why does it not just happen by itself? In a perfect world (Tom Friedman’s world?), it should not need any special incentives or institutions for embracing integration: the economic case for free trade is so powerful that it justifies unilateral reduction of barriers to trade. Why do we not see full integration (indeed, the withering away of national sovereignty) and the world become one seamless unity? Against the compelling logic of integration, there are counter-currents which

have inhibited implementation of the degree of integration that economic theory would suggest.

First, comparative advantage may be one of the few issues on which economists agree, but it is counterintuitive, and has never really been accepted by the public at large, most of whom still see merit in self-sufficiency, and have a desire to give available work to their fellow-countrymen.

Secondly, the benefits of integration are at an aggregate level – the economy as a whole is better off. But economic theory does not promise that everyone will be better off – only that there would be enough benefit to allow the losers to be compensated, and still leave a surplus.

These are old narrowly-economic arguments, associated with trade in goods. More recently, the resistance to globalisation is on more general grounds. One of the effects of globalisation is a tendency for the homogenisation of cultures, and a trend for some of the interesting aspects of society (including the best jobs) to gravitate to the centre – the “winner takes all” phenomenon (so that local stars of sport and culture have to play second fiddle to the world-best performers). The judgement of the market says that we are better off, but we have to ask if this provides the stimulus and variety in our society to encourage and accommodate diversity, necessary for a tolerant and well-adjusted community. Are we comfortable when the best jobs shift overseas (the “branch economy” effect)? Is the narrow economic case for openness missing the dynamic aspects, which mean that the global winners will increase their advantage over time, attracting the smartest resources to the centre and leaving the periphery with the lame and the losers? Relevant here are the arguments about “first mover advantage”: once a country has established its position in a complex industry, it is hard for other countries to compete. At the same time, globalisation may make it harder to compensate the losers of economic change: high-taxing countries may be less attractive to investors (even domestic investors), who will gravitate to those countries with less concern for redistribution. Globalisation sharpens the edge of capitalism – comparative advantage finds it harder to absorb the diversity found in countries and sharpens social divisions. There is a groundswell which resists integration, or at the very least is yet to be persuaded. Globalisation is perceived as a threat, not an opportunity.

None of these counter-arguments takes away the powerful case for a high degree of integration, but they draw attention to the paucity of rules and institutions which can ensure that the full benefits of international integration

are achieved and that these benefits are equitably divided so as to make them politically sustainable. Just as domestic rules and institutions assist transacting parties to reach equitable outcomes between them, and politically negotiated redistribution rubs the sharp edges off the free operation of market forces in our domestic economies, so too we need to rewrite and enhance the international rules to make the system work better, to address equity issues without doing too much harm to the undisputed efficiency gains from integration, and to reinforce the political compact which makes this degree of international integration consistent with national sovereignty.²

As soon as we understand that globalisation is not governed solely by Adam Smith’s invisible hand and that there are counter-currents which inhibit its full development, we recognise the need for rules and institutions which will:

- Facilitate international transactions (provide greater certainty).
- Actively support the process of integration.
- At the margin, share the benefits of integration more equitably.
- Form the framework on which other political objectives will be built (cf. EEC).

This raises two questions. What rules are needed? This will be examined in the next section. In the one following, we will explore the second issue: who will formulate and enforce them? The central issue here is whether these rules and institutions should be multilateral, bilateral, or regional/collective.

- **Lesson 2.** While greater international integration has strong elements of inevitability, and will happen without policy intervention, it needs nurturing. Some of the opposition comes out of ignorance, and can be addressed through education and argument. But there is some substance to the concerns about globalisation, especially in a dynamic context: there is more to a successful society than is captured in the idea of comparative advantage. Emerging countries, in particular, see themselves as starting behind scratch in a race where the “first mover” has a head-start. To get the full benefits out of integration, we need more international rules and forums to address the issues of the distribution of the benefits of globalisation. For both these purposes, we need more and better institutions whose reach extends beyond individual sovereign nations.

Maximising the benefits and dividing them equitably: the need for more rules and institutions

It would be hard to exaggerate the complexity and pervasiveness of rules, procedures and standards which govern commercial transactions within the jurisdiction of a single country. Rules lessen uncertainty and smooth transactions, governing the relationship between people and modifying the outcomes (and the sharing of the benefits) of these relationships. Think what a huge efficiency improvement comes from something as simple as everyone agreeing to drive on the same side of the road (at least within one country). Think what it does for international sport that the rules for the main games are universal: when the World Cup is held in soccer, no one needs to learn a new set of rules to participate. There are two aspects of this. First, there needs to be a much more comprehensive set of rules. Second, there needs to be much wider and more effective participation in the rules setting, not only for fairness reasons to overcome the current "democratic deficit" in the rule making, but also to ensure that the rules take into account the needs of all the participants.

While multilateral institutions have been able to put in place a variety of rules (covering all sorts of technical aspects of international linkages), many of the international rules currently in place derive, almost by accident, from the domestic rules in the largest countries. Any new drug or medical device has to get US FDA approval if it is to stand a chance of selling internationally. Similarly, US patent and copyright rules will set the norms elsewhere – even when these rules have been made with US interests in mind.

Bankruptcy illustrates the point. Every country has its own domestic bankruptcy rules, to handle the *in extremis* cases where businesses no longer have the resources to repay their debts, and the means must be found to override legitimate contracts and either arrange delays ("Chapter 11" in the United States) or gather together the remaining assets of the enterprise and distribute them equitably among the creditors (usually, in these enlightened times, leaving room for the debtor to continue some sort of existence outside a debtors' prison). No such rules exist internationally.³ During the Asian crisis there were examples where *ad hoc* arrangements were made, with universally beneficial outcomes (*e.g.* Korea). But by and large such arrangements were strongly resisted by the creditors – with frequent references to the "sanctity of contract" and warnings that capital would never flow again until debts were repaid in full.⁴

Another example concerns rules, but ones written by a sub-set of the people who are affected. Internationalisation of finance has required that there be some uniformity of rules for prudential regulation, and these were developed by the G10 countries within the framework of the Bank for International Settlement (the central bankers’ “club”) in Basle. While these were developed specifically for the G10 banks, it was inevitable that they would become the international standard – no bank could participate fully in international affairs unless it met the Basle Rules. When these rules came to be reformulated a decade or so ago, in recognition of the narrow authorship of the original rules, a much fuller process of consultation took place, although it would have to be said that the new rules are tailored to the needs of the banks in the most advanced countries. So progress has been made, but there is still some distance to go.

- **Lesson 3.** Rules (which might best be seen as the sort of “institutions” that Douglass North [1990] advocated) are much less well developed internationally than within domestic jurisdictions. In this rule-deficient world, the smaller countries and the emerging countries see themselves as particularly disadvantaged.

Multilateral versus regional, with illustrations from our region

The arguments so far make a strong case for integration, but *global* in scope. The postwar international infrastructure was multilateral in vision, with these institutions set up as guardians of the multilateral mode of integration: the International Monetary Fund, and most notably the GATT with its emphasis on “Most Favoured Nation”, *i.e.* some guarantee that all would be treated the same, with no special deals on tariffs. Implicit but just as important, tariffs could only go one way – down. Where political realities forced recognition of regional trade arrangements, these were discouraged through Article XXIV, which required special dispensations.

The mindset of received economic wisdom was also predominantly multilateral. By the 1970s, there was a universal model of how economies should be run – the “Washington Consensus”⁵ – with its multilateralist free-trade, market-based, deregulated hands-off approach. Much was achieved with this multilateral emphasis (including in this region: Singapore may be the best example of a beneficiary of openness). But the low-hanging fruit – the easy benefits – have largely been picked, and the system is up against the deeply entrenched recalcitrants – European and Japanese farmers, and the US shipbuilders to mention just a few. Multilateralism is not in retreat (a modest

victory was notched up recently when the US rolled back its emergency steel tariffs) but it is, if not stalled, at least facing diminishing returns.

If further progress is to be made, it may be with a different and smaller number of participants around the table – participants who can identify their common interests more clearly, and who may be readier to trade off some elements of benefit (and some degree of sovereignty) in order to move to an overall improvement. The discussion in the first half of this chapter points to two places where a regional focus might invigorate the overall integration effort and squeeze more value out of it while reaffirming (rather than undermining) globalisation. The first is in *rule making*, both to help formulate the universal rules and to develop region-specific rules. The second is in building *geographically-based institutions* on which a wider range of co-operation and understanding – beyond the narrow economic issues – can develop. Let us look at each of these in turn.

- **Rules.** The discussion has emphasised the need for a rewriting and expanding of the rules and institutions on international economic relationships. The multilateral framework can take us only so far: widespread agreement on anything except trivia and platitudes among the nearly 200 members of the IMF is next to impossible. It is no accident that many of the existing international rules are either “principles” that didn’t require a lot of thrashing out, or are imposed by a small group of big countries (again, not requiring much thrashing out). The current rule-making and enforcing institutions favour the big countries, particularly the United States. Regional groups can learn to sing in unison to help the smaller and medium-size countries have their voices heard (one of the functions of the G10 is to co-ordinate their view in other forums). There will be more opportunities for give-and-take tradeoffs that turn rule-making into a negotiation. Regional arrangements can be some counterweight to the power of the big nations in drawing up the rules and administering the multilateral institutions. In any case, there is no presumption that international uniformity is always best. We do not need the same building codes in Sydney that they have in quake-prone San Francisco. It will not be appropriate to impose uniform labour standards on everyone. In fact, one of the dangers is that inappropriate rules and standards will be imposed (as the Basle II Rules are doing?). This might be a case where subsidiarity is appropriate – devolve the power of rule making to the lowest level at which it can be effectively made. In

some cases, there are advantages in having a degree of competition in regulatory regimes (provided that this results in a “race for the top”, where the best regulatory regime is favoured by the market forces, rather than for the bottom where market forces seek out the most lenient regimes – see Lee, 2003). There will be many opportunities to develop regional rules which will have enough coverage and uniformity to be a major advance on the current feeble rule structure. The East Asian countries could, for example, agree to include collective action clauses in all the international bonds they issue (to help resolution in case of repayment problems). They could have their own foreign investment dispute resolution, with enough international authority to enforce outcomes. One pertinent way of addressing the volatility of international capital flows would be to create a region-wide register of flows (co-ordinated with the BIS/IMF work in this area) to ensure that governments know what is going on and can respond to excessive inflows, rather than waiting for the damaging reversals of capital. They could have their own Basle Rules for prudential supervision, sufficiently tailored to their own needs to make them more relevant to the financial sector of the region, while having enough uniformity and substance to reassure the international financial community.

- **Broader integration.** If one of the important functions of international institutional arrangements is to provide the framework for countries to get along with each other and resolve disputes, then the highest priority is always to get along with our neighbours. The best example of this is the European Community, whose initial institutional building blocks were purely economics-oriented arrangements (*e.g.* the European coal and steel community), but which developed to the stage where political ties are now so strong that a war among the members – or even a major falling out – is unthinkable. The co-ordination is now very wide-ranging, covering (*e.g.*) foreign policy. Why did it work? It is worth noting that it took a long time and required an inordinate amount of persistence. Wyplosz (2001) argues that the presence of substantive bureaucratic institutions was vital to this process. The bureaucrats always had a plan in the bottom drawer which could be produced, whenever the political climate was propitious, to shift the integration forward. Of particular interest is the reform dynamic of new membership: the strongest force for economic

reform in Eastern Europe at present is the prospect of membership of the EU, with the obligations and rules this implies. The central lesson is that when countries get used to talking to each other, and develop bureaucratic dialogue, there will be an ongoing search for new areas of co-operation. When there are enough of these spider-web ties between countries, political problems will be addressed in rational ways – “jaw-jaw rather than war-war”. But the benefits go far beyond preventing wars – just as talking with one’s neighbours opens up all sort of opportunities for fruitful co-operation, so too with nations.

How is the East Asian region doing in the integration stakes? There is quite a long history – most notably ASEAN and, more recently, APEC. The Asian crisis of 1997-98 was a watershed and catalyst for exploring regional mechanisms that would make countries less vulnerable. “The reluctance of Asian Governments to leave all their stabilisation eggs in the IMF basket is understandable. The organisation is dominated by the United States and European governments and it demonstrated its fallibility during the 1997-8 crisis” (Henning, 2002, p. 76). The crisis gave a great fillip to regional arrangements, because it was generally judged (rightly or wrongly) that the International Financial Institutions (representing the multilateral mode) had failed.⁶

The Chiang Mai Initiative (CMI) was one response; its central objective was to pool some foreign exchange reserves. It was built on earlier currency-swap arrangements between the ASEAN countries, but the size of the facility is much larger and the country coverage wider. This wider grouping (“ASEAN + 3” – *i.e.* ASEAN plus China, South Korea and Japan) seems to be the key emerging regional cohort. Some see it as developing into an Asian Monetary Union on the model of the EU (see Bergsten, 2001 and Henning, 2002), while others see little gain and much difficulty in this direction (Wyplosz, 2001⁷). Certainly, when the differences in terms-of-trade shocks between, say, Japan and Indonesia are considered, the region does not seem to be an obvious candidate for an “AMU”, judged on the usual economic criteria of optimal currency areas.

Whether the bilateral currency-swaps are important⁸ and whether this will lead to AMU will be resolved over time. But Henning (2002, pp. 30-31) is surely right in saying: “With the CMI arrangements, ASEAN + 3 has created for itself an option that it did not possess a few years ago: to build upon these arrangements if governments of the region are dissatisfied with their treatment

outside the region and multilateral institutions in future crises”. Perhaps most importantly, it has created a forum for the discussion of regional issues at a technical level, and there is no need for this to be confined to the narrow agenda currently on the table.

In trade, there is still plenty to discuss. There are numerous trade-oriented regional groups and the fact that trade integration is already very high (higher than Europe, even after the latter has had 40 years of integration) may suggest that these benefits are already reaped. Is the way forward FTAs, which are the current vogue? There is a much stronger intellectual case for the sort of “open regionalism” practised within APEC (and set down as a work-in-progress at Bogor in 1993) than for bilateral FTAs.⁹ The hope is that there is more trade creation than trade diversion. To pick up the terminology of Lawrence (1996), they need to be building blocks rather than stumbling blocks. In the face of others setting up these kinds of trading arrangements, it may be better to follow suit rather than to be isolated. The strongest justification for the FTAs now in vogue may be that “everyone is doing it”. Of course, there is some hope that these FTAs not only expose countries to the benefits of foreign trade, but might also become ubiquitous so that they are not too far removed from multilateral free trade. But hub-and-spoke arrangements will never have the uniformity of approach that comes with wider agreements, and make the rules fiendishly complex (what is “domestically produced”? – see Garnaut, 2003). It certainly seems to be a third-best world, whereas patience and persistence with regional arrangements would seem to be far superior.^{10,11}

These may open opportunities for wider discussions. Deal-making and reciprocal tradeoffs may be more important than before. With China now receiving 80% of the foreign investment flow to the region, and growing not only at a speed unmatched in the region but in a way that (casting economic purity aside for a moment) might be typified as having “comparative advantage in everything”, there is a danger that Southeast Asian industry may be hollowed out and some countries may become “hewers of wood and drawers of water” to fuel China’s growth. Whatever the immediate comparative advantage of some of East Asia’s resource-rich countries, Indonesia and the Philippines (at least) both need to attract a good share of industrial development to cope with their population growth. Perhaps a regional trade arrangement could address this issue in the same way that ASEAN has tried to “allocate” industry specialisation among its members. This could, in time, become the forum for addressing the specific drawbacks and division of the benefits of integration. The EU shows the need for persistence – institutions give this. Similarly, small groups are likely to be best at redistributing the benefits of integration.

A more powerful regional institutional infrastructure could give the region a louder voice in international rule making and, over time, redress the under-representation of Asia (Henning, 2002, pp. 73-74) in the councils of the world. For the sceptics, it might be worth noting that the international system *does* respond, at least sometimes. Following the urging of RBA Governor Fraser,¹² the Euro-centric Bank for International Settlements significantly altered its membership to give far greater recognition to Asia – including the setting up of a regional office. It can be done.

There is doubtless much more benefit to be reaped from these rule-making and trade-enhancing activities, but the main benefits may lie at a more general level – in the swapping of ideas. “Idea-swapping” institutions should have the intimacy of a club.¹³ Australia benefited greatly during the reforms of the 1980s from the peer pressure exerted by the OECD framework. One of the obligations of OECD membership is to submit to an annual “examination”, at which a country’s policies are subjected to detailed analysis by the OECD secretariat and members. Just as this pressure kept reform on the public agenda, East Asian countries can benefit from the peer pressures exerted by policy-oriented interaction at a regional level. Of course surveillance exists at the moment, but it is more nuanced, soft, more forgiving, and less intrusive than is needed if it is to do the job. One area where there is still a lot of work to be done (and where mutual support would be useful) is in the strengthening of financial sectors. It was their collapse, rather than the exchange rate fall, that proved so damaging (and costly to fix) in the 1997-98 crisis. This was a lost opportunity: if a forum had existed to bring together and co-ordinate the views of the East Asian countries, the mistakes made by the IMF (see Grenville, 2004) might have been much reduced, and the domestic policy response might have been better. As well, better regional co-ordination might have allowed the region to tap the very considerable resources which Japan was offering through the Asian Monetary Fund, while providing a forum to correct its deficiencies.

This discussion has focused on the East Asian region, because that is where the challenges lie for Australia. For completeness, however, we need to mention two different and successful modes of integration. First there is the Closer Economic Relations (CER) Trade Agreement between Australia and New Zealand – bilateral arrangements that have led to the near-complete economic integration of the two countries. Two points from this experience are worth noting. Despite many similarities in the economies, this has not yet produced a currency union. Nor has it produced the slightest tendency towards political union. The second example has been mentioned in passing already: the successful existence of international institutions which are neither multilateral

nor regional. The OECD is a good example of this, and its powerful role in promoting globalisation and better policy making within countries has already been noted. The Bank for International Settlements is another – a reminder that international co-operation will often be based on common technical issues and expertise, rather than geography.

Success will come through a layering of institutions. Multilateral, regional and bilateral arrangements each meet different purposes, providing competition and checks and balances. We should not be surprised at this layering, or see it as superfluous. After all, most countries have three layered levels of government to handle the variety of problems which arise at different levels.

Conclusions: What is Australia’s role?

Where does Australia fit in this argument for more regional integration?

By the mid-1990s Australia seemed quite well placed in terms of regional integration. APEC (with Australia as a prime mover) was meeting regularly at head-of-state level and substantive content was being put into the relationship via the Bogor Agreement. While Australia was not a member of ASEAN, strong links had been formed and it was not out of the question that these might lead to some form of membership. There were close working ties in all sorts of operational matters with our Asian neighbours (most notably, the Security Agreement with Indonesia). Above all, there seemed to be an altered mindset within the Australian public, which found a new balance between the old ties to Europe, the vital links to the United States, and the emerging possibilities in a rapidly growing East Asia. This seemed to promise so much.

Today, much of this regional reorientation has been lost, and Australia no longer seems to be a candidate for regional membership. With APEC weighed down with extra membership not relevant to its task, much of the economic action has shifted to ASEAN + 3, and the geographic centre has shifted northward, away from us. If (as seems likely) the Asian Crisis of 1997-98 can explain much of the reorientation, this outcome is ironic, as Australia responded well to the crisis. Australia was quick to join the support packages that were put together (Japan and Australia were the only countries that participated in all three support exercises) and we were active in lobbying in the United States and the IMF when they seemed to be misreading the seriousness of the situation in Indonesia.¹⁴ Its own economic policies during the crisis – principally allowing the exchange rate to move a fair way, while supporting it against the most extreme movements, without tightening either monetary or fiscal policy – paid

off. Of course we made mistakes as well. When the Japanese proposed an Asian Monetary Fund, we should have welcomed the idea *in principle*, and constructively suggested how the original proposal needed modification (specifically, to include a place for IMF-type conditionality of some kind), rather than viewing the proposal through the prism of the IMF/US viewpoint, with their obvious chagrin at being excluded.¹⁵ At the same time, we may have misunderstood what were the most fruitful vehicles for co-operation – the resources we put into being part of the ASEM process seem absurdly out of proportion to the potential importance of this grouping. The discussion above shows why we need to be in *regional* forums that will serve a substantive relationship-building role (*i.e.* ASEAN + 3), not a talk shop for partners widely separated by their geography and peripheral in their common interests. Similarly, the effort we have put into the Commonwealth (whose members have no geographic links and very few common interests)¹⁶ was a waste of our diplomatic effort (Gyngell, 2003).

One further curious anomaly in our recent history of international involvement was the key role Australia played in widening the GAB to become the NAB.¹⁷ When we observe how these funds are used to support countries of interest to the G3 (often of little immediate interest to us), while our experience during the Asian crisis tells us that such funds will not be readily available for crises in our region, we might conclude that our effort and contribution have been misdirected.

Most ominously, it has been demonstrated that there is a vein of insularity and narrow-mindedness in Australia which can be tapped by any politician who wishes to exploit it: coming to terms with Asia is a generational process, not yet complete and easy to divert for short-term political gain.

What might we do? In a rather unwelcoming environment, Australia's purely diplomatic effort may be doing about all that it can. This suggests we might turn our efforts to more specific forms of co-operation. One of the recent successes has been the co-operation between the Australian police and their Indonesian counterparts following the Bali bombing. One particularly noteworthy element of this success is the fact that it has been so low-key. It is an example of the specific spider-web ties that in themselves may not seem to have great diplomatic meaning but that, taken together, will help the countries exchange ideas, and smooth out misunderstandings as they arise. We might speak up more loudly in favour of regional arrangements. The United States is ambivalent when others are doing them (planting faint praise on CMI – see

Truman, quoted by Henning, 2002, p. 13), while using them when it suits their interests (*e.g.* NAFTA, NAFA).

While accepting that there may be a case for Australia to spend more on defence, soldiers seem the wrong presumptive response to the issues that might arise in our region. What about more effort to get good reporting by Australian journalists on our region? What about many more links between our bureaucrats (as has happened with the police)? In business, we are being left behind by Singapore, which sees a more urgent need than we do to build business ties in countries such as Indonesia, which will help both their countries. One area of potential serious aggravation is NGOs, who want to mix their humanitarian aims with a type of intrusive politics which will often be unwelcome and unhelpful to our national interests.

What has Australia got to offer, in what must be a two-way relationship? The list is impressive enough: its eclectic multicultural “can-do” successful society; mostly “good” history; education skills and capacity; well-developed and pretty effective corporate law and governance; deep experience at local government, in a world that is emphasising greater decentralisation; privatisation experience, where this is still high on the agenda; experienced journalism and a free press; its experience at economic reform – recent and pretty successful. This non-exhaustive list shows that there is a lot more than trade or professional diplomacy. But most of the people involved in these activities do not see themselves as the vehicle for integration and reform. They are not intrinsically insular: it is just that they have a job to do in Australia and do not feel any particular pressures to widen their horizons. The greater focus on the “bottom line” and the achievement of specific objectives has taken the focus off the wider, longer-term objectives. Nowhere is this clearer than in our universities, which are happy to become outward-looking and international if it helps their budget, but which (for the most part) will leave the longer-term national-interest issues (including the debate on Australia’s place in the world) to someone else. The task is how to change this. If the argument made by Wyplosz (2001) in relation to the European Union is correct, this requires much more than the occasional get-together and chin-wag: we need to build institutional ties. Twinning arrangements between like-minded institutions might be a start. But it will not happen if we just leave it to market forces. We need an action agenda and it is hard to imagine who can provide this, if not the government. One place to start would be to make it clear to Australian government institutions that they should actively seek out a role with our regional neighbours: when East Asians get together to discuss water, weather or worms, their Australian counterparts should have made every effort to be there,

even if there is no immediate benefit to their own institution's narrowly defined objectives. This should be part of the work programme and strategic plan.

One last point links economics and politics. We have seen a lot of debate over whether Australia is part of Asia, with suggestions that this should be measured in terms of *similarities* (e.g. by percentage of population of Asian origin, or similarity of mindset). In economic terms, this is the wrong perspective. One of the oldest, simplest and strongest lessons of economics is that the benefits of integration will be greatest if the partners are *different* – if they have complementary skills and resources, rather than the same. The question here is whether we are *different* enough to make a significant contribution (combining this, of course, with the sensitivity and understanding to make co-operation feasible and the energy to harness these complementarities in the sustained way that will be needed to make an impact). Do we view the world differently? Is our background different? Are our skills and resources different? The answer to these questions is obviously "yes", and it is this difference that will give us the opportunities to reap the efficiencies of complementarity, to our mutual benefit.

NOTES

1. Of course, not all of this took place in the same environment as today; the degree of globalisation depends on the political environment. The colonial era provided the metropolitan power with the authority to enforce integration – Manchester cloth sold to India in exchange for products which cold England could not produce. It was not necessary, in this colonial context, for the counterpart to be as enthusiastic about the benefits of trade. The traders could combine this motive with proselytising, either for formal religions or for some more worldly concept of “civilisation”. But it would be wrong to see this solely as an imposed process. The United States itself needed the capital inflows from the Old World to finance its infrastructure and industry in the second half of the 19th century. Similarly, Latin America was developed with capital, which flowed outside a formal colonial relationship. So we should not conclude that the high degree of globalisation in the 19th century was solely an imposition of a bygone colonial system.
2. This need for international rules (explored in more detail in Grenville, 2000) is closely related to arguments made by Rodrik (2002) that “Global markets without global governance are unsustainable” and Friedman (1999) that “as your economy grows (with globalisation), your politics shrinks”. Weiss (2003) argues against the idea that globalisation diminishes the role of the state.
3. The nearest thing to institutional arrangements is the “Paris Club” for government debt and the “London Club” for other debts.
4. At the time, the IMF was part of this process of resisting debt settlements. In part this can be explained by the lobbying effect of Wall Street (the efforts of the New York-based IFI were notable), but the more important issue may have been the mindset of the time. As late as September 1997 (*i.e.* when the Asian crisis was well under way) the Fund (at its annual meeting in Hong Kong) was attempting to have free capital movements embodied into the Fund charter, in the same way that free trade was. In this mindset, the “invisible hand” would work out solutions, and anything that smacked of “capital controls” was anathema. The Fund recognised that its position needed to be changed (see Krueger, 2001), but even now, despite strenuous efforts to put in place measures that would cover only a part of the problem (*i.e.* sovereign debt), even this partial solution has not found agreement. One

problem is that one of the lessons coming from the Mexican crisis of 1994/5 is that some countries and creditors will be rescued from a repayment. The "moral hazard" legacy left by the crisis had encouraged influential creditors and debtors to resist *ex ante* bankruptcy arrangements; borrowers feel such arrangements will discourage lending to them and lenders feel they might encourage easy renegeing on debt (and so close off the opportunities to produce more resolutions of the Mexican and Korean variety, where they got full repayment with no "haircut").

5. Although that terminology was not invented until later.
6. "The formation of the regional dialogue and co-operation was driven by the deep dissatisfaction with the IMF's performance in 1997 and 1998 and the perception that the US support was unreliable" (de Brouwer, 2004a).
7. Wyplosz sees the search for regional currency linkages as a premature reaction to the failure of soft pegs. In his view, it is far too early to conclude that regional currency arrangements will have an endurance significantly exceeding previous peg arrangements. He is sceptical of rigidly fixed arrangements – the cost is high ("macroeconomic stability function is precious, especially when it is recognised that the fiscal policy instrument is blunter and more politically sensitive"). Wyplosz argues that "Europe is unique" and contrasts this experience with that in East Asia:
 - Exchange rate stability was pursued as an encouragement to trade, not as a mechanism for reducing vulnerability. Stability among the members was the priority, not stability *vis-à-vis* the major external currencies. "A hard peg implies the same loss of sovereignty." "Monetary union requires the deep abandonment of sovereignty and the setting up of a common central bank." "It carries the distinct disadvantage of tying the Asian countries to far-away economies. It would be a very roundabout way of mimicking a monetary union, with most of its drawbacks and few of its advantages."
 - There was an emphasis on institution-building. "Collective institutions become the advocates of integration. They move the debate from the purely political sphere to the technical level, allowing for professional assessment and avoiding costly mistakes. They can prepare the blueprints that can readily be put to use when the occasion arises, often unexpectedly."
 - Optimal currency area arguments were unimportant – trade integration was the key issue, driven by politics of intertwining the economies.

- Trade arrangements within Asia are common, but are numerous and fragmented rather than collective. “For the task at hand bilateral agreements are highly cumbersome. Bilateral bargaining is unlikely to foster a collective framework i.e. establish rules and arbitration processes.”
 - Real convergence (as measured by the stage of development) is much wider in Asia than in “old” Europe, or even New Europe.
 - “[T]he only feasible path for Asia must be to combine confidence-building steps and limited ambitions.”
 - There is a risk that CMI will be “both a beginning and an end”.
8. Curiously, these are a series of bilateral agreements rather than an omnibus agreement. Exploring why this is so might reveal where regional arrangements are still encountering problems.
 9. Lloyd and MacLaren (2003) make the case for free trade. See Schott (2003) for some of the pressures that have shifted countries away from the multilateral forum.
 10. The danger is, of course, “trade diversion”, where the bilateral deal results in a country switching its imports from the cheapest source, to import from the bilateral partner. Those with long memories remember the cost paid for the trade-distorting effects of the Commonwealth Preferences – was it Clive James who observed that the main question when purchasing a British-built Standard Vanguard car was whether the chrome bumper-bar would rust through before the muffler fell off? Even if bilateral deals result in a chain of further bilateral agreements, there will still be inefficiencies. Schott (2003) suggests that if Japan and Korea reach a bilateral agreement, this will give rise to a Korean-US agreement as US manufacturers redress the balance, which will require the Koreans to give US preferences in agriculture. This might well leave Australian agriculture disadvantaged.
 11. Wyplosz (2001) sees the East Asian trade institutions as very underdeveloped compared with the bureaucratic arrangements that supported the EU integration.
 12. Including the implicit threat that the region would form its own “Asian BIS”.

13. Effective discussion sometimes requires the dominant powers to keep a low profile. The United States should accept exclusion sometimes, recognising that it can sometimes be “the elephant in the canoe”.
14. Although it would have to be acknowledged that we did not have much impact.
15. Interestingly, Henning notes that the first reaction of the IMF MD was in favour, and that he had argued for more regional arrangements of a GAB type (Henning, 2002, p. 68).
16. This led to us defending the rights of Zimbabwe’s white farmers whose position – whatever the judgements about “fairness” – was an historic anachronism in the post-colonial world.
17. The General Arrangements to Borrow was a G10 agreement to facilitate mutual support in balance-of-payments crises, using the IMF as implementer. This was replaced in 1998 by the New Arrangements to Borrow, with wider membership (including Australia), increased funds and a wider geographic mandate.

BIBLIOGRAPHY

- Adams, C. and R. Semblat (2003), “Economic Integration in East Asia: Options for Currency Arrangements and Policy Options”, Paper presented at a conference at the China Centre for Economic Research, Beijing University, March.
- Agarwala R. and B. Prakash (2002), “Regional Co-operation in Asia: Long-term Progress, Recent Retrogression and the Way Forward”, Asian Development Bank Working Paper 28.
- Arndt, H.W. (1967), “A Pacific-Asia Free Trade Zone?” in *A Small Rich Industrial Country*, Cheshire, Melbourne.
- Asian Development Bank (2002), “Preferential Trade Agreements in Asia and the Pacific”, *ADB Outlook 2002*.
- Bergsten, F. (2001), “America’s Two Front Economic Conflict”, *Foreign Affairs* 80, No. 2, March/April.
- Bergsten, C.F. and Y.C. Park (2002), “Toward Creating a Regional Monetary Arrangement in East Asia”, ABD Institute Research Paper No. 50.
- de Brouwer, G. (2003), “Financial Markets, Institutions, and Integration in East Asia”, *Asian Economic Papers*, 2(1), pp. 52-80.
- de Brouwer, G. (2004a), “The IMF and East Asia: A Changing Regional Financial Architecture” in Chris Gilbert and David Vines (eds.), *The IMF and Its Critics*, Cambridge University Press, Cambridge.
- de Brouwer, G. (2004b), “Policy Dialogue, Surveillance, and Financial Cooperation in East Asia” from Yunjong Wang and Gordon de Brouwer, *Financial Governance in East Asia*, Routledge, London.
- de Brouwer, G. and T. Ito (2003), “Financial, Monetary and Economic Co-operation in East Asia”, mimeo.

- Clarete, R., C. Edmonds and J. Wallack (2002), "Asian Regionalism and its Effect on Trade in the 1980s and 1990s", Asian Development Bank Working Paper 30, November.
- Ferguson, R. (2001), "Globalisation: An Often-Misunderstood Concept", Speech at "Strategy Force 2001", mimeo, March.
- Friedman, T. (1999), *The Lexus and the Olive Tree*, Farrar, Straus and Giroux, New York.
- Garnaut, R. (2003), "Australian Security and Free Trade with America", Speech at the Australian Business Economists' meeting on the US/Australian Free Trade Agreement.
- Grenville, S. (1998), "The Asian Crisis and Regional Co-operation", Speech given at the International Seminar on East Asian Financial Crisis, Beijing, April.
- Grenville, S. (2000), "Globalisation: Writing (and Righting) the Rules", *Reserve Bank Bulletin*, July.
- Grenville, S. (2002), "Policy Dialogue in East Asia", Paper presented at a conference at the China Centre for Economic Research, Beijing University, March.
- Grenville S. (2004), "The IMF and the Indonesian Crisis", *Bulletin of Indonesian Economic Studies*, April.
- Gyngell, A. (2003), "Australia and the Commonwealth: Out Now!", *Sydney Morning Herald*, 15 December.
- Henning, R (2002), *East Asian Financial Co-operation*, Institute for International Economics, Washington, DC.
- Kenen, P. (1969), "The Theory of Optimum Currency Areas: An Eclectic View" in R. Mundell and A. Swoboda (eds.), *Monetary Problems in the International Economy*, University of Chicago Press, Chicago.
- Krueger, A. (2001), "International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring", Speech at the American Enterprise Institute, Washington, DC, November.

- Lawrence, R. (1996), *Regionalism, Multilateralism and Deeper Integration*, Brookings Institution Press.
- Lee, R. (2003), “The Future of Securities Exchanges”, Fifth Round Table on Capital Market Reform in Asia, November, mimeo.
- Lloyd, P. and D. MacLaren (2003), “The Case for Free Trade and the Role of FTAs”, Seminar at the WTO, Geneva, November.
- Mundell, R. (1961), “A Theory of Optimal Currency Areas”, *American Economic Review*, 51.
- McKinnon, R. (1963), “Optimum Currency Areas”, *American Economic Review*, 53, pp. 717-725.
- North, Douglass (1990), “Institutions, Institutional Change and Economic Performance”, Cambridge University Press.
- Panagariya, A. (2000), “Preferential Trade Liberalization: The traditional Theory and New Developments”, *Journal of Economic Literature*, 38, pp. 287-331.
- Rodrik, D. (2000), “How Far Will Economic Integration Go?”, *Journal of Economic Perspectives*, Winter.
- Rodrik, D. (2002), “Feasible Integrations”, mimeo, July.
- Rose, A. (2000), “One Money, One Market: The Effect of Common Currencies on Trade”, *Economic Policy*, 30.
- Schott, J. (2003), “Korea’s FTA Conundrum”, Institute of International Economics (www.iie.com).
- Scott, J. (2003), “Unlocking the Benefits of World Trade” in *The Economist*, 1 November.
- Thirlwell, M. (2003), “Is the International Trading System Fragmenting? Challenges for Australian Trade Policy”, Lowy Institute Research Paper 1.03 (September).

Weiss, L. (2003), "Guiding Globalisation in East Asia: New Roles for Old Developmental States" in L. Weiss (ed.), *States in the Global Economy*, Cambridge University Press.

Wyplosz, C. (2001), "A Monetary Union for Asia? Some European Lessons" in *Future Directions for Monetary Policy in East Asia: Proceedings of a Conference*, Reserve Bank of Australia.

Chapter 3

Regional Integration: History and Trends

by

Juan José Ramírez Bonilla

**Director, Center for Asian and African Studies
El Colegio de México**

History, in the present times, tends to be forgotten. In the case of the Pacific region, such an oversight prevents us from recognising the possible consequences of the three great regional integration projects (the European Union, the Americas' Free Trade Area and ASEAN + 3) on the future evolution of the world economy.

The multiple effects of the 1997-98 Asian crises have not been thoroughly studied. The fact that this was a structural crisis, with political and social repercussions in all of the countries concerned, has been overlooked. In the field of the social sciences (particularly in economics) a consequence occurred that has hardly been noticed:

- Before the crisis, it was commonplace in the Pacific region to speak of differentiated – and to a certain degree, antithetical – economic “models”. Mention was made of a “Western model”, based on economic liberalism, and of an “Asian model” based on associative social mechanisms and strong state influence on economic processes.
- During the crisis, the main analytical approaches used to understand it did not take into account specific aspects of the Asian economies, or indeed of the crisis itself.
 - The specific aspects of the Asian economies, as well as the interrelationship of trust between the social actors, were seen not as an advantage but as the root of all evils. The systems of social relationships that have served as a basis for the “Asian miracles” were disqualified as *crony capitalism*.

- No consideration at all was given to the existence of an economic network on a regional scale that resulted from direct investment flows between the Asian Pacific countries. Dissemination of the crisis was “explained” as a “contagion effect” without considering the mechanisms of this network, which served as the medium for transmitting the crisis. Consequently, the situation was seen as simultaneous crises of national economies, but not as a regional economic crisis.

Furthermore, the 1997-98 crisis was seen as a failure of the “Asian model”. Now, the only universally accepted economic paradigms are those of the “Western model”, and anything else is considered capable of improvement.

History does not figure importantly in the predominating economic approaches. In theory, all that is required is that decisions concerning the political economy adjust to the liberal paradigms, and free market mechanisms will guarantee efficiency and competitiveness. In practice, however, the social actors adopt different attitudes. Some, such as the United States, proclaim economic liberalism but, when deemed necessary, resort to government intervention in economic processes. Others, such as the Pacific Asian governments, seek to re-establish economic intervention mechanisms operational in each national economy and the Pacific Asian regional economy. Still others, such as the Latin American governments, try to faithfully follow the liberal principles despite the negative socioeconomic results obtained over the last twenty years.

These attitudes mark each regional trend and give us an idea of the possible effects of regional integration projects on the world economy in general and the economy of the Pacific region in particular.

The elements of the Asian development strategy

The notion of the “Asian model” brings to mind the Japanese postwar reconstruction, overlooking the fact that Japan’s industrialisation and modernisation dates back to the last third of the 19th century. At the beginning of the last century, the Japanese expansion into Manchuria, Korea and Chinese Taipei was due to military power based on vigorous industrialisation. Japan’s modern development attracted the East and Southeast Asian nationalistic movements that were seeking to shake off the Western colonial powers.

The modern Japanese institutions were seen as the model to follow:

- A strong vertical state, able to guide the economic processes toward national goals and interests, and strong nationalistic business leadership.
- A system of social relationships able to substitute capital/labour antagonism for a harmonic relationship between the two production factors.
- Large industrial conglomerates able to compete with the Western trusts, as well as able to use and benefit from the Japanese national market.

The Japanese success was closely linked to a military expansionist project which culminated in the Great Sphere of Co-Prosperity and the Pacific war. However, the Japanese economy always maintained structural relations with a regional economic network. Consequently, one cannot be understood without the other.

The attraction that Japan exerted on its neighbours was due to the fact that this was the only non-Western country that had managed to industrialise and modernise, as well as to establish an equal relationship with the Western powers. Also, Japan had proclaimed and carried out an Asian version of Manifest Destiny.

The basic elements of a rudimentary Asian identity were resentment towards the Western Colonial powers, and admiration of the Japanese. The postwar success enhanced this admiration and, among the recently decolonised countries, Japan became the model to be followed.

The South Korean military, inspired by the Meiji Reform, adapted the Japanese institutions to their local context. In Chinese Taipei the influence of the Japanese colonial institutions explains, to a large extent, the initial stages of the island's industrialisation. The leadership in Singapore adapted the basic elements of the "Japanese model" to the island-state. The ringing success of the Singapore project influenced the Malaysian elites, and so forth.

In each Asian Pacific nation, whenever a government decided to follow the path of industrialisation, the first example to follow was Japan, and then whichever other country that had followed the Japanese example. Each time, the basic elements of the model were adopted and adapted to the dominant conditions in a national context. The results, one could say, were an Asian

development strategy for each Asian country. This in itself marks a strong difference with the Western forms of economic development.

From national development experiences to the constitution of a regional economy

For the Meiji Japan reformists, the main objective was to avoid falling under the domination of the colonial powers. The means to achieve this were to construct an industrial society, adapting the Western institutions to the local Japanese context. The Reform project had a strong nationalistic implication, and the success of Japanese nationalism inspired the nationalists in all the colonial societies of the Asia Pacific region. When these nations became independent, the first experiences of economic development were also highly nationalistic.

However, the consolidation of each national economy was uncertain. With political independence, links with the Western world were suppressed or, at best, reduced to a minimum. The domestic markets were unable to absorb the goods produced by specialised economies to fit the requirements of the old colonial powers. Access to the export markets became a basic necessity which was not always easy to gain. With time, the necessary conditions were created to establish a regional market that would permit consolidation of national economies.

The regional market was the natural consequence of the economic “miracles” that followed one another. Nevertheless, rapid economic growth finally exhausted the elements that had made it possible. Towards the mid-1950s, Japanese labour was abundant and cheap. At the time of the first oil crisis, the rapid growth had produced a relative labour shortage, and this shortage, combined with a growing demand for labour, produced a rapid increase in wages.

Between 1975 and 1991, with a labour shortage and ever higher wages, the Japanese economy showed a moderate annual growth rate of 4% or 5% on average. In order to guarantee economic expansion, the government was forced to restructure the economy. One of the various measures taken was the exportation of productive capitals to procure the use of natural and human resources from other countries.

In this manner, the Japanese economy entered into an internationalisation phase and the government created the conditions to facilitate it. Thus conditions

began to be created to form an integrated economic network in the Asia Pacific region.

- In the second half of the 70s, the Singapore government introduced an innovation in the Asian development strategy: it was decided to use direct foreign investment to speed up the island-state's industrialisation, being careful always to maintain government control over the economic processes.
- Between 1975 and 1985, intra-regional investment flows were slow to develop. However, in 1985 the increased value of the yen to the dollar, imposed by the Plaza Hotel Agreements, gave the Japanese additional financial resources that were channelled by the Japanese corporations towards US treasury bonds and productive investments in the Asia Pacific region.
- In 1985 the economic crisis resulting from the deterioration of the prices of primary products and raw materials forced the Southeast Asian governments to start industrialising in their own countries. Singapore's success in attracting direct investments set an example for regional economies to open the way for productive capital flows.
- The permanent appreciation of the yen and the acquisition of an ever-increasing trade surplus multiplied the available financial resources, and Japan became the first financial power in the world.
- At the end of the 80s and beginning of the 90s, South Korea and Chinese Taipei, like Japan in the mid-70s, began to experience a relative labour shortage and a rapid increase in wages. They thus also began to export productive capitals – South Korea to all of the Asia Pacific region, and Chinese Taipei to the People's Republic of China.

Limitations of the regional integration process

Special attention must be paid to the following aspects of this process: first, regional integration was a direct result of the internationalisation of the productive activities of Asian enterprises; second, the governments merely acted as indirect agents, insofar as their role was limited to facilitating the exportation or the importation of productive capitals; third, while facilitating the transfer of capitals, the governments lost their capacity to control private agents operating on a regional scale; fourth, a differentiation of interests resulted between the

private agents operating on a regional scale on the one hand, and those who continued operating in the domestic market, as well as the government actors, on the other.

In sum, by facilitating the internationalisation of the private companies, the governments relaxed or suppressed some of the economic control mechanisms. Under those circumstances, in order to appraise their investments, the private actors incurred short-term external debts and resorted to trading on the stock market, in real estate or in the money market, thus creating the conditions which led to the 1997-98 crisis.

In the face of a regional crisis, the capacity of the governments to intervene in the economic processes was severely curtailed. On the one hand, the liberalisation of the financial markets must be maintained at all costs, in order to avoid prohibition of access to FMI's resources.* On the other, the government measures taken to contain the crisis were inadequate, due to the fact that they affected economic variables within the restricted areas of each national state, with little or no influence on the regional economic processes.

It became necessary for the Asian governments to re-establish economic control mechanisms on a regional scale. This in itself laid bare the deficiencies of the free trade agreements negotiated up to that time since, based as they were on a free trade conception, such agreements did not include government mechanisms to regulate the economic processes. Therefore, it became necessary to formulate a second generation of intergovernmental economic agreements, known as Economic Association Agreements. These were organised around the suppression of customs duties and oriented toward establishing mechanisms for intergovernmental co-operation, capable of regulating the economic processes on an international level.

The Americas

The historical perspective also tends to be overlooked in the Americas. In the first place, the contrast between the great world power of North America and the Latin American developing nations frequently makes it difficult to understand the Latin American experiences in the field of economic development. In second place, the economic problems faced by Latin American nations since the 80s produced a drastic regional recession. These societies

* The government of Malaysia was the only one to re-establish controls on short-term investments; although criticised for doing so, it was later congratulated by its critics.

seem to be forever caught in the Sisyphus syndrome: no sooner do they start to recover from a crisis than they are faced with an even bigger one. In the face of permanent instability, it would seem that everything has yet to be done in Latin America to guarantee the continuity of the social and economic processes.

The historical reality, however, is different. Most of the Latin American countries gained their political independence at the beginning of the 19th century. Free of metropolitan tutelage but relatively disconnected from each other, the Latin American economies were largely oriented towards their internal markets. Thus, although there is a predominant Spanish cultural root between them, there have never been adequate conditions for realising Simon Bolivar's dream of creating one big community. Private interests have always stood in the way of the common interest.

Nevertheless, the modernisation experiences of Latin America are not properly understood. For instance, it could be said that Mexico and Japan started their industrialisation processes at more or less the same time. Mexico gained its independence in 1821, and shortly afterwards Benito Juarez's liberal government decreed radical economic and social reforms to put into circulation the real estate belonging to the colonial privileged classes. The Porfirio Díaz government later privatised the communal lands of the country's indigenous population and created a modern banking system, built the infrastructure of a railway, and promoted the start of modern industrialisation.

In contrast with the nationalistic project of the Meiji reformists, the Díaz government showed a marked preference for foreign capital, especially the European over the North American. Under the banner of "Order and Progress", the Mexican elites were able to guarantee for a long period the social and economic stability required by foreign investors.

This period of expansion was interrupted by a long civil war that began in 1910. Its effects were still felt as late as the 1930s. During this critical stage, the United States government sided with the political/military factions which were later defeated. Consequently the winning side, distrustful of the United States government, designed a deeply nationalistic development programme. This new nationalism was strengthened by new circumstances: the social instability frightened away foreign investment, and the economic reconstruction had to rely on domestic resources.

The railroad and oil companies were nationalised, as were agricultural lands, distributed among the producers under a non-private ownership system.

The government created social security systems for labour and public servants, and later nationalised the electric power-generating companies. Furthermore, whenever a production sector unit failed, the government rescued it.

The Mexican state, therefore, became the main promoter of economic growth. While Japan was in the throes of the “miracle” of its reconstruction, Mexico marched toward industrialisation and modernisation. Beyond the new temporary coincidence, the Mexican project differed from the Japanese project on one main issue: it was oriented towards consolidating the domestic market, using every resource necessary to protect it from outside influences.

The oil shock of 1973 benefited the Mexican government. Well able to manage the country’s oil, the government had access to extensive financial resources for its nationalistic, domestic market-enhancing projects. The defensive mechanisms of the oil-consuming countries, however, limited the Mexican boom, and the Mexican government was soon forced to borrow from abroad to continue financing its great projects.

Unrestricted by control mechanisms, the Mexican government went overboard in contracting debts and, in 1982? declared itself insolvent. The government’s bankruptcy put an end to the cycle of national development, and it became necessary to adopt a new development strategy which favoured the linkage of the Mexican economy to that of the United States. This decision set Mexico totally apart from its fellow Latin American nations.

And in South America...

Meanwhile, the need for strong social reforms was evident in the south of the continent. Guatemala in the early 50s was the precursor of Cuba in 1959. In Argentina, Brazil, Uruguay and several other countries, the reformist governments provoked the reaction of the traditionally conservative elites and generated military coups d’état. The military dictatorships of the 60s became the promoters of nationalistic economic modernisation.

Brazil and Argentina can be considered the prototypes for such models. The geographic extension of both those countries, together with the availability of abundant natural resources and the extensive size of the domestic market, made it possible to consolidate internally oriented economies.

As in the Mexican case, as the modernisation process advanced, ever larger amounts of financial resources were required. Without the capacity to generate

these resources domestically, the political/military elites found the easy way out: increasing amounts of foreign debt. Finally, the insolvency of the Mexican government blocked all the paths of fresh capital flows. From that time on, Latin America was afflicted by the syndrome of the “lost decade”, a period of almost zero economic growth, as well as by the impossibility of continuing with more advanced industrialisation and modernisation development processes.

The Latin American economies continue to be producers of mineral and agricultural raw materials, and some small value added manufactures. Experience seems to confirm the non-viability of nationalistic projects based on domestic market protection.

The case of Chile seemed to follow toward the same conclusion. But the military regime of Augusto Pinochet eliminated all the government economic regulations and imposed free trade. True, thanks to such liberal reforms, the Chilean economy attracted foreign capital and became more dynamic. Nevertheless, the Chilean government was unable to orient the economic changes toward a more advanced stage of development. Today Chile’s economy has been able to considerably increase the value of its exports and to diversify its export markets, but it is still stuck in the production of mineral raw materials and primary goods.

Chile’s success, therefore, is relative. It stands out compared to other Latin American experiences, but is insignificant when compared to the situation of the Asian Pacific region developing countries, which have sustained their economic growth, specialising in the production of manufactured goods with increasing value added.

In sum, the economic development experiences of South America are still oriented toward the consolidation of national projects. At first sight, the experience of Chile seems to be different. However, in spite of the participation of foreign investments, the productive processes still basically take place in Chile, since the land remains the main production factor.

The relations between the Latin American countries are marked more by commercial competitiveness than by the need to establish economic integration linkages. Thus it is difficult to reach agreements that would better define a project of Continental integration:

- The Mexican government is aware that, with Free Trade Area of the Americas (FTA-As) it will lose some of the advantages it now holds in the United States market.
- The Brazilian government is wary of the negative social results of Mexico's participation in NAFTA and is unwilling to enter into a similar agreement with the United States. Furthermore, since the latest crisis in Argentina, Brazil is more cautious than ever about strengthening its ties with its main partner in MERCOSUR.
- The Colombian government is desperately looking for a way to overcome the endemic violence in the country. Consequently, regional integration is not a priority at present.
- The government of Venezuela is virtually isolated and is sustained only insofar as everyone else fears greater instability should the Chavez Administration fall.
- The PACTO ANDINO is currently more formal than real, and assembles countries with limited specific importance in the southern region of the continent.

Under these circumstances it is not surprising that the government of the United States wants to maintain the FTA-As project at all costs, offering each Latin American government the possibility of adapting it to their corresponding specific needs. In such a condition, FTA-As would be an aberration, marked by special interests instead of by common interests which would bring into harmony the relationships of all the associated governments.

Conclusions

It has been mentioned that after the second half of the 1980s, the world economy entered into a phase marked by the emergence of three great regional economic blocs. Through time, each of these blocs has tended to expand geographically: the European Union is gearing up to extend its coverage to the former Eastern European socialist countries; in the Asia Pacific region, with the consolidation of ASEAN-10, countries such as Cambodia, Laos, Myanmar and Vietnam now participate in the AFTA and ASEAN + 3 projects; and in the Americas free trade agreements have proliferated. Consequently, today, the dynamics of the world economy are determined by the logic of regional integration.

Each regional bloc project is based on exclusive principles. Therefore, insofar as the development of an extended European Union, of ASEAN + 3, and of FTA-As are concerned, competition will become more complex. The competition between national economies will intensify. That between regional blocs will develop and will become more marked between national economies and regional blocs. Countries remaining outside regional integration will be less able to participate directly in the world economy.

There is every indication that FTA-As will be a geographic extension of NAFTA, which is to say that it will be based on free trade, to a larger or lesser extent, according to each Latin American country's reticence or fears. Mexico's experience shows that free trade has had unequal socioeconomic effects: on the one hand a small sector of the population has benefited from the free trade mechanisms, but on the other the major part of the population depends on activities oriented toward the domestic market, although the most significant aspect of this is that those activities are increasingly informal.

The inequalities are even more worrisome when they are compared with prevailing conditions in the Asia Pacific region. As has been mentioned, private companies were the direct promoters of regional integration. Nonetheless, the governments – while playing an indirect part in the process – were able to establish regulatory frameworks to promote the association of domestic companies with foreign enterprises; to create support mechanisms for the consolidation of local companies; and to establish social policies favourable to the qualitative development of the population. In every case, it is possible to verify that there was a substantial increase in per capita income and a decrease in social inequalities.

At this point it is possible to formulate a first conclusion: in Mexico, the free operation of the supply and demand game has accentuated social inequalities. Consequently, it is quite likely that FTA-As, organised with NAFTA logic, will reproduce on a continental scale the social inequalities present in Mexico. In Asia, the governments have maintained regulatory mechanisms able to orient the economies toward a global market and reduce social inequalities. If the ASEAN + 3 project is based on the logic of the economic association agreements, intergovernmental co-operation will make it possible to regulate the economic processes on a regional scale, limiting the damaging effects of the economic competition in the national, regional and global contexts. The governments will thus be able to limit the social disparities.

Concerning the factor which would favour or limit carrying out extended regional integration projects, it should be pointed out that in the mid-1990s the Group of Eminent Persons in APEC proposed the creation of a community of Pacific economies as the main objective of the forum. The proposal, however, did not take into account that in the Asia Pacific region and on the American continent, there are two different development strategies in action.

The Asian strategy, as has been mentioned, implies government regulation of the economic processes, and the existence of non-conflictive relations between the economic actors. In the Western strategy, the market mechanisms predominate over the regulatory mechanisms, and consequently the relations between the actors are also predominantly competitive and conflictive.

In the Asia Pacific region, the development strategy was the result of voluntarily adopting mechanisms that permitted the industrialisation and modernisation of Japan, and their adaptation by the corresponding governments in the region to each of the national contexts. Here is, consequently, a common institutional under-layer and a common economic policy practice. These two factors are the necessary precondition for the establishment of an economic community, ruled by an ample economic association agreement. Thus, by means of intergovernmental co-operation, the economies will be able to intensify to a maximum the international division of labour practiced by Asian companies during the period before the 1997 crisis. Each economy can develop competitive advantages after its insertion in the regional productive network, where co-operation could substitute competition between private producers (or the same or different economies).

In contrast, in the Americas the philosophy of the liberal economy has been imposed from outside on the governmental agents. Unable to generate the necessary domestic financial resources to guarantee the service of debt (external and internal) or new productive investments, Latin American government agents have accepted international savings on a conditional basis. That is to say, they have had to suppress government intervention in the economy and develop market mechanisms.

Of course, the new context of the liberal economy has been advantageous to the foreign companies and the national companies able to face the competition. It has, however, been deadly for the middle and small producers. In these conditions, the Latin American economies operate on the basis of two distinctly separate segments: that of a small number of competitive companies able to function in the international market; and that of a large number of

domestic market-oriented companies that can barely survive. The problems faced by companies in the second segment are so big that this explains the constant growth of the informal sector in the economies.

Consequently, informal work, underemployment and unemployment are elements that widen the increasing breaches between opulent minorities and extensive impoverished social sectors, or between the population and the governmental agents. The latter occasionally become aware of the origin of the chronic social unrest and are suspicious of promoters of regional integration projects which may further emphasise the strong social tensions.

As if this were not enough, the social, economic and/or political instability present in all Latin American societies forces the representatives of each government to minimise the linkages with the economies of other countries, for fear of internalising the instabilities of their neighbours.

In sum, everything indicates that the governmental agents in Latin America are faced with a paradox:

- They guess that the consolidation of the regional blocs in Europe and the Asia Pacific region requires the need of an extensive, and especially in-depth, regional integration project.
- They are aware that a project based exclusively on free trade will accentuate the social tensions and friction present throughout the continent.

It is the author's opinion that the only way to overcome the paralysis produced by such a paradox is to substitute the logic of bilateral negotiation with the promoters of FTA-As, for a two-level negotiation: the first would be exclusive to the Latin American countries, so that they can define their common interests; the second would imply that the Latin American governments should negotiate, as a group, their interests with the promoters of the free trade project. In the middle of both forms of negotiation, intergovernmental forms of co-operation must be established that will permit the closing of the socioeconomic breaches within and between the countries of the continent.

Without intergovernmental co-operation, consolidation of the three great regional blocs will inevitably lead to a destructive competition. Incorporating it into an Economic Association Agreement of the Americas, it might be possible to establish the basis for a Pacific and an Atlantic economic community.

BIBLIOGRAPHY

- Association of Southeast Asian Nations (2003), *2002-2003 Annual Report*, ASEAN, Jakarta.
- Csapo, Laszlo (2003), “The Beginning of the End of US World Hegemony: European and Asian Perspectives”, Academy of the Social Sciences in Australia, *Dialogue*, 22(3), pp. 33-48.
- DTEC (2002), *Thai International Cooperation Program, 2001 Report*, Department of Technical and Economic Cooperation, Bangkok.
- Hashim, Azirah (2003), “Language Policies and Language Education Issues in Malaysia” in Jennifer Lindsay and Tan Ying Ying (eds.), *Babel or Behemoth: Language Trends in Asia*, Asia Research Institute, National University of Singapore.
- Hull, Terence H., Eddy Hashmi and Ninuk Widyantoro (forthcoming), “‘Peer’ Worker Initiatives for Adolescent Reproductive Health Projects in Indonesia”, *Reproductive Health Matters*.
- Jones, Gavin W. (1999), “The Role of Education in ASEAN Economic Growth: Past and Future” in Wong Tai-Chee and Mohan Singh (eds.), *Development and Challenge: Southeast Asia in the New Millennium*, Times Academic Press, Singapore.
- Jones, Gavin W. (2000), “Global Human Development: The Education Agenda” in Academy of the Social Sciences in Australia, *Facts and Fancies of Human Development*, Occasional Paper Series 1/2000, Canberra, pp. 100-119.
- Jones, Gavin W. (2003), “The Fifth Asian and Pacific Population Conference: Towards a Repositioning of Population in the Global Development Agenda?”, *Asia Pacific Population Journal*, 18(2), pp. 21-32.

- Jones, Gavin W. and Peter Hagul (2001), "Schooling in Indonesia: Crisis-related and Longer-term Issues", *Bulletin of Indonesian Economic Studies*, 37(2), pp. 207-31.
- Lindsay, Jennifer and Tan Ying Ying, eds. (2003), *Babel or Behemoth: Language Trends in Asia*, Singapore, Asia Research Institute, National University of Singapore.
- McIntosh, Alison and Jason L. Finkle (1995), "The Cairo Conference on Population and Development: A New Paradigm?", *Population and Development Review*, 21(2), pp. 223-260.
- Natarajan, Kalai and Hao Xiaoming (2003), "An Asian voice? A Comparative Study of Channel News Asia and CNN", *Journal of Communication*, June, pp. 300-314.
- Rahayu, Sri Kusumastuti *et al.* (2003), "Special Assistance for Students (BKM): Is It A Suitable Replacement for the JPS Scholarship Program?", SMERU Research Institute, No. 6, Jakarta.
- Reid, Anthony (2003), "Completing the Circle: Southeast Asian Studies in Southeast Asia", Asia Research Institute Working Paper Series, No. 12, Singapore.
- Santana, Kenny (2003), "MTV Goes to Asia", *Yale Global*, 12 August.
- SARS Preparedness and Response Team, World Health Organization, Western Pacific Regional Office (2003), "Severe Acute Respiratory Syndrome (SARS), A Challenge for the Region", presented at the 54th session of the Regional Committee Meeting for the Western Pacific, 8-12 September.
- Sondakh, Lucky and Gavin W. Jones (2003), "An Economic Survey of Northern Sulawesi: Turning Weaknesses into Strengths under Regional Autonomy", *Bulletin of Indonesian Economic Studies*, 39(3), pp. 273-302.
- UNESCO Institute for Statistics and OECD (2002), *Financing Education – Investments and Returns: Analysis of the World Education Indicators, 2002 Edition*, UNESCO and OECD.
- World Bank (1995), *Lao PDR Social Development Assessment and Strategy*, World Bank, Washington, DC.

*Chapter 4***Integration: The Way Forward***by****K. Kesavapany*****Director, Institute of Southeast Asian Studies
Singapore****Introduction**

Since the 1990s, the East Asian region has gone through some turbulent times, starting with the 1997/98 Asian financial crisis, the global economic slowdown, and more recently the SARS epidemic. These problems have had severe economic consequences on the East Asian economies, particularly the Southeast Asian countries that had recorded impressive growth rates in the early and mid-1990s. There is no more talk of Tigers.

The outlook for the region is, however, starting to brighten and the Asian Development Bank forecasts that the East Asian region will achieve a record growth rate of 6.6% in 2004. Several reasons have been attributed to this change in outlook. Among them are the global economic recovery led by the growth in the United States and Japan, improving domestic conditions, and the continued strength of the Chinese economy.

Things are therefore once again beginning to look up for the East Asian region, given the high level of interest among the countries to create formal economic arrangements. These arrangements would serve to deepen the level of economic integration in the region. This process is different from the market-driven integration that characterised the East Asian region from the mid-1980s. The increase in economic interdependence took place without any formal framework of co-operation, as a result of increased intra-regional trade, investment, technology and migration flows. Firms adopted the “flying geese”

model, moving their production processes to cheaper areas abroad as the domestic costs grew.

The new trend is for more emphasis on formal economic co-operation, and agreements between two or more countries, which are designed to achieve growth through trade and investment liberalisation and trade facilitation. ASEAN in particular is involved in a series of proposed preferential agreements with countries such as China, Japan, South Korea, India, Australia and New Zealand.

The ASEAN Economic Community

Within the Southeast Asian region, the ASEAN leaders are working on broadening and deepening their economic co-operation as well. Recently, at the Ninth ASEAN Summit in Bali, they agreed to establish an ASEAN Economic Community (AEC) by 2020. The idea of an AEC was first proposed by Singapore Prime Minister Goh Chok Tong during last year's ASEAN Summit in Phnom Penh. The AEC is one of three pillars (the other two being the ASEAN Security Community and the ASEAN Socio-cultural Community) that make up the ASEAN Community as contained in the Bali Concord II. In line with ASEAN Vision 2020, it is envisaged that the AEC will become a single market and production base with free flow of goods, services, investments, capital and skilled labour.

The ASEAN Economic Ministers' High Level Task Force (HLTF) on Economic Integration had unveiled a slew of economic initiatives with clear timelines (many within the next two years) to expedite the economic integration process and realisation of the AEC. These initiatives include:

- Fast-track integration of 11 priority sectors.
- Faster customs clearance and simplified customs procedures.
- Non-tariff measures to eliminate barriers to trade.
- Accelerated implementation of the Mutual Recognition Arrangements (MRAs) for key sectors (*e.g.* electrical and electronic equipment and telecommunications equipment).
- Harmonisation of standards and technical regulations.

In the area of trade in goods, improvements in the Common Effective Preferential Tariffs (CEPT) Scheme Rules of Origin (ROO) will be finalised by end-2004. This would include making the ROO more transparent, predictable and standardised, and taking into account the best practices of other Regional Trading Arrangements (RTAs) including the World Trade Organization (WTO)'s ROO. To ensure transparency on Non-Tariff Measures (NTMs) and elimination of those that are barriers to trade, the following measures will be undertaken:

- Establish an ASEAN Database on NTMs (by mid-2004).
- Set a clear criterion to identify measures that are classified as barriers to trade (by mid-2005).
- Set a clear and definitive work programme for the removal of such barriers (by 2005).
- Adopt the WTO agreements on technical barriers to trade and on sanitary and phyto-sanitary and import licensing procedures, and develop implementation guidelines appropriate for ASEAN (by 2005).

One of the most important recommendations by the HLTF was the creation of a more effective dispute settlement mechanism (DSM) with powers to make legally binding decisions in resolving trade disputes among member states. The number of trade disputes is expected to rise significantly as the region moves towards a higher level of economic integration. Hence, a credible DSM would be absolutely critical for the AEC to succeed.

By end-2004, the following measures will be undertaken to enhance the DSM:

- The establishment of a legal unit within the ASEAN Secretariat to provide legal advice on trade disputes.
- The establishment of the ASEAN Consultation to Solve Trade and Investment Issues in order to provide quick resolution to operations problems (this would be similar to the EU mechanism).
- The establishment of the ASEAN Compliance Body modelled after the WTO Textile Monitoring Body to make use of peer pressure to resolve trade disputes.

Through these economic initiatives, ASEAN plans to speed up the economic integration process. ASEAN also intends to strengthen the implementation of its existing economic initiatives, which include the ASEAN Free Trade Area (AFTA), the ASEAN Framework Agreement on Services (AFAS) and ASEAN Investment Area (AIA); to accelerate regional integration in the priority areas; and to strengthen the institutional mechanisms. These measures are clearly bold and ambitious.

Besides the “ASEAN-X” formula, ASEAN may also use the “2 + X” approach where two member countries which are ready to integrate certain sectors can go ahead first. In this regard, Thailand and Singapore have already announced that they would move ahead by “twinning” their economies. At the Bali Summit, both countries called for the realisation of the AEC well before 2020. All these economic initiatives are likely to contribute to a rapid realisation of the AEC project.

Why form such an economic community?

In this increasingly competitive environment, there are deep concerns that Southeast Asia will be overtaken by the emerging market economies of China and India. In particular, there is a growing perception that foreign direct investment (FDI) inflows are being diverted away from ASEAN towards China. China is now the world’s largest recipient of FDI – the country received USD 53 billion in FDI inflows in 2002 (and about the same in 2003).

Against this backdrop, the AEC comes at an opportune time. It could provide the means for ASEAN economies to revitalise and remain competitive in the face of growing economic challenges. It is expected that a sizeable integrated ASEAN market of over 500 million people would retain the region’s attractiveness as an FDI destination. In fact, many of the economic initiatives on the AEC are specifically aimed at reducing the transaction cost of doing business in the region so as to make it attractive to multinational corporations.

ISEAS “FTA-Plus” Approach

In February 2003, the Institute of Southeast Asian Studies (ISEAS) prepared a concept paper on the AEC. The main objective of this paper was to flesh out the idea of the proposed AEC, *i.e.* basically to envisage what the AEC would be like in 2020.

The ISEAS paper argued that the end-goal of an AEC by 2020 would not be a customs union like the European Economic Community of the 1950s. Basically, a customs union is a group of countries among which trade barriers are removed and a common external tariff policy is established with non-member countries. It is one integration level above an FTA, where tariffs are harmonised among member countries; here, member countries are allowed to have different tariffs with non-members. Given the different degrees of openness and stages of economic development among ASEAN countries, forming a customs union would be extremely difficult to achieve by the given deadline.

Instead, it would be more realistic to envisage the AEC as an “FTA-plus” arrangement that covers a zero-tariff ASEAN free trade area and has some elements of a common market (viz. free movement of capital and skilled labour). The ISEAS paper envisages the AEC with the following characteristics:

- a) Free movement of goods, services, investments and capital. This would include achieving a zero-tariff free trade area and the elimination of all non-tariff barriers.
- b) An attractive regional production platform that would be a magnet for FDI.
- c) Free movement of skilled labour and creative talent.
- d) Free movement of tourists from all ASEAN countries.
- e) Harmonisation of customs procedures and minimisation of customs requirements.
- f) Harmonisation of standards that are consistent with international standards.
- g) A well-developed institutional and legal infrastructure to facilitate the economic integration of ASEAN.

Achieving a higher level of economic integration may seem daunting at first glance, but ASEAN is not starting from scratch. This is because ASEAN has already put in place building blocks towards achieving an integrated ASEAN market. This would include economic integration initiatives such as the ASEAN Free Trade Agreement (AFTA), ASEAN Framework Agreement on Services (AFAS) and the ASEAN Investment Area (AIA). Looked at

holistically, the formation of an AEC could be seen as a logical step up the economic integration ladder.

The key policy recommendations in the ISEAS study are as follows:

- a) Establish clear deadlines for the implementation of services trade liberalisation under AFAS.
- b) All ASEAN countries should be committed to implementing domestic reforms, especially in the services sector.
- c) National custom agencies should be linked electronically so that submissions and processing between the agencies and traders are paperless.
- d) Removal of the need for work permits for ASEAN skilled and creative workers that are employed in an ASEAN country outside their home country.
- e) Create a visa-free region for ASEAN tourists.
- f) Strengthen the ASEAN Secretariat so that it can effectively coordinate, implement and enforce policies, agreements and protocols.
- g) Establish suitable institutions with supranational powers to facilitate economic integration. For example, it is recommended that a high-level judicial body to enforce the ASEAN DSM be established.
- h) Establish a scorecard system to ascertain the extent to which agreements signed by ASEAN countries have been implemented.

ASEAN-ISIS “Common Market Minus” Approach

ASEAN-ISIS – a consortium of Southeast Asian think tanks/research institutes – suggests in their study that the ultimate form of integration for the AEC would be the creation of a fully integrated market (a common market) in 2020. This would mean that by 2020 the AEC would be declared a common market but it would take into account areas where member countries could reserve deeper integration for a later stage (beyond 2020). The study suggests that ASEAN adopts a “Common Market Minus” approach. Its advantage is in the explicit formulation of a “negative list” that can be brought under the umbrella of the integration project.

A common market is understood to be an arrangement in which there are completely free flows of trade, including internal trade – as in a customs union – as well as free mobility of labour and capital. Full mobility of labour involves the right to reside and accept employment in all member countries, and mutual recognition of professional and technical qualifications. Full capital mobility requires lack of exchange controls, and full rights of establishment for firms in all countries.

Under a Common Market, credible removal of tariffs may require policy harmonisation or common policies on taxes, wages, prices, etc. It may even require common rules governing competition and monopoly, as well as in environmental regulations. However, it is still a matter of controversy whether a full common market requires a single currency and a common system of prudential regulations of banks and other financial institutions.

Nevertheless, the main focus should be given to achieving genuinely and completely free flows of trade and investment as the main vehicle for ASEAN economic integration. In view of the wide tariff differentials as well as varying levels of economic development within the region, it is recommended that the “ASEAN-X” formula be formalised so that ASEAN could proceed on a two-speed mode. To realise the AEC by 2020, ASEAN ISIS recommended the following measures:

- a) Consistent implementation and acceleration of the AFTA and AIA programs.
- b) Measures should also be taken to seriously eliminate all non-tariff barriers.
- c) Harmonisation of external tariffs must soon be introduced into the ASEAN agenda, especially among members with higher tariffs.
- d) A host of facilitation measures – such as harmonisation of customs procedures and standards – and other measures as proposed in the ISEAS Concept Paper and the ASEAN Competitiveness Study (ACS) are to be undertaken as part of the short-term time frame, *i.e.* in the next two years.
- e) A credible DSM should be established, also within the next two years.

- f) ASEAN policy makers should officially adopt the principle of a “two-speed” ASEAN (*i.e.* a two-tier economic integration process).
- g) ASEAN policy makers should support the creation of “regional units” as a first step towards institutional integration. Regional units are staffed by nationals who are formally independent of governments.
- h) ASEAN should agree on introducing safeguard mechanisms, but these safeguards will be managed by the “regional units”.

Regional Units should also be given charge of other areas where common policy approaches have been adopted. This includes the management of development collaboration (*e.g.* the IAI^{*}) and the monitoring of progress. In these two areas such regional units should be established immediately.

Progress in ASEAN economic integration

Trade among ASEAN countries has grown from USD 44.2 billion in 1993 to USD 95.2 billion in 2000, representing an average annual increase of 11.6%. As of the year 2000, intra-regional exports made up about 23.3% of total ASEAN exports. This may seem relatively low, as compared to the intra-regional trade in other blocs such as the EU and NAFTA. It is, however, expected that through the implementation of the ASEAN Free Trade Area (AFTA) and the reduction in non-tariff barriers, we can expect to see an increase in intra-regional trade.

AFTA was first established in 1992, with the signing of a Common Effective Preferential Tariff (CEPT) Scheme to eliminate tariff barriers among Southeast Asian countries, with a view to integrating the ASEAN economies into a single production base and regional market. The CEPT, under AFTA, was fully implemented in 2003, with the original six members (Malaysia, Singapore, Indonesia, the Philippines, Thailand and Brunei) complying with the Agreement, which requires that tariff rates on a wide range of products traded within the region be reduced to between 0 and 5%. These six signatories account for over 96% of the total trade of ASEAN.

* At the Fourth ASEAN Informal Summit in Singapore in November 2000, ASEAN agreed to launch the Initiative for ASEAN Integration (IAI) with the aim of narrowing the development gap within ASEAN and assisting the newer members in the process of regional integration.

By the beginning of 2002, only 3.8% of the products, or 1 683 items out of 44 060 in the CEPT inclusion list, had tariffs above 5%. The average ASEAN CEPT fell from 12.76% to 2.91% over the 1993-2002 period. For the newer members, the earlier targets have been advanced in the light of rapid changes in the global economy. Thus, Vietnam is expected to reach its target for tariff reduction to between 0 and 5% for its range of items in the inclusion list by 2006, Laos and Myanmar by 2008 and Cambodia by 2010. The ultimate aim of AFTA is to eliminate all import duties by 2010 for the six original members of ASEAN and by 2015 for the new members.

Apart from merchandise trade, ASEAN also aims to liberalise trade in services through the ASEAN Framework Agreement on Services (AFAS). AFAS was signed during the fifth ASEAN Summit on 15 December 1995. It aimed to enhance co-operation among the ASEAN members in the services sector by eliminating intra-regional trade restrictions and expanding the scope of liberalisation in services beyond those undertaken under the General Agreement on Trade in Services (GATS). Over a span of about eight years since AFAS was signed, three rounds of negotiations have taken place. However, analysis of commitment by individual ASEAN countries indicates that not much progress was achieved in the first two rounds. The common trade barriers as evinced by these commitments are mainly in the form of restrictions on equity participation, on the type of commercial establishment that is allowed to be set up by the foreign company, and on the movement of natural persons. These barriers continue to affect the efficiency and competitiveness of the services sector in these countries. While progress in AFAS has been rather slow, the ASEAN countries are seeking to accelerate liberalisation through the adoption of the “ASEAN-X” principle, where agreements could be concluded by those countries that are ready while others could accede at a later time.

Another key agreement that ASEAN has focused on is the ASEAN Investment Area, which was signed on 7 October 1998. The AIA aims to make ASEAN a competitive, conducive and liberal investment area. The AIA is expected to have important implications for investment strategies and production activities in the region. The privileges offered by the AIA in investment, market access and the granting of national treatment took immediate effect for ASEAN investors, with the exception of those sectors in the list of exclusions. AIA will encourage investors to think increasingly in regional terms and to adopt a regional investment strategy and network of operations. It is expected to provide greater scope for division of labour and industrial activities across the region, creating opportunities for greater industrial efficiency and cost competitiveness. Current and potential investors

are expected to benefit through greater investment, greater transparency, a more liberal and competitive investment regime and lower transaction costs for business operations across the region.

ASEAN has also devoted a lot of attention to trade facilitation in the area of customs and through the elimination of technical barriers to trade with a view to lowering the cost of doing business in the region. ASEAN's efforts have been directed at the simplification and harmonisation of customs procedures, specifically through such measures as the harmonisation of tariff nomenclatures. Two important developments have taken place here. The first relates to the harmonisation of product standards for priority sectors. Thus far, ASEAN has identified 20 priority sectors, whose product standards would be harmonised to international standards. The second relates to the development of the mutual recognition agreements (MRAs) across ASEAN members. An MRA on telecommunications has already been put in place and negotiations are under way in the areas of cosmetics, pharmaceuticals and electrical and electronic products.

Strategic economic linkages with trading partners

The ASEAN leaders are also keen on establishing economic linkages with their Northeast Asian neighbours – China and Japan – in an effort to deepen regional integration in East Asia, reduce their dependence on the US market and maintain their relevance as an investment destination.

On 4 November 2002 during the ASEAN-China Summit in Phnom Penh, Cambodia, the Leaders of ASEAN and China signed the Framework Agreement on Comprehensive Economic Co-operation. The Agreement will serve as the fulcrum for establishing an ASEAN-China FTA within a decade; it covers trade in goods, services and investments plus measures that seek to strengthen and enhance economic co-operation. The agreement offers the newer ASEAN members, Cambodia, Laos, Myanmar and Vietnam, special and differential treatment and flexibility in implementation. It also includes an “early harvest” package that involves the quick reduction of tariffs on a number of products, mainly agricultural products which represent about 10% of all tariff lines in the harmonised system of tariff reduction. The early harvest package, which is aimed at accelerating the FTA process, would be implemented over a three-year period beginning 1 January 2004. For trade in goods, the negotiations on tariff reduction or elimination are now being conducted until 30 June 2004.

The ASEAN-China FTA, once established, will be the world's biggest free trade area, encompassing 1.7 billion people, a collective GDP of almost USD 2 trillion, and intra-regional trade of USD 1.2 trillion. The FTA is expected to increase intra-regional trade and enable firms that were operating below optimum capacity before the FTA to reap efficiency gains from the lower unit costs. The FTA will increase the productivity and competitiveness of the firms and facilitate greater investment flows into the region. It is estimated that the FTA would increase ASEAN's exports to China by 48% and China's exports to ASEAN by 55%. It is also expected to boost ASEAN's GDP by 0.9% and China's GDP by 0.3%.

In the short run, however, ASEAN will have to be prepared to face competitive pressures from a rising China, and its accession into the WTO. During the period of 1990-2000, China experienced an average real growth rate of 10%, and its exports quadrupled from around USD 62 billion to USD 250 billion. China has a huge market and a practically inexhaustible supply of low-cost skilled and unskilled labour. Some firms might be attracted to move to China, given its huge integrated industrial base.

At the present stage of development, the economic structures of ASEAN and China are more competitive than complementary. Both look towards the West and Japan for their export markets and for sources of capital and technology. China and ASEAN will compete head-on in several sectors, such as the traditional labour-intensive sectors like textiles, as well some of the high-tech sectors like electronics. For instance, the removal of quotas on Chinese textiles and apparel in 2005 will mean that ASEAN will have to compete openly with China in important third markets, *e.g.* the United States and the European Union. It is likely that ASEAN will lose its market share as the Chinese products become more competitive, pushing down the prices. However, trade and investment are not zero-sum games, and it is possible for China and ASEAN to mutually benefit through closer economic co-operation.

In the long run, with the establishment of the ASEAN-China FTA, firms would view China and ASEAN as a single integrated market, and they will restructure their supply chain and rationalise their production networks accordingly. Despite the similarities in their trade structures, China and ASEAN could harness the synergies and comparative advantage of their own economies to create complementarities among themselves. As China increasingly plays an important role in the global production networks, this can benefit the rest of the East Asia, as a growing portion of imports from China will be inputs in production processes, and not just finished consumer goods.

ASEAN is also keen on strengthening its economic linkages with Japan. ASEAN and Japan represent a market of 590 million people and a total GDP of USD 4.9 trillion. Japan has traditionally been a key trading partner and investor in ASEAN. From 1993 to 2000, the share of Japan's trade with ASEAN averaged 15.04%, while the share of ASEAN's trade with Japan averaged 14.74%. During the same period, the annual value of exports from Japan to ASEAN averaged USD 62.7 billion while the value of exports from ASEAN to Japan averaged USD 46.4 billion. In terms of investment, in 2001 Japan accounted for 18.4% of the total FDI into ASEAN.

At the ASEAN Summit in November 2002, the leaders of ASEAN and Japan endorsed a framework for Comprehensive Economic Partnership (AJCEP), including elements of a possible FTA, to be completed as soon as possible – within 10 years – with due consideration given to the level of economic development and sensitivity of various sectors within each country.

By 2020, the AJCEP is expected to increase ASEAN's exports to Japan by USD 20.6 billion or 44.2% using 1997 as a base. Japan's exports to ASEAN would also increase by USD 20 billion or 27.5%. The estimated positive impact on GDP growth would be 1.99% and 0.07% for ASEAN and Japan, respectively.

Given that ASEAN and Japan have complementary economic structures, the CEP should work to maximise this complementarity between the economies; address the barriers that impede the flow of trade in goods, services and investment between the two regions; and enhance their level of co-operation through trade facilitation measures. In order to successfully establish the CEP, Japan must overcome its domestic pressures, particularly in the agricultural sector, and continue with domestic banking reforms. ASEAN looks forward to Japan regaining its vigour to implement the reform programme that Prime Minister Koizumi has proposed. In a recent ISEAS conference on ASEAN-Japan Relations, Professor T.J. Pempel mentioned that while Japan continues to be an important source of technology and capital for Southeast Asia, it has "not been taking the economic leadership role to boost the region's economies".

Currently, ASEAN is also looking to establish an FTA with another Northeast Asian neighbour – the Republic of South Korea. Together the Southeast Asian and the Northeast Asian countries could act as building blocks for the eventual formation of an East Asian Economic Community. Given the

strength of the Korean economy, Korea can be expected to contribute towards the region's overall economic growth.

Although not strictly part of the East Asian region, India too hopes to link itself to it. Under its “Look East” Policy, India has purposely taken initiatives to strengthen links with East Asia, principally through ASEAN. In this regard, ASEAN and India have signed a Framework Agreement on a Comprehensive Economic Cooperation (CEC) in October 2003 that could eventually pave the way to an FTA by 2016. Prime Minister Goh Chok Tong has vividly described this process as two jumbo jets – the other being China – which would propel growth in East Asia in the 21st century.

While there are substantial benefits that could be reaped from these agreements, the extent to which the benefits will be realised depends very much on the level of commitment among the negotiating parties to implement the agreements without delay. ASEAN, for its part, has shown that it is ready and able to move the integration process forward both at the sub-regional and regional levels. Hopefully, the Northeast Asian countries would be similarly disposed. One of the most valuable lessons that we can learn from the European experience was that they had strong political desire and a common vision to integrate their economies to form the current European Union. In addition, while a “two-speed” ASEAN may now seem inevitable, it is important to ensure that the less-developed ASEAN member countries are not left far behind – otherwise there could be serious implications for ASEAN's cohesiveness.

Trade arrangements affecting regional economic integration

The proliferation of bilateral and regional trade agreements in Southeast Asia and East Asia can, however, give rise to a host of technical problems, including mismatches in the phasing of tariff reductions under overlapping arrangements and implementation of different rules of origin under separate FTAs. This is the so-called “spaghetti bowl effect”, which is unavoidable to some extent. It is therefore crucial that the agreements are “kosher” and WTO-compatible, and that they do not inadvertently increase the costs of doing business in the region.

Southeast Asian and East Asian economies should carefully design their FTAs so that they do not become stumbling blocks or eventually lead to a “Fortress Asia”. This is unlikely because East Asian economies have become so open and globally linked in areas beyond trade. They appreciate the positive effects of globalisation as much as it tries to avert the backlash. Furthermore,

East Asia cannot afford to close up among themselves and be regionally inward-looking, because while the region is resource-rich and has growing markets on the demand side, there is potential in science and technology to be tapped from the more advanced industrialised countries. In any case, East Asia has to get on with information and communication technology and the knowledge-based economy, which means tapping opportunities beyond the region. Multilateralism will generate greater net benefits for the economies, and the FTAs should serve to complement and reinvigorate the multilateral trading system.

In general, an FTA is supposed to be more of a building block than a stumbling block to free trade if

1. It undertakes substantial liberalisation in almost all goods and services that could be traded.
2. Rules of origin are WTO-compatible and proper dispute settlement procedures are in place.
3. It is open for new members to join on similar terms and conditions.

FTAs signed or under negotiation in East Asia are generally in line with these broad principles because they are open economies, as noted. East Asian integration via formal FTAs does complement and supplement market integration as fostered by foreign investment and multinational corporations. Intra-regional trade is as much propelled by domestic demand for finished goods and services as via inter-firm transactions due to cross-border production networks in industries such as automobiles, electronics, textiles and garments. If examined closely, most of Singapore's concluded FTAs do have these characteristics, and are thus WTO-plus agreements in many ways. Singapore's concluded FTAs have been creative and innovative to incorporate various principles involving rules of origin to take account of Singapore's extensive outward processing activities, including a concept of change in tariff classification which is a principle being adopted by the ASEAN Secretariat in ASEAN + 1 FTA arrangements.

Concluding remarks

Although the approaches to economic integration in the ASEAN region as suggested by ISEAS and ASEAN-ISIS are very different, both envisaged an AEC that is built on existing economic integration initiatives. Regardless of

which approach ASEAN would eventually adopt, implementation policies to realise the AEC must be credible and effective. This would require strong commitment by all member countries of ASEAN.

Does ASEAN have the political will to integrate despite the growing economic challenges? Certainly one of the most valuable lessons to be learned from the European experience was a strong political desire and a common vision to integrate their economies to form today's European Union. Judging by Bali Concord II and the HLTF's recommendations, it does appear that member countries are committed to integrating ASEAN into an economic community.

However, past experience indicates that implementation has always been ASEAN's problem despite clear and specific deadlines (*e.g.* the backtracking by some member countries in their AFTA commitments). The big question would therefore concern ASEAN's readiness to make the crucial decisions in the long march ahead.

PART II

SECTOR-SPECIFIC ISSUES

Chapter 5

Trade and Economic Integration in the Asia Pacific Region*

by

Homi Kharas
World Bank

Why integration now?

Two economic events of historic proportions provide the context for regional integration in the Asia Pacific today.

The first event, the currency and financial crisis of 1997/98, still affects every aspect of economic policy making. The crisis shattered a deeply held and broadly shared view of the policy keys to development success, and called for a review of what now needs to be done to build on the basic tenets: macroeconomic stability, high savings and investment, rapid expansion of education, and a strong export orientation.¹ Many in the region consider the crisis to have been a “defining moment” (World Bank, 2002b).

The second major event was China’s accession to the World Trade Organization (WTO) in November 2001 – the culmination of a 15-year-long bid for membership. China’s economy is already one of the largest in the world, and China’s prominence as an economic force in the region has clearly risen since the crisis. Thus it is no surprise that many policy makers in the region feel the need to understand the trends at work in China before they can formulate their own development strategies (World Bank, 2002b). Certain challenges will need

* Based on the Overview of Krumm and Kharas (2004), *East Asia Integrates: A Trade Policy Agenda for Shared Growth*.

to be met, and adjustments made. However, the scope for gains from a dynamic China is large across the range of countries in East Asia.

The region is now shaping its responses to these two events. The economic crisis has forced policy makers to rethink the financial, trade and investment linkages that connect regional economies. At the same time, it has given new impetus to ideas for regional institutions to help shape common responses. East Asian countries had historically pursued unilateral and non-preferential approaches to liberalisation, sealed through commitments made under WTO agreements. Indeed, through the crisis, market access was largely preserved. But equally, significant gaps in the international architecture were exposed, on finance, investment flows, and macroeconomic (especially exchange rate) co-ordination.

In this context, the trade policy agenda for integration is only one element of a broader set of policy and institutional changes taking place in the region. Success will ultimately depend on the consistency of approaches among all elements of integration. To achieve such consistency, the scope of discussion must be broadened. To this end, the integration agenda covers three areas:

1. Widening opportunities in trade arrangements.
2. A behind-the-border agenda to maximise the development impact of international commitments.
3. Broad sharing of benefits to reinforce social stability and a long-term political commitment to further reforms.

Widening opportunities in regional trade arrangements

Today, the region's policy makers see trade and investment integration as key elements of strategy. Although a few trade barriers were erected in response to the Asian economic crisis, they were minor and temporary.² Indeed, instead of more protection, the crisis produced a new impetus for openness. Liberalisation of trade and investment policies is recognised as a way to spur gains in efficiency. As such, it fits well with the new emphasis in Asia on innovation in firms and on economy-wide productivity growth to replace the old model of growth through physical and human capital accumulation (Yusuf *et al.*, 2003).

A multi-track approach is being followed, with support for a new global round of trade negotiations as well as for regional and bilateral arrangements. The willingness of the world's richer countries to target the needs of developing countries in the context of the Doha Development Agenda is helpful, but the outcome of these negotiations is still uncertain. And regional and bilateral agreements fit in well with other political aims of East Asian countries, giving these agreements a momentum that the global discussions have yet to achieve.

Intra-regional trade in emerging East Asia has grown faster than trade with any other market and now makes up 7.2% of global trade.³ While the largest economies account for the bulk of this trade, the regional trade of most smaller economies has also grown. Likewise, for the Asia Pacific Region more broadly, intra-regional trade has grown faster than the rest of its trade and now accounts for 14% of global trade.⁴ Recent trends in the magnitude and composition of intra-East Asian trade bode well for further integration (see Ng and Yeats, 2003).

Scope for gains from regionalism

East Asia has achieved a high degree of market-driven regional integration, but regionalism – more formal economic co-operation and economic integration arrangements and agreements between countries – has traditionally been quite limited.⁵ The major exceptions have been the ASEAN Free Trade Area (AFTA), established in 1993, and dialogue under the Asia Pacific Economic Cooperation (APEC) forum. However, the past several years have seen a plethora of proposals for new bilateral and regional trade arrangements.

Addressing intra-regional barriers can ensure continued dynamism in regional trade and investment flows – including in response to China's growing role. The stated motivation of several initiatives, including the Framework Agreement for ASEAN - China Economic Cooperation, is to take advantage of complementarities and build on existing strengths in order to make the region collectively more efficient and competitive and thereby attract investment. The regional agreements under consideration are increasingly comprehensive in scope, going beyond the removal of tariffs and non-tariff barriers on trade in goods to include trade facilitation measures, such as conformity of standards and procedures across national boundaries, and trade in services. The New-Age Partnership between Singapore and Japan announced in January 2002 is notable in this regard.

The countries in the region could reap worthwhile economic benefits from increased regionalism aimed at removing border barriers, according to analysis using the standard models for evaluating benefits from regional trading arrangements (Table 1). As is typical in these models, the gains are shown to be greater the wider the country and sectoral coverage of the regional arrangements. Notably, the gains for ASEAN countries are shown to be greater than those for the other countries in the region. Given that the lower- and middle-income countries of ASEAN are likely to benefit less from China's WTO accession than the newly industrialising economies, greater regionalism in East Asia can help spread the gains across a wider set of economies.⁶

Table 1. Effect on economic welfare of various regional trade proposals
(percentage of GDP, excluding agricultural liberalisation)

Broader scope and wider coverage increases gains

Proposal	ASEAN	China	Korea, Rep. of	Japan	United States
China + Korea + Japan	-0.26 (-0.16)	+0.1 (-0.2)	+1.0 (+0.6)	+0.1 (+0.2)	+0.0 (+0.0)
ASEAN - China	+0.9 (+0.5)	+0.0 (+0.1)	-0.1 (-0.1)	+0.0 (+0.0)	+0.0 (+0.0)
ASEAN- Japan	+1.1 (+0.2)	-0.1 (-0.1)	-0.2 (-0.1)	+0.0 (+0.1)	+0.0 (+0.0)
ASEAN + 3	+1.5 (+0.6)	+0.1 (-0.2)	+1.1 (+0.8)	+0.2 (+0.2)	-0.1 (+0.0)
ASEAN + 3 + CER	+1.3 (+0.6)	+0.0 (-0.1)	+1.1 (+0.9)	+0.2 (+0.2)	-0.1 (+0.0)
APEC liberalisation (MFN)	+0.7	+0.5	+0.7	+0.4	-0.0
APEC preferential liberalisation	+0.8	+0.6	+0.9	+0.4	+0.0

Note: Calculations for ASEAN include only Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam. CER includes Australia and New Zealand. Figures in parentheses refer to net welfare effects when agriculture is excluded.

Sources: Scollay and Gilbert (2003) for free trade agreement proposals and Scollay and Gilbert (2001) for APEC liberalisation proposals.

Broadening to sensitive sectors

One danger with the current regional arrangements is that they have extensive provisions for excluding sensitive sectors. Such exclusions could substantially reduce the potential for welfare gains from an agreement. Within AFTA, for example, the lack of progress in agriculture and other sensitive sectors has been disappointing. To give some indication of the importance of

this point, some economic models suggest that if agriculture is included in the ASEAN - China or ASEAN + 3 proposals, the estimated welfare gains for ASEAN countries roughly double (Table 1). Unless countries tackle the sensitive sectors in regional trade arrangements – and ultimately at the global level – many of the potential economic benefits alluded to earlier will not be realised.

Reduction of trade barriers in *agriculture* is particularly important for poverty reduction. Agriculture is the main livelihood for poor households: for more than 90% in Cambodia and Vietnam, more than 75% in Indonesia, and roughly 70% in Thailand and the Philippines (World Bank, 2002a).

Regional agricultural markets already are large.⁷ Likewise, agricultural trade barriers are not just an issue for developed countries; the emerging economies of East Asia also maintain high barriers. Hence, there may be further scope to address the sensitive food security and safety issues initially within the context of East Asian arrangements.

China's commitment to a regime of low protection in agriculture is fortunate for other countries that are well placed to supply it with imports, providing a direct boost to their foreign exchange earnings and to the incomes of poor households. The initial levels of effective protection are likely to be far lower than others have estimated, implying that sectoral shifts are likely to be less dramatic than others are predicting.⁸ Nonetheless, China's agricultural trade liberalisation plan is the expected source of about half of the efficiency gains from the WTO accession package. Reduced protection and greater scope for imports are likely for a range of products, including oilseeds, sugar and dairy (where the principal form of protection has been tariffs, which are being reduced substantially) and cotton (where export subsidies are now ruled out). The ASEAN - China trade agreement, with its "early harvest" provisions, provides another avenue to ensure that poor agricultural households have every opportunity to benefit from trade opportunities in the region. China's binding to low tariff levels as part of its agricultural policy therefore offers scope for the liberalisation of agriculture in a regional setting, which could set in place a favourable political dynamic for more open agricultural sectors throughout East Asia.

Addressing deeper integration

The greatest welfare gains, however, are likely to come from addressing the deeper integration agenda being proposed here. In particular, the benefits

from integrating trade in services and overcoming technical barriers to trade are likely to be many times those from reducing border barriers alone.⁹ Gains from liberalising services trade are felt not only within the services sector itself, but also within other sectors because services are vital inputs in their production processes. As manufacturing in East Asia moves into a phase where participating in global markets will become more dependent on services, it increasingly will be held back by poor efficiency in the services sector, which has been protected from competition. Services liberalisation in East Asia lags relative to that of other regions, and action to integrate trade in services could help restore its global competitiveness. Simulation results from China, consistent with findings from other parts of the world, indicate that even small productivity gains of 1% in services outweigh those based on static border trade efficiency gains alone.¹⁰

In the East Asian goods trade, traditional concerns that a regional arrangement will merely divert rather than create trade are less worrisome because a relatively low-tariff bloc already exists, and because many of the region's economies, especially the more developed, are moving toward lower average tariffs. The challenge in pursuing regional integration arrangements will be to avoid the "spaghetti bowl" effect of different rules and regulations associated with different agreements, which can add unnecessary administrative costs to firms doing business across the region and result in a bloc-ed up world. Such costs can be especially high when a host of bilateral agreements are put in place, with large numbers of side agreements that each permit some discriminatory treatment. Inconsistencies between agreements with overlapping membership also can become a problem. The exchange of ideas on a regional basis can help avoid such difficulties. While in theory there is reason to expect that unco-ordinated bilateral and regional agreements build in incentives toward global free trade, this outcome depends crucially on maintaining a common set of principles for each agreement – that is, focusing on trade facilitation measures; allowing the most liberal rules of origin; and generally contributing positively to multilateral trade liberalisation. For example, allowing for accumulation under rules of origin will be important to the facilitation of production networks in the region, and allowing for multiple rules for conferring origin would make it easier for more firms to participate in regional trade (see Brenton, 2003b).

Another way to proceed would be to unbundle proposed agreements into components for deeper integration that could realistically be agreed on and would yield immediate results in terms of increased efficiency and development of intra-industry trade and production networks. In the case of China and

ASEAN, for example, two-way business transactions are already proliferating, and – long before government policy makers began to act – businesses had recognised and responded to the China challenge. Such transactions could be facilitated and enhanced by an agreement that focuses on trade and investment facilitation, such as customs.

It also would be preferable to focus attention and the resources of policy makers on as few regional arrangements as possible but to make them broad in scope and country coverage, especially for small economies that have limited capacity to evaluate the development implications of these arrangements.

Finally, a further benefit from stronger regional co-operation could be to link issues of common interest to an effective multilateral stance, whether in services liberalisation or regarding discipline on antidumping measures.

Development orientation for a behind-the-border agenda

Many of the mechanisms required to maximise the developmental benefits of trade and investment liberalisation are “behind-the-border” institutional and regulatory reforms. Each of the new regional and bilateral partnerships reflects this business reality. Technical barriers and product standards, logistics, services sectors, intellectual property rights, competition policy, and environmental and labour standards have become as important a part of the private sector environment as trade policy itself. The thrust is to place trade policy within a broader framework of development and poverty reduction.

Technical barriers and standards: balancing trade with consumer interests

As the traditional barriers to market access decline, measures aimed at trade facilitation become more critical. Conformity with health and safety standards can be one of the most decisive determinants of access.¹¹ Many of the standards in use represent legitimate consumer interests, but the use of technical regulations, such as standards, has risen to further commercial policy in multilateral, regional, and global trade. An important problem for exporters is that different national governments often apply different technical specifications to meet the same goal.

For East Asian developing countries, importing countries’ sanitary and phytosanitary (SPS) standards can impose significant additional costs that impede exports. For example, it has been estimated that application of the strictest EU standard rather than the international Codex Alimentarius standard

for aflatoxin has cost Thailand USD 350 million in export losses in cereals and dried fruit, China USD 380 million, and Vietnam USD 15 million. The adoption of a Codex standard on tetracycline could double Thailand and China's beef exports (Otsuki and Wilson 2001, 2002). Exporting countries also have to contend with importers' use of precautionary measures – such as the EU import ban on genetically modified organisms (GMO), which hurts Thailand's tuna exports as well as exports from China, which is the third largest GMO producer in the world. Only some of these standards may be justified on grounds of consumer safety and preferences; others may simply be protectionism in disguise.

The WTO rules in this area aim at ensuring that technical regulations, voluntary standards, and testing and certification of products do not constitute unnecessary barriers to trade. Under the Sanitary and Phytosanitary Standards (SPS) Agreement, WTO members are encouraged to adopt internationally recognised standards, but also are free to apply stricter ones. Although the agreement recognises importing countries' right to implement SPS measures that diverge from international norms, it does require them to provide scientific justification for such measures and applies risk assessment mechanisms.

In many cases, East Asian economies will want to adopt unilaterally the international standards being set.¹² At the same time, East Asian countries can benefit from rationalising standards in a regional context. Co-operation on standards is one of the important issues generally encompassed in regional arrangements. Recognising that foreign standards can achieve the same level of social or consumer protection as domestic standards, mutual recognition agreements (MRAs) are one option. Such agreements have mainly been used between developed countries, but ASEAN currently has signed two MRAs, with plans for an additional 20 products, thus avoiding duplication of testing and conformity assessment.

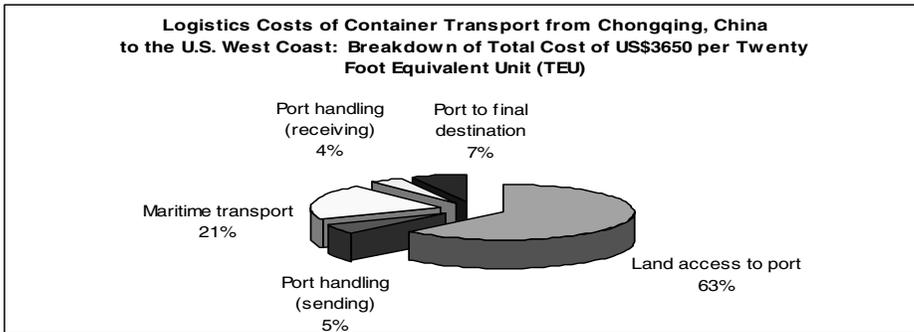
Transport and logistics

The commodity mix in East Asia is changing rapidly from resource-based commodities to low- and medium-technology goods to high-technology goods. Logistics improvements, essential for moving up the value chain, have very high payoffs in East Asia (Krumm and Kharas, 2004, Chapter 5). High-value agriculture (flowers, fruits, seafood) and manufacturing (electronics) demand sophistication not only in production but also in logistics handling. Timeliness matters, and a fast, reliable supply chain is essential.

In East Asia, the key logistical bottlenecks seem to be high internal land transport costs and port logistics. This situation is in sharp contrast to external transport costs: with the sharp decline in trans-Pacific shipping costs over the last decade, producers in many parts of East Asia can reach the US market more cheaply than inland areas or neighbouring countries. For example, the inland transport costs of moving goods from some remote regions of China to external markets are roughly 10 times the inland transport costs at the other end (Figure 1). Port logistics have been identified as a high priority (Figure 2). Modest improvements could lead to more than USD 50 billion in additional exports from emerging East Asia to the rest of APEC, with an even larger impact on efficiency of imports (Wilson *et al.*, 2002).

Figure 1. **Inland transport costs for remote regions**

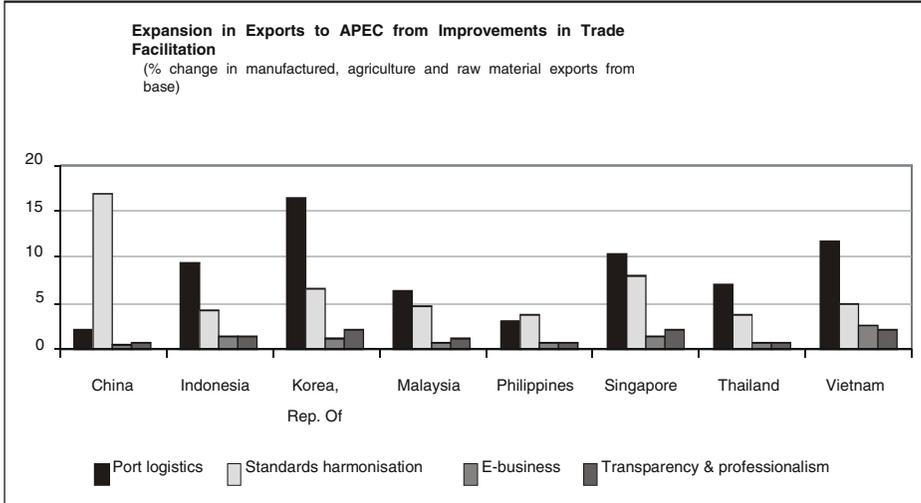
High land costs are the most significant barrier



Source: Carruthers and Bajpai (2002).

Figure 2. **Expanded exports to APEC from improvements in trade facilitation**

Better logistics and harmonised standards are key to expanding trade



Source: Wilson et al. (2002).

High inland transport and logistics costs are a particular impediment for the poor in remote areas or landlocked countries. In Lao People’s Democratic Republic, poor inland transport contributes to a 25% differential in paddy prices for farmers. On the island of Mindanao in the Philippines, agricultural producers are plagued by poor access roads, lack of storage facilities and inadequate trading areas, leading to small volumes and high costs, compounded by inter-island shipping freight with high tariffs, product deterioration, and cargo losses. In Mongolia, poor transport between Ulan Bator and the central regions contributes to a 40-85% price difference for the flour staple. Constraints on internal logistics also impede the shipment of food commodities from surplus to deficit areas, worsening food security.

Logistics requirements become more onerous for trade in differentiated products than for trade in homogenous products. Manufacturing firms, especially those integrated into global production chains, seek not only low transport costs but also a host of sophisticated logistical needs: short transit times, reliable delivery schedules, careful handling of goods in cold storage chains, certification of product quality, and security from theft. This situation suggests that by strengthening infrastructure services, East Asian economies can

influence their comparative advantage and, particularly, their prospects for expanding production of more sophisticated products.

Improving logistics involves investing in transport infrastructure, but also introducing complementary policies outside the transport sector. Transport regulatory agencies can improve logistics performance by allowing paperwork clearance for inland travel of containers and removing distortional queuing pricing for commodities accessing the transport system. Multimodal co-ordination is essential to promote seamless freight movement. In Korea, for example, inland container terminals and the development of intermodal exchanges have made it easy for containers to reach cities far from the ports. Co-ordination is also critical for urban land use, standards, licensing, and security. Examples of helpful urban land use policies include diverting traffic around congested areas and providing space for landside container storage.

Better cross-border trade facilitation – customs, e-commerce, paperless clearance, electronic processing and safety measures – can stimulate trade throughout the region. Some studies show that for emerging East Asia, modest improvements in trade facilitation could expand trade by more than USD 200 billion (Wilson *et al.*, 2002; also see Figure 2). Customs is the most obvious example. In some East Asian countries such as Singapore, trade documentation takes only 15 minutes to clear; two to three days is required for customs documentation and clearance of sea cargo. By contrast, customs clearance takes a minimum of five days in Manila and seven days in Jakarta. In China, trade documentation clearance takes a day, whereas sea containers can take 30-35 days to clear (Janet Tay Consultants, 2002). Several countries, including Cambodia and Vietnam, are addressing corruption in customs as critical to private sector trade (World Bank, 2001b, 2003a).

Certain logistics needs are best served by the private sector, particularly in ports, freight forwarding, third-party logistics, warehousing, trucking, and the bus industry. Foreign entry may play an important role in increasing competition and the quality of logistics.

Services sector liberalisation

East Asia has lagged behind other developing regions in liberalising trade in services (Mattoo, Rathindran and Subramanian, 2001). Evidence suggests that the productivity gains associated with more efficient services are particularly high, and that competitiveness in high-value, differentiated agriculture and in manufacturing depends on efficient business services.

A nonpreferential approach to market opening, negotiated within a multilateral context, may be important for overall efficiency. It ensures that access is provided by the most competitive providers and avoids conferring a first-mover advantage on inferior regional suppliers. Nonetheless, regional arrangements may provide the advantages of greater policy space for regulatory co-operation and learning-by-doing. Most regional partnerships already in place or under discussion include the services sectors, whereas these sectors have proved much harder to tackle in global talks. Because the liberalisation of services may be necessary for industries to benefit fully from the removal of regional barriers to goods trade, it may be preferable to give the services sector a high priority from the start of any negotiations.

East Asia is actively pursuing services liberalisation in the context of the regional arrangements just outlined. Even preferential liberalisation can improve the status quo, given that many existing barriers are frictional (such as unnecessary qualification requirements for foreign professionals and border hurdles for foreign transporters). Initial opening among regional partners may provide opportunities for learning-by-doing and lessen concerns that foreign competition would prematurely drive out potentially competitive domestic providers. Regulatory co-operation, such as the harmonisation and mutual recognition of domestic regulations in financial, professional and (a range of) other services, may be more feasible in a regional context.

Investment and competition policies

Raising the productivity of investment in East Asia requires harnessing the full force of competition inherent in global markets.¹³ Lower barriers to international trade and investment can be a powerful pro-competitive force, like in the services sector where investment is one of the major modes for trade in services. The greatest potential for making investment more productive lies in unilateral domestic reforms to remove policy barriers to competition. International agreements on investment and competition can provide benefits through reciprocity. However, most of the remaining restrictions on reciprocal market liberalisation and non-discrimination are in the services sector. Vehicles already exist at both the regional and multilateral (General Agreement on Trade in Services, or GATS) levels for realising gains potentially arising from service investment commitments.

International agreements that focus on protecting investors cannot be expected to expand markedly the flow of investment to new signatory countries. The bilateral investment treaties of East Asian countries already contain many

protections, and, even though they are relatively strong, these protections do not seem to have increased investment flows to their signatories.

Policy barriers to trade, such as high tariffs or quotas, are the most important restraints on competition. Another restraint is frequent recourse to antidumping and other types of contingent protection. Antidumping laws were originally created to counteract the predatory practices of foreign sellers into a home market. In practice, more than 90% of the antidumping cases investigated would never have been launched if a competition standard – potential threat of injury to competition – had been used as a criterion (Messerlin, 2000). Since 1995, more than 1 800 antidumping investigations have been initiated, many of them against East Asian exporters. In 2001 the countries most often subject to investigations included China (53), Korea (19), and Indonesia and Thailand (16 each).

Large international companies with market power can form cartels that fix prices, allocate markets and restrain competition. The uncovering of several international cartels in the late 1990s has encouraged prosecutions, including by Korea. And there may be further scope for initiatives to discipline international cartels, ranging from extending the reach of industrial nations' anticartel laws to notification and information exchanges by national enforcement authorities to a multilateral agreement.

Intellectual property rights: nurturing domestic innovation

Given the recent surge in knowledge-intensive trade and investment flows, intellectual property rights (IPRs) have become a mainstream topic in global trade discussions. As the subject of the 1995 Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement, IPRs have in fact become a contentious issue in the WTO. Developing countries are concerned that across-the-board upgrading is premature, given their positions as users rather than producers of technological innovations. Much of the debate has focused on the impact of more stringent rights on East Asia as a user of technology created elsewhere, but strengthened IPR regimes also play a role in local technology generation by compensating inventors and creators.

Within the more advanced emerging economies and parts of China, stronger IPR regimes, successfully enforced, could stimulate innovation in technology, provided other conditions are favourable (Krumm and Kharas, 2004, Chapter 6). Korea's dramatic success in patenting may be particularly relevant. The number of Korean patents registered in the United States grew

quickly in the late 1990s, propelling Korea to sixth in the US patent ranking, overtaking India, Brazil, and Singapore. Korea's strengthened IPR regime played a role, but so did industrial upgrading, a big push in research and development from the *chaebols* (big company groups), and the government's selective targeting of the semiconductor/electronics industry, where Korea has emerged as a leading innovator worldwide. Given that impending TRIPS-related obligations mandate stronger patent protection, it will be worthwhile for countries to identify complementary policies to boost innovative activity among private firms in their economies.

For a broader range of middle- to low-income East Asian economies, copyrights might offer more scope for gains, given the considerable talents of software developers, musicians, artists, and authors. Indonesia is one example of a country in which there is potential for expansion in copyright-sensitive industries as rights are improved and successfully enforced, particularly for the software industry, small film industry, and investment in artist development by music recording companies.

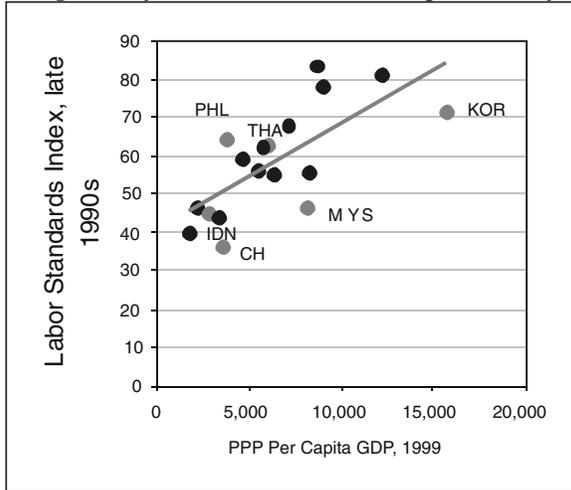
Traditional knowledge happens to be concentrated in lower-income nations, and its protection is generally expected to have direct benefits for reducing poverty. Often overlooked is the fact that protecting traditional knowledge and genetic resources also promotes efficient innovation in agriculture and biosciences. Yet traditional knowledge needs to be combined with research and development (R&D) activity, which is heavily concentrated in industrial countries, for mutual benefits from derived products. Some difficult conceptual and practical obstacles will need to be overcome before substantive progress can be made in protecting or compensating the ownership of traditional knowledge. In East Asia, the Philippines is experimenting in this field with existing and pending legislation.

Environment and labour standards

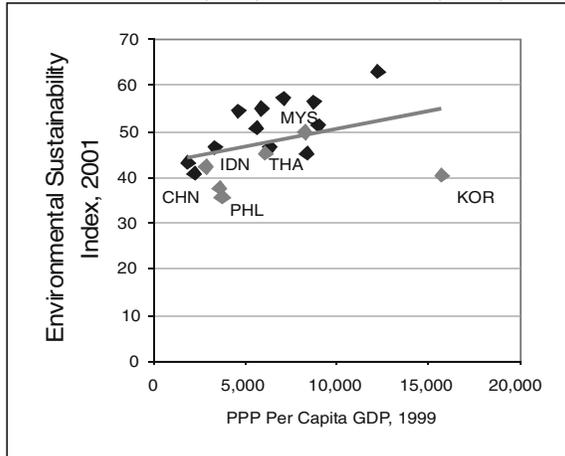
In general, environmental standards and workers' rights are weaker in East Asia than in other parts of the world with similar income levels; indices of environmental sustainability and regulation place East Asia near the bottom, as do indices of labour standards (Figure 3). Many observers have assumed that the region's weak standards play a role in its strong export competitiveness and ability to attract foreign investment. And within the region there is great suspicion that efforts to introduce higher standards in global trade talks are backdoor ways for rich countries to deny new export opportunities to developing countries.

Figure 3. **Environmental and labour standards, East Asia**

These standards are generally lower in East Asia than predicted by level of income



Source: Verite (2002) and World Bank (2001a).



Note: PPP = purchasing power parity.

Source: Esty and Cornelius (2002) and World Bank (2001a).

But in fact, the available evidence does not suggest that stricter environmental and core labour standards would hurt trade. Econometric evidence contradicts the “pollution haven hypothesis”, showing no significant relationship between environmental regulation and exports of pollution-intensive manufactures for East Asia (Krumm and Kharas, 2004, Chapter 7, Table 7.5). Analysis shows that exports and investments in East Asia in the most sensitive sectors (pollution-intensive industries and labour-intensive

industries) appear to benefit when standards are raised. The argument is that standards help set transparent “rules of the game”, which then promote technological upgrading and skills development from which all parties benefit. Thus the evidence suggests that East Asian countries can raise their environmental standards without adversely affecting their exports and investment inflows.

As for the impact of trade on the environment, evidence suggests that, while trade-induced growth adds to pollution and the output of dirty industries, this effect is outweighed by the demand for a cleaner environment as a country raises its income and acquires better technologies. For example, an analysis of the effects of trade liberalisation on water pollution in Chinese provinces during 1987-95 – a period in which there was both an extensive pollution levy system and significant opening to trade – illustrates that trade opening was beneficial to the environment overall (Dean, 2002).

The links between trade competitiveness and core labour standards are equally complex. As with trade and the environment, causality operates in both directions: weak labour standards and poor working conditions may influence trade flows and patterns, but labour standards themselves are policies determined by many factors, including openness to trade. Within East Asia, labour standards appear to be strengthening. The number of International Labour Organization (ILO) fundamental ratifications has been increasing, and there is no evidence of backsliding on regulations or legislation. While better labour standards and improved working conditions could raise the costs of labour, workers who are treated better may also respond with more effort and invest in more skills, which could lower costs overall.

Econometric evidence suggests that stronger labour rights are empirically associated with higher export performance in East Asia (Krumm and Kharas, 2004, Chapter 7, Table 7.3). This association is particularly the case for core labour standards, including rights of free association and a ban on child labour. It is therefore likely that East Asian countries could introduce core labour standards, based on social concerns, without undue concern that their export competitiveness will suffer.

Reinforcing social stability through broad sharing of benefits

To pursue these trade arrangements and behind-the-border agendas, East Asian policy makers will need a supportive authorising environment. To be effective, trade policy must be widely perceived as reinforcing social stability

and not contributing to further inequalities. Since the economic crisis of 1997/98, many Asian countries have become more democratic and their authorities more broadly accountable for economic policy decisions. Important constituencies question the distribution of benefits that are produced by complex trade negotiations. Evidence on how trade policies affect different groups in society and different countries in the region must be brought into the policy debate more squarely in East Asia. Here it is important not simply to generalise from other countries' experiences; East Asia has specific characteristics that determine the distribution of benefits from trade. This understanding is critical for designing a set of measures that enable the poor and the population more broadly to take fuller advantage of the growth opportunities from trade.

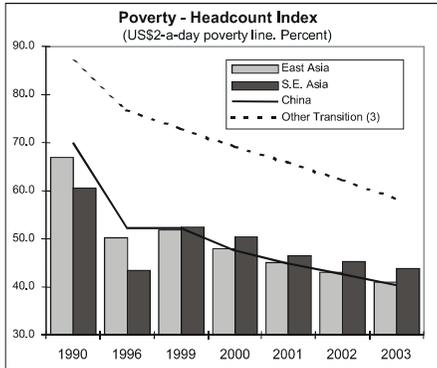
While progress in poverty reduction has been significant in the region, more needs to be done. Well ahead of schedule, the region has attained the Millennium Development Goal of reducing extreme poverty incidence by half.¹⁴ Even so, roughly 13% of the people of emerging East Asia were living on less than USD 1 a day in 2001. Inter-country differences are wide, with the proportion ranging from virtually zero in Korea and Malaysia to more than 30% in Cambodia and Lao People's Democratic Republic. Using the USD 2 a day poverty line, estimates for 2001 range from virtually zero in Korea to more than 75% of the population in Cambodia and Lao People's Democratic Republic (World Bank 2003c).

The wide gap between rich and poor countries in East Asia has been responsible for a rise in regional income inequality. The most recent estimate of the Gini coefficient for interpersonal inequality within emerging East Asia is 46, higher than that in high-income countries (40), though lower than that in Latin America (58). Part of the increase has been driven by mildly rising inequality within countries, including China, Vietnam and the Philippines. But the bulk of the interpersonal inequality within emerging East Asia – 70% – is driven by inequality across location and across countries (Figure 4).¹⁵ Policies and institutions that contribute to trade and the fuller integration of the low-income countries and regions of East Asia will be critical to addressing income inequality in East Asia and contributing to a stable region.

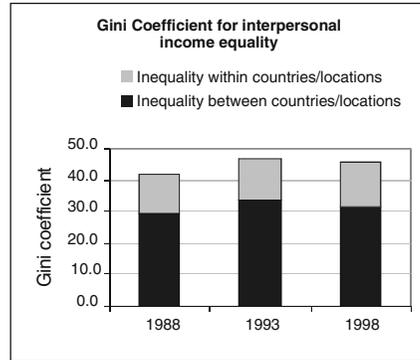
Figure 4. Poverty and inequality

Although poverty has declined steadily . . .

. . . inequality, driven by gaps between countries and locations, is cause for concern



Source: World Bank (2003a).



Note: “Country” is defined such that both China and Indonesia are divided into rural and urban parts.

Source: Milanovic (2003). Based on household survey data.

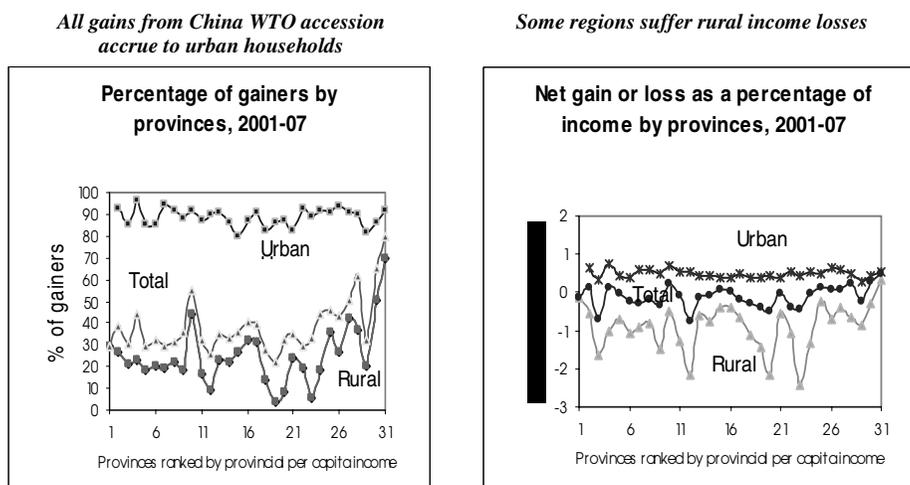
Impact of trade reforms on households

At the household level, the impacts of the changes induced by specific trade policy reforms are complex. Policy makers need tools to better understand how households will be affected in order to guide their policy sequencing and to help them identify concrete risk-mitigation measures where needed.

One of the more promising approaches is a micro simulation-cum-computable general equilibrium modelling approach that draws on the richness of detail available from a modern integrated household survey to provide a reasonably detailed “map” of predicted welfare impacts by location and socioeconomic characteristics. The approach has been applied to assess who within China will gain from accession to the WTO (Krumm and Kharas, 2004, Chapter 8). The finding is that, overall, the reduction in tariffs, quantitative restrictions, and export subsidies associated with accession will have only a small immediate impact on mean household income, inequality, and the incidence of poverty. These findings are perhaps not surprising in the case of China, given that the changes in agricultural effective protection are likely to be far lower than others have estimated and that significant changes already have

been taking place in the manufacturing sector. Nonetheless, the approach allows policy makers to go beyond averages and aggregates that may hide offsetting impacts across various households and to identify those segments of the population for which the impact may well be more significant. For China, importantly, all gains accrue to urban households. Meanwhile, rural families in some provinces will suffer income losses (Figure 5). The severest impacts will be felt in the northeast region covering Heilong Jiang, Jilin, Liaoning, and Inner Mongolia – a region in which rural households depend more heavily on feedgrain production (for which falling prices are expected from WTO accession) than those elsewhere in China. The most vulnerable households are those dependent on agriculture, with relatively fewer workers and weak economic links to the outside economy through migration.

Figure 5. Effects of China to WTO on household incomes



Source: Krumm and Kharas, 2004, Chapter 8.

These impact analyses suggest that efforts to encourage labour flexibility are key to protecting households adversely affected by reforms. Workers need skills to be flexible, and they must be allowed to move occupationally and geographically. In some cases, labour market reforms must be carried out in parallel with trade reforms. In China, for example, while there is a considerable degree of labour mobility (as evidenced by the large migrant population), restrictions and impediments remain. With increased labour flexibility, all households – not only urban – can potentially benefit from WTO accession. In Vietnam, expanding the labour market options for vulnerable rural households

and urban workers affected by enterprise restructuring will be critical. Impact “mapping” can also be used to guide targeted safety net programs.

Sectors important to social stability: specific micro interventions

In any economy, a handful of sectors tend to be critically important in terms of social stability and the poor. The extent to which poor people, especially poor producers, benefit from expanded trade opportunities not only depends on trade policy but also on complementary measures designed to tackle behind-the-border constraints to efficient production and exports. These measures, among other things, foster the development of competitive markets and public action to provide information, reduce transaction costs (often linked to corruption), call for delivery of public services, and address market and collective action failures. Poor producers are not only economically disadvantaged but also often politically powerless, and when their interests are pitted against those of more powerful actors, they frequently lose. It is crucial that anyone designing a set of measures that enables the poor to take fuller advantage of greater access to markets understand the institutional and political economy underpinnings of the organisational structure of a particular commodity or a sector.

This approach has been applied to rice in Cambodia and Vietnam and cashmere in Mongolia (Krumm and Kharas, 2004, Chapter 9). In Cambodia and Vietnam, as in much of East Asia, most of the poor earn a living by growing rice. In Mongolia, the livestock herding tradition, which is centuries old, provides a livelihood to the bulk of the rural population. Domestic resource cost estimates confirm that these two commodities offer scope for efficient and expanding international trade opportunities. In these economies, the external trade policies for rice and cashmere, by and large, no longer represent important impediments. This situation suggests that policy makers look more deeply into domestic institutions and the value chain domestically to identify the sectoral institutional and policy constraints between the two ends of the supply chains for rice and cashmere that reduce the ability of poor producers to benefit from these expanding trade opportunities.

Analysis of institutional arrangements along the value chain for these two sectors highlights the considerable impediments that exist both to upgrading the value of rice and cashmere production and to increasing the share of poor producers in the value chains. In all three countries, powerful constituents appropriate rents through explicit preferences (credit for state-owned enterprises in Vietnam, export tax in Mongolia), industrial structure (near monopsony for a

few millers in Cambodia), and corrupt practices (illegal fees) that are tolerated while poor producers remain trapped in low-productivity states in the absence of improvements in public service delivery (poor road network, inadequate research and extension, and so forth). Similar forces may be present in many economies, but they are compounded in these three transition economies by the absence of strong market institutions – institutions that are still developing as part of the transition from planned to market economies. According to the analysis, the poor can benefit from expanded opportunities presented by global integration, provided that these constraints are addressed. Giving voice to poor producers' interests by placing these issues on the policy agenda is crucial to fostering reforms that unleash the productivity potential of poor people and increase their bargaining power.

The trading arrangements and behind-the-border agendas just discussed are also critical to ensuring a broad sharing of the benefits from trade in key commodities. Reducing market access barriers in agriculture in developed countries is critical for sectors that are central to social stability, including agricultural staple crops such as rice. Efforts to relieve transport and logistics constraints in remote areas are an important component of realising efficiencies along the value chain. Many of the people who have yet to benefit from East Asia's successful trade strategies are located in these more remote areas. As illustrated by the research findings on the effects of China's WTO accession, changes in trade policy alone may have a relatively small impact. Other complementary policies will be essential for benefits to reach the poor more broadly.

Trade and stability

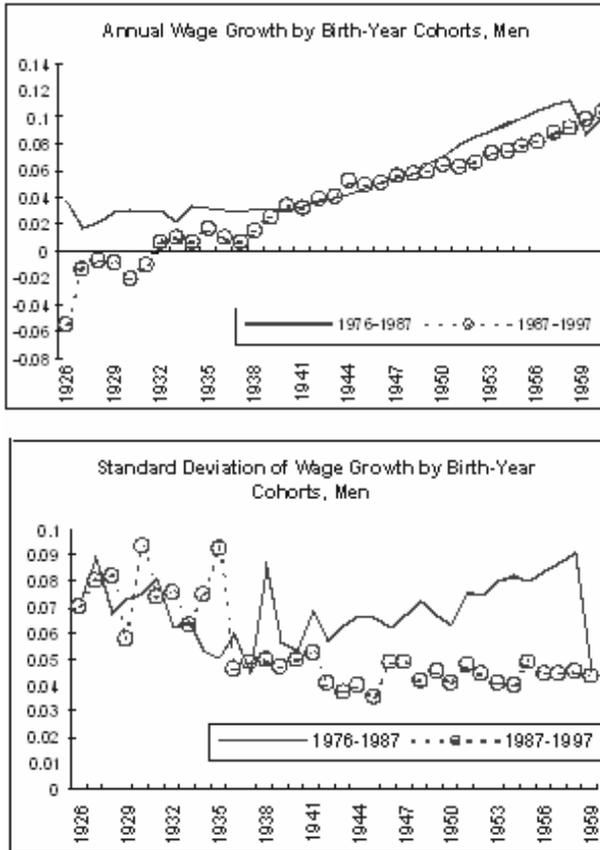
Employment and earnings stability is another important element in efforts to ensure a supportive authorising environment for trade. In most of the region's economies, labour is flexible; the adjustment to demand shocks takes place through wages, protecting employment, and spreading the gains or losses over the broad labour force.¹⁶ The East Asia financial crisis and more recent global slowdown have brought concerns about volatility to the forefront. Trade liberalisation, it is argued, may have increased the exposure of the economy to more and larger shocks in the tradable goods sectors. If a sector faces larger or more frequent shocks, workers in that sector may experience greater fluctuation in employment or earnings and therefore greater job and earnings insecurity. Adjustment can be costly, with loss in efficiency and displacement of workers. There is particular concern that volatility transmitted via trade liberalisation

may make workers more vulnerable and that poorer workers might be hurt disproportionately.

The analysis carried out for East Asia suggests that trade liberalisation has *not* resulted in increased volatility or vulnerability for wage workers (Krumm and Kharas, 2004, Chapter 10). Research in three countries (Korea, Thailand and Indonesia) examined the relationship among trade, idiosyncratic shocks, and fluctuations in workers' earnings and employment. The first comparison is between periods of different degrees of openness to trade; the second is among industries characterised by different degrees of trade exposure (Figure 6). Although the analysis is constrained by data availability, it finds no correlation between greater exposure to trade and greater variability in earnings or employment. Indeed, worker cohorts experienced lower year-to-year fluctuation in their earnings during the 1990s – characterised by fewer trade barriers – than in the previous decade. There is some evidence that employment is more volatile in trade-intensive industries; at the onset of the East Asia financial crisis, employment fluctuated more widely in the more trade-intensive industries than in the less trade-intensive industries. However, employment in these industries recovered rapidly, with few long-term adverse impacts.

Figure 6 (a) and (b). **Trade and Stability in Labor Markets, Republic of Korea**

(a) No higher earnings volatility is evident in periods of greater openness

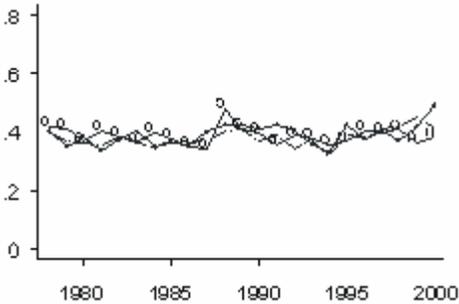


Source: Kim (2002).

(b) Nor is higher earning volatility evident in sectors more exposed to trade

Standard deviation of log of real wages of sample cohort of Korean males by low, medium, and high trade exposure groups, 1976-2000

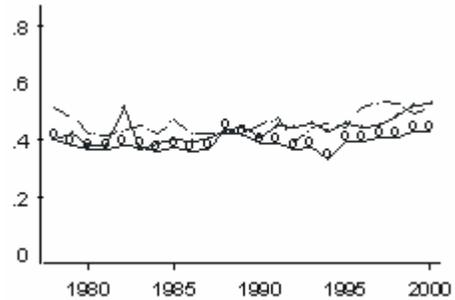
Korean Men, Secondary Education, Age 40 in 1990
 [o] Low exposure, [+] Medium exposure, [-] High exposure



Source: Kim (2002).

Standard deviation of log of real wages of sample cohort of Korean males by broad sectors, 1986-2000

Korean Men, Secondary Education, Age 40 in 1990
 [o] Manufacturing, [+] Services, [-] Others



The analysis does find a clear relationship between vulnerability and workers' educational level and gender. Workers who have little education and those who are female are much more likely to fall into poverty. In Indonesia, for example, the proportion of unskilled workers falling from high-paying jobs into low-paying jobs was two to three times that of skilled workers. Thus, while trade openness makes an important contribution to growth and does not worsen vulnerability, policies to reduce the vulnerability of workers must also focus on broadening education and developing skills.

Conclusions

East Asia is emerging from the financial and currency crises of 1997/98 with a new perspective on development. East Asian policy makers are turning to the region as well as to the rest of the world to develop a coherent set of economic policies that can deliver stability, growth, and regional integration. This chapter does not try to be comprehensive, but focuses on fundamental strategies that promote regional integration, along with domestic policies to maximise the impact of this integration on development and distribute the gains from trade widely.

Several bilateral and regional – as well as multilateral – initiatives have been advanced to pursue this strategic agenda. The regional agenda takes on additional significance post-Cancun. While the multilateral approach may offer most benefits, regional and bilateral initiatives can complement if properly designed and placed within a longer-term framework. But to succeed, these initiatives must have two features. First, they must provide a compelling vision of how integration can deliver broadly shared growth and prosperity. There are concerns in Asia that a narrowly focused approach to globalisation, like that found in the 1980s and early 1990s, has worsened the income distribution within countries and widened the gap between the richer and poorer countries of the region. Even though the evidence may not support such concerns, the new initiatives must move beyond the perspective of trade policy to broader approaches that emphasise the links between trade and social stability and the coherence with overall development, stability, and growth.

Second, as initiatives for regional integration move beyond the narrow confines of trade policy, they must deal increasingly with second-best issues and tradeoffs, including in areas once treated as sensitive. An empirical approach is required to guide the region on priorities and to recognise the diversity of economies within the region. Given the substantial potential gains, it is clearly worthwhile for policy makers to devote major efforts to getting the reforms right. The research of the East Asia and Pacific region of the world suggests some broadly applicable priority areas for regional action.

Broadening agreements to include agriculture and services

China's approach to agricultural trade liberalisation offers scope for the region, especially Southeast Asia, to benefit significantly. China will emerge as a major importer of agricultural and natural resource-intensive commodities. If agriculture can be liberalised in a regional setting, as in the proposed ASEAN - China Free Trade Agreement, then a favourable political dynamic can be set in place that will lead to more open agricultural sectors overall. All countries need to improve their ability to meet sanitary and phytosanitary standards through better laboratories, negotiation of mutual recognition agreements, or co-ordination of standards. For ASEAN countries in particular, the inclusion of agriculture in global and regional trade agreements is important – potential welfare gains can be roughly doubled.

Several international studies suggest that the gains from liberalising services could be very substantial – the same order of magnitude as that for liberalising trade in manufactured goods and agriculture. This is an area in

which East Asia has lagged behind other developing regions. The imperative for moving ahead with services liberalisation is stronger because of the emergence of China as a low-wage, efficient manufacturer. Other countries in the region will find it very difficult to compete in international markets on the basis of wages alone. Instead, they must rely on better producer services to enhance their competitiveness. Improved services will permit them to participate in regional production networks that offer prospects for maximum efficiency. Regional arrangements may provide the advantages of greater policy space for regulatory co-operation and learning-by-doing.

Improving logistics and trade facilitation

East Asia's progress on logistics has failed to keep pace with its growth in trade. Logistics costs in many parts of East Asia are high, and logistics industries are underdeveloped. Logistics play a critical role both in determining aggregate levels of trade and in ensuring that development benefits spread beyond coastal regions. For East Asia's less open and accessible countries and regions, the development of more tightly integrated domestic markets and logistics systems is a high priority. Complementary institutional actions are needed not only to promote an appropriate mix of transport modes, but also to extend better transport services to remote areas and establish better conditions for market development. Beyond strengthening physical infrastructure, governments also need to undertake improvements in the regulatory environment and in the conditions for cross-border facilitation. Regional integration efforts need to focus on harmonising and simplifying customs procedures, sharing information, modernising information and communications technology and customs administration, and establishing transparent transit rules and post-entry compliance audits. Plans for improvements must take into account the interests of related public and private communities – including customs, freight forwarders, shippers, port operators, shipping lines, insurers and bankers. Co-operation is especially important in assisting landlocked countries and those with long land borders, mostly in the Mekong River region.

As the traditional barriers to market access in the region decline, measures aimed at trade facilitation become more critical. Appropriate design is critical to avoid unnecessarily costly, even unworkable rules and regulations for firms doing business across the region. Co-operation with one set of partners could make it more difficult to harmonise with other partners. The increasingly broad scope of issues now on the regional agenda – for example, in services and investment – make arrangements increasingly complex and increase the scope for inconsistencies. It will be important for East Asia to move toward a more

liberal “rules of origin” standard that would promote integration and that would provide an alternative set of rules as the basis for arrangements with partners in other parts of the world. Establishing and enforcing standards across national boundaries in East Asia, including mutual recognition and harmonisation, could facilitate regional integration while protecting legitimate consumer interests.

Institutional strengthening to safeguard and benefit the poor

The fear that globalisation has increased volatility seems to be misplaced. Available evidence for East Asia suggests that greater openness to trade does not make workers more vulnerable; indeed, greater openness has in fact stabilised wage incomes and employment across all skill categories. That said, women workers and workers with little education are noticeably more vulnerable than others to falling into poverty, emphasising the need for policies to broaden education and develop skills. To ensure that the poor within countries benefit from openness, policies are also needed to support workers’ geographic and occupational mobility, as are specific actions to reduce transport and marketing costs in order to improve farm gate prices for the products on which the poor rely. At the same time, East Asian growth has brought with it imbalances – both between countries and within countries. For social stability in the region, it will be important to do more to ensure that greater regionalism does not cause disintegration – namely, that it does not widen the gap between the more attractive investment destinations, the economies with more capacity and skill and those without.

This rich agenda suggests scope for countries in the region to build on their own commitment to deepening regional economic ties. Regionally and bilaterally, they can achieve deeper integration, potentially make gains in sensitive sectors (although with due care to use these agreements to further multilateral liberalisation), while strengthening social stability. This implies taking a more comprehensive approach to policy than before, moving beyond narrow trade and industry interests focused on protecting specific manufacturing sub sectors to adopting a strategy with sectoral components that are aligned to encourage integration and competition as means of delivering growth, stability, and poverty reduction.

NOTES

1. See World Bank (2000) for a first assessment of the new policy and institutional agenda.
2. During the crisis, real exchange rate depreciation also played a role in reducing protectionist tensions. Nonetheless, the dangers of protectionism and of vested interests capturing political support in specific cases should not be underestimated.
3. Emerging East Asia is defined here as the Association of Southeast Asian Nations (ASEAN), plus other newly industrialising economies, China, and Mongolia. ASEAN members are Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.
4. Asia Pacific is defined here as emerging East Asia, plus Japan, Australia, New Zealand, and Papua New Guinea. Source of data is IMF Direction of Trade, for 2002.
5. See Schiff and Winters (2003) for a discussion of regionalism from the perspective of developing countries more broadly.
6. Nonmembers may be net losers, though Table 1 suggests these losses may be minimal. Nonetheless, consistency with the WTO could be questioned, and such arrangements could be subject to challenge in the WTO.
7. Notably, China (with Hong Kong and Chinese Taipei) is the first or second largest market for almost all economies of East Asia; ASEAN is also a large and important market, with the rest of ASEAN being the first or second largest market for all the ASEAN economies, and the third or fourth largest market for the Northern Asian economies. See Chapter 4 of Krumm and Kharas (2004).
8. Assessments of the impact of WTO accession on China's agricultural sector based on limited comparisons of statutory tariffs and the rates agreed on in the accession process would be misleading. Recent research reveals that

overall protection for crops such as rice, wheat, and maize is far less than indicated by statutory tariff rates (Huang and Rozelle, 2002).

9. See results in Hoekman and Konan (1999) for the European Union and Egypt and in Brenton and Manchin (2002) for the European Union and Russia.
10. See Ianovichina and Walmsley (2002) for China.
11. Many non-reciprocal preference schemes have had a low rate of uptake by developing countries, including those in East Asia, in large part because of stringent rules of origin. For example, Cambodia made use of only 36% of its entitlement under the EU's Everything But Arms initiative in 2001 (Brenton, 2003a).
12. For example, by Codex Alimentarius, the Organization for Animal Health, the International Organization for Epizootics, or the Hazard Analysis Critical Control Point (HACCP). In Malaysia, the Ministry of Health operates a voluntary certification programme for private firms in the food processing sector. This programme was introduced in 1996–97 in response to EU requirements for HACCP in fish processing plants.
13. The discussion in this section is based on World Bank (2003b).
14. On the basis of a higher poverty line of USD 2 per day, two-thirds of the population was poor in 1990; this has declined to about two-fifths today.
15. This situation contrasts with the one in Latin America, where the bulk of inequality reflects differences within countries, and only 19 Gini points are attributable to between-country differences. For East Asia, the definition of "country" is such that both China and Indonesia are divided into rural and urban areas.
16. The most severe test of this occurred during the Asian economic crisis. Except in Korea, unemployment in the crisis countries was kept to manageable levels; most of the adjustment fell on wages.

BIBLIOGRAPHY

The word *processed* describes informally reproduced works that may not be commonly available through libraries.

Bora, Bijit (2001), “Prospects for Harmonizing Investment Policies in the East Asian Region”, Draft prepared for the World Bank, UNCTAD, Geneva.

Brenton, Paul (2003a), “Integrating the Least Developed Countries into the World Trading System: The Current Impact of EU Preferences under Everything But Arms”, Policy Research Working Paper, World Bank, Washington, DC. Forthcoming, *Journal of World Trade*, Vol. 37, pp. 623-646.

Brenton, Paul (2003b), “Notes on Rules of Origin with Implications for Regional Integration in South East Asia”, World Bank, Washington, DC. Processed.

Brenton, P. and M. Manchin (2002), “Trade in Services, Foreign Direct Investment and Technology Transfer: Implications of an EU-Russia Free Trade Agreement for Economic Efficiency and Growth”, Report prepared for the European Commission. Processed.

Carruthers, Robin and Jitendra N. Bajpai (2002), “Trends in Trade and Logistics: An East Asian Perspective”, Working Paper No. 2. World Bank, Transport Sector Unit, Washington, DC.

Centre for International Economics (2002), “Integration and Poverty: An Economy-Wide Analysis”, Draft prepared for the World Bank, Canberra and Sydney, November.

Dean, Judith M. (2002), “Does Trade Liberalization Harm the Environment? A New Test”, *Canadian Journal of Economics*, 35 (4), pp. 819–842.

Esty, Daniel C. and Peter K. Cornelius (2002), *Environmental Performance Measurement: The Global Report 2001–2002*, Oxford University Press, Oxford.

- Fink, Carsten, Aaditya Mattoo and Ileana Cristina Neagu (2002), “Assessing the Impact of Communication Costs on Trade”, Policy Research Working Paper 2929, World Bank, Washington, DC.
- Hoekman, Bernard and Denise Eby Konan (1999), “Deep Integration, Nondiscrimination, and Euro-Mediterranean Free Trade CEPR”, Policy Research Working Paper 2130, World Bank, Washington, DC.
- Huang, J., and S. Rozelle (2002), “The Nature of Distortions to Agricultural Incentives in China and Implications of WTO Accession”, Paper presented at Seminar on WTO Accession, Policy Reform and Poverty Reduction in China, World Bank, Beijing, 28-29 June.
- Ianchovichina, Elena and Terrie Walmsley (2002), “Regional Impact of China’s Accession”, World Bank, Washington, DC. Processed.
- Janet Tay Consultants (2002), “Facilitating Trade: The East Asian Experience in a Comparative Context”, World Bank, Washington, DC, May. Processed.
- Kim, Dae II (2002), “Openness and Worker Vulnerability in Korea: A Descriptive Study”, World Bank, Washington, DC. Processed.
- Krumm, Kathie and Homi Kharas, eds. (2004), *East Asia Integrates: A Trade Policy Agenda for Shared Growth*, Oxford University Press and World Bank, Washington, DC.
- Mattoo, Aaditya, Randeep Rathindran and Arvind Subramanian (2001), “Measuring Trade Liberalization and Its Impact on Economic Growth: An Illustration”, World Bank, Washington, DC. Processed.
- Messerlin, Patrick (2000), *Measuring the Costs of Protection in Europe*, Institute for International Economics, Washington, DC.
- Milanovic, Branko (2003), “Worlds Apart: International and World Inequality, 1950–2000”, World Bank, Washington, DC. Processed.
- Ng, F. and A. Yeats (2003), “Major Trade Trends in East Asia: What Are Their Implications for Regional Cooperation and Growth?”, Policy Research Working Paper 3084, World Bank, Washington, DC.

- Otsuki, Tsunehiro and John S. Wilson (2001), “Global Trade and Food Safety: Winners and Losers in a Fragmented System”, Working Paper 2689, World Bank, Washington, DC.
- Otsuki, Tsunehiro and John S. Wilson (2002), “Beef Trade and Veterinary Drug Standards”, World Bank, Washington, DC. Processed.
- Oxfam (2002), *Rigged Rules and Double Standards: Trade, Globalization, and the Fight against Poverty*, Oxfam, Oxford, UK.
- Schiff, Maurice and L. Alan Winters (2003), *Regional Integration and Development*, Oxford University Press, Oxford, UK.
- Schmidhuber, J. (2001), “Changes in China’s Agricultural Trade Policy Regime: Impacts on Agricultural Production, Consumption, Prices, and Trade” in OECD, *China’s Agriculture in the International Trading System*, OECD Proceedings, April.
- Scollay, Robert and John Gilbert (2001), *New Subregional Trading Arrangements in the Asia Pacific*, Institute for International Economics, Washington, DC.
- Scollay, Robert and John Gilbert (2003), “Impact of East Asian Regional or Subregional FTAs”, Report for Australian Department of Foreign Affairs and Trade, May.
- Verite (2002), “Report to California Public Employees’ Retirement System (CalPERS): Emerging Markets Research Project”, Available at verite@verite.org.
- Wilson, John *et al.* (2002), “Trade Facilitation: A Development Perspective in the Asia Pacific Region”, World Bank Working Paper presented to APEC, World Bank, Washington, DC. Processed.
- World Bank (2000), *East Asia Regional Overview: Recovery and Beyond*, World Bank, Washington, DC.
- World Bank (2001a), *Indonesia: Environment and Natural Resource Management in a Time of Transition*, World Bank, Washington, DC.
- World Bank (2001b), *Cambodia Integrated Framework*, World Bank, Washington, DC.

- World Bank (2002a), *East Asia Regional Overview Making: Progress in Uncertain Times*, World Bank, Washington, DC, November.
- World Bank (2002b), “Trends, Issues and a Glimpse of the Future”, East Asia Regional Office Mimeo, World Bank, Washington, DC.
- World Bank (2002c), *Global Economic Prospects, and Developing Countries: Making Trade Work for the Poor*, World Bank, Washington, DC.
- World Bank (2003a), *Vietnam’s Exports: Challenges and Opportunities*, World Bank, Washington, DC.
- World Bank (2003b), *Global Economic Prospects and Developing Countries: Investing to Unlock Global Opportunities*, World Bank, Washington, DC.
- World Bank (2003c), *East Asia Regional Overview: “East Asia Rebounds, but How Far?”*, Washington, DC, Available at:
www.worldbank.org/ph/news/asiarebounds.htm.
- Yusuf, Shahid *et al.* (2003), *Innovative East Asia: The Future of Growth*, World Bank and Oxford University Press, Washington, DC.

*Chapter 6***The Evolution of Transport Arrangements***by**T. R. Lakshmanan***Director, Center for Transportation Studies
Boston University****Introduction**

Global network corporations – major agents of contemporary globalisation – exploit economies of scale in their expanding markets and economies of scope from their corporate (knowledge, financial and marketing) networks, while locating and maintaining production centres world wide in order to take advantage of lower factor prices. These activities, which create a globally distributed production system and related flows of knowledge, capital, goods and services, have been made possible by and are making possible a variety of recent developments: innovations in transportation and complementary communication technologies; organisational and institutional innovations creating new logistical systems; reform of the regulatory regimes of the transport and communication network industries, coupled with a variety of international arrangements that are promoting increasingly freer trade in transport and communication services (Lakshmanan *et al.*, 2001).

It is widely recognised that technical change in vehicles (jets, containers, mega-ships, etc.) and in transport physical infrastructure have led to sharply declining costs, greater speed, and greater reliability, thereby promoting worldwide trade. At the same time, innovations in the complementary communications sector have increased the capacity and functionality of transport operations, equipment and infrastructure. The new information technology (IT) devices enhance the responsiveness and efficiency of operators and travellers, making possible other innovations.¹ The rapid growth in trade in

goods and services, spurred by the transport and IT innovations, in turn promotes a market for logistical innovations (*e.g.* just-in-time) that facilitate faster, cheaper and more predictable movement of goods in ever larger quantities (Lakshmanan and Anderson, 2004).

As noted above, the final development facilitating global trade and production is change in the non-material infrastructure of transport (and communications) – economic institutions, transport governance in the form of regulations, policies and international arrangements for trade in transport and communication services. Historically, network industries such as the transport and communications industries have been highly regulated and have in most countries been public monopolies. Initiatives in recent years to reform governance structures and international arrangements to promote free trade in transport and communications are altering the institutional landscape, with varying results in different parts of the world.

This chapter aims to review the history, current status and likely future prospects of the governance structures and international arrangements under which transport services are offered in the Asia Pacific region. The discussion is set in the context of the challenges that Asian Pacific service providers, buffeted by technical change and market shifts, face in the increasingly competitive international transport and communication markets, and the various issues related to different approaches to liberalisation and opening up inter-country market access to transport services.

The chapter limits the discussion to the air transport sector. A variety of barriers to international competition in that sector's services have been erected since the end of the Second World War. Those barriers pertain to free entry into and exit from air transport markets, public subsidies to airlines, and a patchwork of bilateral agreements among national governments that try to balance the air traffic volume among the national carriers. However, in the last two decades several factors have exerted pressure towards reform of this restrictive international regulatory system, in the region and elsewhere in the world. These factors, which promote open and competitive aviation markets in the region, derive from changes in the scale and composition of air transport demand (*e.g.* the different needs of tourists, business travellers, shippers and airlines), technological and other supply-side shifts, and the growing inadequacy of existing international institutions and arrangements in the context of both demand- and supply-side shifts.

For many Asia Pacific airlines that have grown under the protective bilateral air agreement regime, adaptation and transition to the emerging liberal regime, and building capacity for economic and financial sustainability in emerging competitive aviation markets, are challenges. The chapter discusses the relevant issues of structural adjustment and the institutional reforms and international arrangements to support structural change.

Air transport markets in Asia Pacific

Air traffic: current status and future prospects

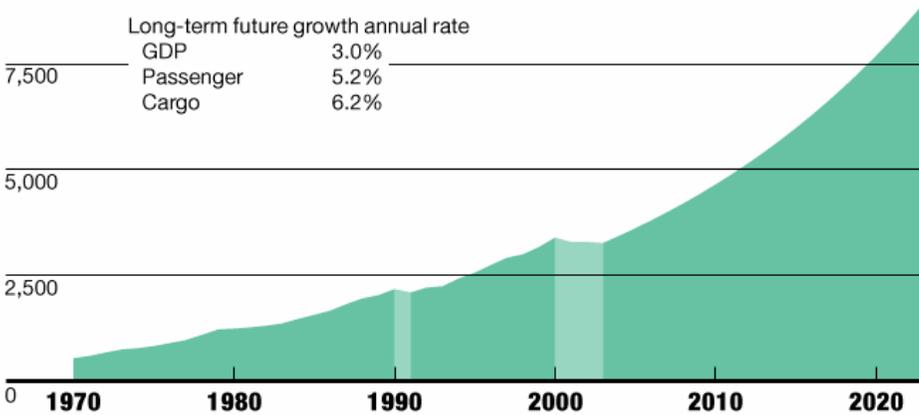
Air transport is a major industry that has experienced significant growth in recent decades. Worldwide air traffic has more than doubled between 1985 (1.573 trillion RPKs) and 2000 (3.394 trillion RPKs), and is forecast to more than double again to 8.875 trillion RPKs by the year 2022 (Figure 1). Factors underlying this continuing growth performance include long-term economic growth fostered by globalisation of trade and production; airline network service improvements; the steady trend towards deregulation and liberalisation of air transport markets following US efforts since 1978 to deregulate its domestic passenger and freight markets; and the subsequent liberalisation of international bilateral air service agreements (ASAs), and the consequent declining fares.

Figure 1

World Air Travel Continues to Grow

Revenue passenger kilometers, billions

10,000



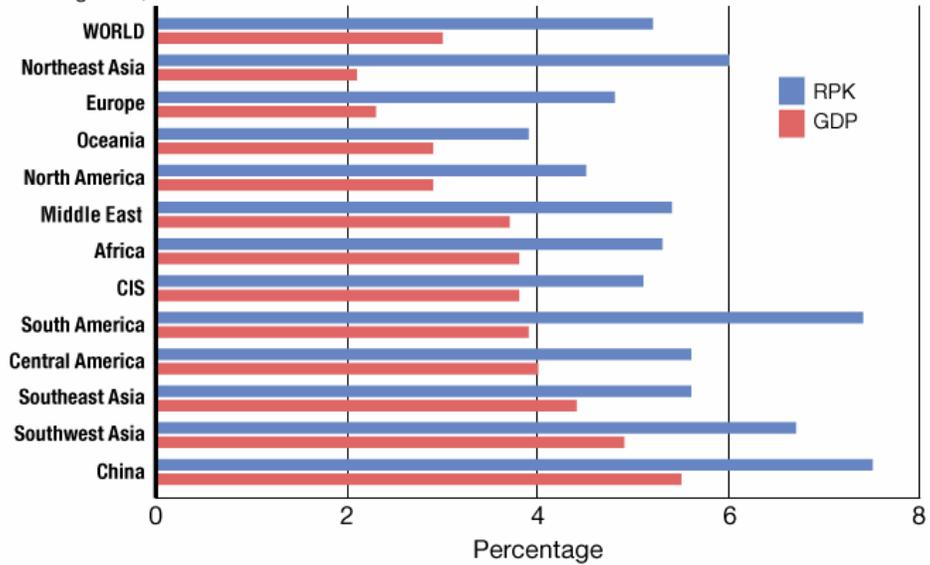
Source: Boeing, *Current Market Outlook*, 2004.

The growth levels and patterns of aviation traffic are uneven across countries and regions, reflecting varying levels of economic growth, sizes and densities of home air markets, levels of efficiency of traffic collection and distribution networks, degrees of liberalisation of air travel markets, and the resulting competitiveness of the aviation system (Figure 2). Thus North America and Europe have the largest air transport markets, given their higher per capita income levels, dense and efficient air networks, and more competitive air service markets deriving from more liberalised and open transport governance structures.

Figure 2

GDP and RPK Growth Varies by Domicile

Annual growth, 2004–2023



Source: Boeing, *Current Market Outlook*, 2004.

However, the annual growth rates of these two mature markets are expected to be considerably lower than that of the regions in Figure 2, which make up the Asia Pacific Region (with China to grow 7.5% per year, much faster than North America and Europe). Thus the North American and European shares of world air traffic are expected to decline by 2022 from 24% to 20% and from 14% to 13% respectively, while the Asia Pacific share will increase from 16% to 19% (Boeing, 2004). Robust economic growth, rising real disposable income, the relaxation of travel restrictions and increasing air transport reform and liberalisation have combined to stimulate rapid air travel growth in the Asia Pacific in recent years (Oum and Yu, 2000). Towards the end of this decade the economies of the Asia Pacific are expected to be comparable in size to those of North America and Europe, so that their share of worldwide international scheduled passenger traffic will be much higher than of total traffic (IATA, 2004).

Table 1. **US and Asia Pacific airlines (RPKs and revenues) 2002**

Ranking in parentheses

Airline	RPK (millions)	Operating revenue (millions)
United	204 235 (1)	19 352 (2)
American	187 600 (2)	19 703 (1)
Delta	173 486 (3)	16 741 (3)
Northwest	127 317 (4)	11 415 (8)
FedEx	-	15 590 (4)
Continental	103 235 (6)	9 899 (12)
JAL	88 996 (8)	13 487 (5)
Singapore Airlines	70 795 (11)	5 113 (19)
All Nippon Airways	10 129 (10)	6 259 (14)
Qantas	67 486 (13)	5 486 (17)
Cathay Pacific	47 153 (16)	4 426 (21)
Thai Airlines	42 395 (19)	-
Korean Air	40 532 (21)	3 089 (25)

Source: *Air Transport World*, July, 2001.

Table 1 lists the passenger revenues of major Asia Pacific airlines as compared with those of North American airlines. The US airline industry is much larger, reflecting the large domestic market. Apart from the two Japanese lines, Asia Pacific major airlines are relatively smaller in terms of network size, air traffic and revenues. As elaborated below, this situation reflects in many cases a combination of restrictive bilateral international agreements, air networks concentrated often in one airport (leading to inefficient operations), and poor traffic collection and distribution systems.

A parallel picture emerges from Table 2, which lists the top dozen airports ranked by passenger volume in the United States and the Asia Pacific region. Apart from Tokyo Haneda, the top dozen places in the world are mostly in the United States, and some are in Europe. However, many Asia Pacific airports appear in the second tier.

Table 2. Top dozen airports in the United States and Asia Pacific Region, 2002

(Passengers, world ranking in parentheses)

US airports	Passengers (thousands)	Asia Pacific airports	Passengers (thousands)
Atlanta (1)	76 876	Tokyo Haneda (3)	61 080
Chicago (2)	66 501	Hong Kong (15)	33 876
Los Angeles (5)	56 198	Bangkok (18)	32 177
Dallas/Fort Worth (6)	52 826	Singapore (22)	28 979
Denver (10)	35 651	Tokyo Narita (24)	28 895
Phoenix (11)	35 534	Beijing (26)	27 160
Las Vegas (12)	35 009	Sydney (33)	23 893
Houston (13)	33 946	Seoul International (40)	21 057
Minneapolis (16)	32 630	Fukuoka (44)	19 500
Detroit (17)	32 437	Taipeh (45)	19 228
San Francisco (19)	31 448	Sapporo (49)	18 400
Miami (20)	30 060	Osaka (55)	17 351

Note: Parentheses indicate world rank by passengers.

Source: *Airline Business*, June 2003, Vol. 9, No. 6.

The picture is quite different with cargo traffic (Table 3). While the top two cargo airlines are American dedicated, more than half those listed are Asia Pacific. A similar situation prevails for cargo airports. Japan and the newly industrialising countries in the Asia Pacific Region have many of those in the top tier. The reason for the relatively stronger performance of Asia Pacific airlines and airports in the freight sector is that the Asia Pacific is home to major rapidly growing manufacturing locales which are crucial nodal centres in the global system of production and service delivery. In this system, there is increasingly finer division of labour, with value added at many places and extensive cross-hauling of materials, components and final products. The role of air cargo is crucial, particularly in sectors where high value is added. Further, the rising offshore investment of Japanese, Korean and Taiwanese corporations, the emergence of China as a market and major production area, and the expanding global role of many regional cities promote cargo traffic growth in the region.

Table 3. Top cargo airlines and airports in the United States and Asia Pacific Region in 2003

Airlines	RTK (million)	Cargo Revenue (\$ billion)
FedEx (1)	14 632	16.351
UPS (2)	7 295	2.846
Singapore Airlines (4)	6 909	1.430
Korean Air (5)	6 247	1.449
Japan Airline System (6)	5 024	1.732
Cathay Pacific (8)	4 854	1.204
China Airlines (9)	4 600	0.836
EVA Airlines (Taiwan) (13)	4 126	0.798
United (14)	3 658	0.673
Northwest (15)	3 578	0.735
American (16)	3 229	0.561
Asiana (17)	2 801	0.601

Note: Parentheses indicate world rank by cargo RTK.

Airports	Freight (million tons)
Memphis (1)	3.390
Hong Kong (2)	2.516
Tokyo (3)	2.002
Los Angeles (4)	1.758
Seoul (5)	1.705
Singapore (6)	1.660
Miami (8)	1.624
New York (JFK) (9)	1.575
Louisville (10)	1.522
Taipei (12)	1.381
Chicago O'Hare (15)	1.277
Bangkok (16)	0.957

Source: *Airline Business*, November, 2003, Vol. 19, No. 11.

Another major source of traffic growth in Asia Pacific is the rapidly growing number of tourist arrivals. The World Tourism Organization estimates

that the Asia Pacific share of world arrivals will increase from 11.5% in 1990 to 20.3% by 2010 (WTO, 1994).

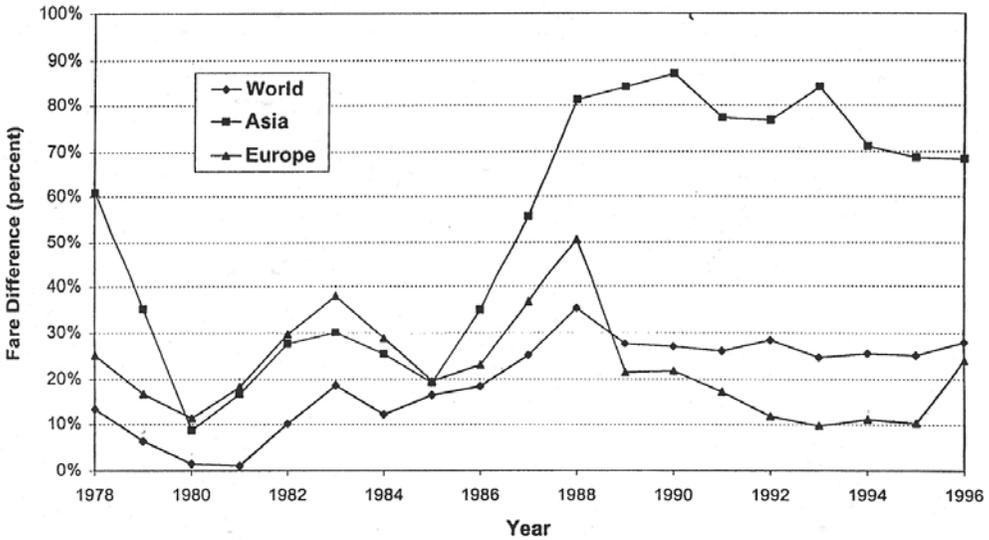
Emerging challenges for Asia Pacific aviation

Given the rapidly growing Asia Pacific aviation markets, the long-run objectives of public policy are to promote strong and competitive airline industries, while at the same time protecting air transport consumer interests. Three issues are relevant here. First, how competitive are the Asian Pacific airlines globally? Oum and Yu (1998) note that the cost advantages enjoyed by major (non-Japanese) Asian carriers, deriving from lower labour and other input costs, are disappearing with rising incomes and currency appreciation. Meanwhile, high-cost carriers in other regions are adapting to rising cost structures by global outsourcing of their inputs. US carriers are improving their productive efficiency and marketing advantages by creating efficient national and international hub-and-spoke collection and distribution networks. Indeed, a recent benchmarking study of the underlying productivity of 50 leading airports shows that North American airports take the top 10 positions, while only Sydney Kingsford Smith (11) and Singapore (25) make it to the top half of the ranking² (Pilling, 2003). It appears that Asian airlines (which are in different stages of development) must improve their productive efficiency by removing regulatory barriers and increasing market competition among themselves and with others.

The second challenge for Asian airlines is to continue to maintain and improve market share, as the high airfares in the region will decline under competitive pressures. The average air fares to, from and within Asia are (adjusted for distance) significantly higher than those in the United States (Figure 3). Such fares resulting from regulatory protection promote airline inefficiency and lack of competitiveness. The rising regional incomes and changing age profiles of populations will increase the importance of the price-sensitive tourist demand segment, putting further downward pressure on airline prices. Consequently, the regional higher fares are unsustainable and will likely decline under the pressures from competitive airlines and from air service consumers who have so far underwritten the high average yields of Asian airlines. Again, the rational response to this potential for rapidly declining future average yields is for the regional airlines and governments to move away from protective structures of bilateral agreements towards regimes of open market access and efficient operations.

Figure 3

Difference between International Fares (U.S.-Foreign) and U.S. Domestic Fares Adjusted for Distance



Source: Morrison and Winston, 1997.

The third challenge to the Asia Pacific airlines is a strategic one deriving from the need to make gains in an expanding market by developing (among other things) intra-regional and intercontinental hub-and-spoke network systems that provide an efficient collection and distribution capability. As O'Connor (1995) points out, the management and co-ordination of the production system in China and Northeast and Southeast Asia by North Asian and other global corporations is reorienting air traffic to a North-South alignment linking the major cities on the Asia Pacific rim. Existing regulations and agreements governing most regional airlines fragment the region and handicap the ability of Asian airlines to build efficient intra-regional networks, even as the larger and more efficient US and EU airlines offer strategic alliances to individual airways as part of their global networks.

The key point here is that the Asia Pacific air transport sector has outgrown the regulatory regimes and bilateral agreements under which many Asia Pacific airlines operate. The current regulatory framework reduces the incentives of airlines to be efficient and competitive in the international marketplace. The pressures to change and restructure towards regimes of open

market access continue, and need to be confronted: the greater the delay in liberalising the extant airline governance system, the higher the adjustment costs to the airlines and their national economies.

Reform of institutions governing air transport markets in any country is never easy and the complications increase rapidly when efforts at institutional restructuring in many countries (differing in size and stage of development) are attempted. The next section describes the origin and evolution of the extant air transport governance structures, the pressures for change, recent initiatives to reform the transport economic institutions, and the ongoing restructuring of the airlines and aviation infrastructure.

Governance structures for international air transport in the Asia Pacific

International aviation regulatory framework: history and evolution

Airline services are internationally traded, more so in the Asia Pacific region than, for example, in the United States. The economic principle of comparative advantage underlying free trade agreements such as GATT and NAFTA would suggest gains from free trade in air transport services. However, the current system of international arrangements for air travel, deriving from the 1944 Chicago Convention, restricts inter-country market access. At the end of the Second World War, the United States, with its large production capacity and large number of operable aircraft, was expected to dominate the world airline sector in a liberal regime. Countries responded by forgoing gains from trade to protect domestic airline industry – viewed as an infant industry and an industry “showing the flag”. Consequently, air transport has been traded until recently through the principle of bilateral reciprocity and agreements.

Bilateral air service agreements (ASAs, or the so-called Bermuda agreements) were negotiated in detail between pairs of countries and specified the airlines flying a route, the capacity they can offer, and the various freedom rights they are entitled to, thereby attempting to achieve reciprocity in outcomes.³ As international trade agreements for various goods and services were negotiated in recent decades, only “soft rights” of air transport – such as maintenance and repair of aircraft, marketing and retailing of air transport, reservation systems – were considered. GATT and NAFTA excluded the consideration of “hard rights” of international air market access.

Whatever the origin of the bilateral international agreements, they have been used by many Asian governments in a mercantalist vein to protect the

interests of their airlines. By restricting price competition and seating capacity, and by route and airline designations, a fixed-size market is allocated between the two countries. Anti-competitive postures promote airline interests over those of the consumers. The system has been under considerable pressure in recent years from several sources. We turn now to a discussion of these economic, technological and institutional forces of change and the kinds adaptation and restructuring they demand of the air transport sector in the Asia Pacific.

Pressures for change in international air transport arrangements

The challenges for change in the international air transport governance system stem from three sources: a) changes in the scale and composition of air transport demand, b) supply-side shifts in the form of technological shifts, new services and new organisational mechanisms that provide efficiency and service variety, and c) increasing inadequacy of existing international institutions and arrangements to promote the adaptation and restructuring of the Asia Pacific airlines to the emerging demand and supply conditions.

International air travel has been growing in the region almost twice as fast as in the North American region in the 1990s (Findlay, Forsyth and Bora, 1996) and is likely to keep that torrid pace in the next two decades (Figure 2). Under the bilateral ASA regime, the airline industry in many countries did not grow fast enough to satisfy burgeoning demand, thereby constraining the development of international trade and tourism – two vital engines of regional growth (Bowen, 1997).⁴ Such rapid growth also undermined the historical rationale for the bilateral ASAs – namely the state protecting the flag carriers from external competition. Indeed, the outward-oriented airlines such as Singapore and Cathay Pacific (operating with much less “protection” from the state) emphasised international traffic and emerged as among the most profitable airlines in the world. Further, the price-sensitive tourism market, expected to grow at a faster rate than business, will demand lower fares than currently available air fare regimes can offer. To deliver such fares will require the shift away from current restrictive international arrangements in order to foster competitive Asian Pacific airlines in the global marketplace.

On the supply side, traffic growth and a number of attempts since the late 1980s to renegotiate the restrictive bilateral ASAs to permit multiple designation (as demonstration effects of effective liberalisation processes in the United States and European Union) have yielded a wave of new air service suppliers. Bowen (1997) identifies in Southeast Asia more than 20 new airlines, of which those located in countries with a dense network of services (*e.g.*

Indonesia, South Korea, Philippines) have prospered successively in domestic, intra-Asian and interregional markets (*e.g.* Asiana of South Korea). As the incumbent and new entrant carriers become large exporters of air services, they have incentives to reform the existing regulatory system into a more competitive one, hoping to make up by earnings in export markets whatever rents they may lose in domestic markets. Such ideas of prospective net gain from regulatory reform on the part of Asian airlines provide one more strong force for change in the system (Bowen and Leinbach, 1996).

If the Asia Pacific air transport industry is to respond effectively to these pressures deriving from the evolution of demand, technology shifts, new services, and management innovations, it must adapt by restructuring its networks, operations and institutional structures. Its capacity to do so depends again on major reform of existing international aviation governance structures – either through modifying existing institutional regimes (towards more liberal bilaterals) or through erecting new regimes (regional or multilateral arrangements). As the region moves towards such reform of air transport international arrangements, the eventual outcome will be a liberalised market characterised by freedom of entry and exit, a well-operating price system and removal of infrastructure capacity constraints.

That outcome can offer international aviation in the Asia Pacific the flexibility to restructure itself into a robust competitor in the global marketplace, and at the same time increase consumer surplus. Indeed, the benefits of liberalised international aviation are potentially significant. Findlay, Hufbauer and Jaggi (1996) estimate the potential cost savings from competitive air service to users in several Asia Pacific countries (Table 4). The total cost savings could be \$21.7 billion by 2010 (Japan accounting for 43% of it), and could accumulate to \$152 billion between 1997 and 2010.

Table 4. Possible cost savings to users from competitive aviation services in 2010 and for the period 1997-2010 (billions of dollars)

Country	Cost savings in 2010	Cumulative savings, 1997-2010
Australia	1.0	7.0
Canada	1.5	11.0
Hong Kong	2.2	15.0
Japan	9.4	66.0
Korea	3.9	27.0
Malaysia	1.0	7.0
Singapore	2.7	19.0
Total	21.7	152.0

Source: Findlay, Hufbauer, and Jaggi, 1996, p. 23.

Issues and problems in reforming international aviation arrangements and requisite restructuring

1. External challenges to Asia Pacific aviation

The early stimulus for reforming aviation regulatory regimes came from the United States, which deregulated its domestic market in 1978 by allowing airlines to set their own fares and choose markets to serve. The effects of this “big bang” approach have been declines in domestic air fares, more flight frequency (from hub-and-spoke operations) and more direct flights. Annual net benefits, accounting for price and quality changes, are estimated at \$20 billion (Morrison and Winston, 1999). In this new deregulated environment, the airlines have built hub-and-spoke efficient collection and distribution systems, improved their operational efficiency and become more competitive.

As their domestic yields dropped under competition, the US airlines have aggressively pursued international markets, with the US government initiating a variety of initiatives for liberalising international aviation arrangements. Two of these initiatives are:

- *Renegotiation of bilateral ASAs.* During the 1980s, relatively open (with multiple designation) bilaterals were negotiated with European and Asia Pacific nations (South Korea, Singapore, Thailand). These bilateral ASAs allowed access to the Asian market for more American carriers while opening the US market to new entrants (e.g. Asiana, EVA airlines). The policy of multiple designation has developed subsequently to some degree among Asia Pacific countries, thereby enhancing intraregional aviation.
- *Transborder “open skies” agreements.* These agreements between two or more nations (intended to lead to free trade in aviation, eliminate entry barriers and allow no government regulations of routes and capacity, but with no cabotage in the United States and with foreign ownership restrictions) were completed first with the Netherlands, later with many European countries, and since 1997 with many Asia Pacific countries (e.g. Singapore, Korea, Malaysia, New Zealand).

The incentive for US domestic carriers to exploit economies of scope on an international basis led to an elaboration of their domestic networks in order to collect and distribute international traffic through their respective hubs. As the liberal bilateral agreements noted above were negotiated world wide, there was legal acceptance of strategic alliances among airlines, which allowed the airlines to channel more traffic through their international hubs, thereby lowering costs through exploitation of economies of scope, density and market presence.

However, many of the US international agreements with Asian countries (e.g. Japan) contain extensive fifth freedom (“beyond”) rights, with Japan resenting the asymmetrical benefits to US carriers and slowing further liberalisation. Moreover, many agreements between Asian countries have restrictive third and fourth freedom rights. In this context, American airlines have instituted airline alliances with code-sharing, enabling them to set up networks covering the entire continent more easily (with acquisition of majority or minority stakes in feeder airlines) than Asian airlines can (Oum and Yu, 2000) – posing a serious challenge to Asia Pacific aviation in the emerging international aviation environment.

The European Union (EU), starting later than the United States and following a more gradualistic approach, has moved to a free market situation for airlines within Europe – allowing full cabotage, unregulated fares, and foreign

ownership among EU carriers (Button, 2002). However, individual countries continue to negotiate bilaterals with non-EU countries. The European Commission has, however, recently won the right (through a European Court of Justice ruling) to negotiate a liberal US-EU bilateral agreement. The individual states will continue other external negotiations without unduly advantaging their national carriers.

These liberalisation efforts of the United States and European Union and the international hubbing (star-burst operations) and intercontinental alliances by American and European mega-airlines pose a major threat to Asian airlines that do not have efficient Asia-wide collection and distribution networks (Oum and Yu, 2000). In this situation it would help if Asian countries created a regional open skies block.

2. *Different starting positions*

Asia Pacific countries differ considerably with regard to their aviation sector, which implies that the process of structural change required for the transition to the coming liberal regime will not begin from the same starting point. Some of these differences between US/EU and Asia Pacific airlines, in terms of size and network patterns, relate to inherent variations in comparative advantage. Others are not market oriented but derive from the longer history in the region of protective regulations and the associated institutional structures, and can lead to dislocations (*e.g.* the potential loss of legal monopolies or loss of public subsidies). Reforming international aviation arrangements on an uneven playing field is not easy. Clearly, Asia Pacific carriers need incentives to become efficient and competitive as they attempt to restructure their activities to respond to the needs of a globalising economy and the new regimes of international aviation arrangements.

Further, a combination of market conditions and continuing restrictive international aviation agreements have led in recent years to internationally uncompetitive carriers in some major countries (Japan, China), while carriers based in countries with more open international institutional structures are among the more competitive (*e.g.* Singapore, Cathay Pacific). The demonstration effects of US domestic aviation deregulation persuaded Japan in 1986 to privatise JAL and allow multiple carriers on the same route, with the airlines recently offering discount fares. However, it is not a truly competitive system, with the overall fares in Japan being higher than in the United States (Yamauchi and Ito, 1996).⁵ Effective competition has not arrived and the consumers' benefits are more limited. While US major carriers have achieved

very competitive cost and revenue structures, Japanese airlines (targeting business customers and lacking hub-and-spoke networks) are less competitive. Given this comparative disadvantage in aviation markets (a sharp contrast to the Japanese prowess in many industrial sectors), and the dissatisfaction with the fifth freedom rights negotiated with the United States in the 1952 treaty and subsequent MOUs, Japan has not been an enthusiastic supporter of open international air transport arrangements, and has instead pursued the short-term interests of air carriers.

While Chinese carriers are rapidly developing international routes, they need to grow in size and international reputation. Liberalisation of international air transport arrangements have to wait until China's carriers become more competitive. In the interim, since China is interested in joint ventures across the board, alliances with foreign carriers may be the path to more liberalisation (Oum, Park and Zhang, 2000).

Further, compared to the United States and European Union, government aviation policy in Asian countries is driven more by producer interests. However, consumer interests are becoming stronger. That should strengthen the drive towards liberalisation of international aviation arrangements, and will be particularly salutary in high-fare countries such as Japan.

3. Air transport infrastructure

Air transport service levels are critically dependent on a complex aviation infrastructure comprising airport access facilities (landing and take-off slots), ground services, air traffic control (ATC), and navigation systems. The US experience with domestic deregulation and liberalisation of international markets suggests that efficient and competitive air operations via hub-and-spoke networks are possible only if appropriate capacity is available in the hubs. The problems of rising demand and its spatial concentration in hubs are clear from the fact that in the 1990s, 44% of international air passenger traffic was concentrated in 25 airports in 17 countries, and 50% of air freight handled in 15 airports (OECD, 1997). If runway capacity or landing slots are scarce, that limits competition. Further, barriers to entry by new airlines in these airports will rise, although individual routes may experience more competition.

To prevent the loss of liberalisation benefits due to air transport capacity restraints in the Asia Pacific, two options are open: expansion of infrastructure capacity, and increasing access to existing infrastructure (Lakshmanan and Anderson, 2001). In the last decade or more, there has been

considerable investment in airport development and expansion in many Asia Pacific countries – with the larger investments in Hong Kong (\$20 billion), Japan (\$17 billion), China (\$12.5 billion), and Korea (\$5 billion) (Dempsey and O’Connor, 1997). The long-term prospects for enhancing capacity and easing market entry depend also on improved methods of managing existing airspace, serving clusters of runways, and the use of new technologies to improve scheduling, sequencing and spacing of aircraft (Lakshmanan and Anderson, 2001).

While such physical capacity expansion can accommodate some of the rapidly growing demand at large airports, part of the congestion results from inappropriate policies on air transport infrastructure access. It is important that in the short run, economic pricing policies are implemented in order to promote efficient use of existing infrastructure, so that longer-run investment decisions are not distorted. The American experience since the start of deregulation 25 years ago shows that control over slots and gates can confer considerable advantages on incumbent carriers and often act as a major barrier to entry. From an economic perspective, slot auctions and other charging schemes that would promote efficient use of existing infrastructure capacity are called for. The EU and Canada have learned from the US experience by reserving some gates for common use at several airports. Australia, on the other hand, carried out deregulation in a context where almost all airport terminals were owned by one or two incumbent airlines; this situation is cited as a contributing factor in the initial demise of the new entrant, Compass Airlines (OECD, 1997).

4. Ownership issues

As airlines confronting liberalisation of international arrangements adapt and restructure, ownership changes occur frequently. Government-owned airlines are often privatised; there may be mergers and acquisitions among private airlines. Typically, there is flexibility of ownership in the private airlines to ensure that they can achieve optimal sizes and networks. A good example of privatisation following the liberalisation of the domestic markets is in Australia, where a government-owned international carrier (Qantas) acquired a government-owned domestic carrier (Australian). This privatisation, accompanied by multiple designation of carriers on foreign routes and a more liberal approach to negotiate capacity on overseas routes, has resulted in airlines that are growing and becoming robust competitors in the international arena. However, some national governments and carriers in the region are strongly averse to the idea of a foreign carrier operating within their boundaries. Often, they impose a limit on the proportion of foreign ownership of airlines.

International alliances have been formed partly to get around the foreign ownership and other restrictions appearing in the bilateral agreements. Such international alliances also avoid the complicated problems of the fifth freedom rights – a sore point in Japan, for instance (Oum and Yu, 2000).

Paths to liberalisation of international air transport arrangements

There are alternative paths to reform of international air transport arrangements, and to implementation of the relevant transition processes. Some of these ways have been at least partially tried to liberalise aviation markets in different countries. At a broad level, the choice depends on the underlying philosophical attitude to markets and government. One school puts more emphasis on markets, with government intervention limited to serious cases of market failure (*e.g.* wide monopoly power). The second school of thought is more interventionist in industrial policy – with the government deciding on market entry, pricing, and output levels. The underlying idea is that government control and regulation are preferable except in cases where the market can demonstrably achieve policy objectives more effectively. Given the multidimensional character of aviation, these approaches do not appear in pure form, though the Anglophone countries and Japan respectively broadly exemplify the two schools of thought.

In practice, one approach to regulatory reform is the application of the “big bang” strategy (adopted by the United States towards the deregulation of its domestic air markets) to reform of international arrangements. That would mean a sharp and comprehensive recasting of the governance or institutional structure of aviation markets. While this would lower transaction costs (as economic actors need only to adjust once) and remove some first-mover advantages, it will place a heavy burden on the sector, since the Asia Pacific countries have considerably different existing institutional frameworks and legal systems. Such a big bang approach is therefore an unlikely option for Asia Pacific region.

A more likely approach to reform, and probably the only viable one, is gradualism. The experience of the EU with the development and implementation of a common air transport policy (Button, 2002) and that of the United States in its pursuit of open skies bilaterals suggest the advisability of a gradual institutional change with no preset sequence of changes. This approach allows learning-by-doing. The US open skies programme (first formulated in 1979) took time to catch on, and became acceptable in the Asia Pacific only after the benefits of US domestic reform, and the rapid growth of air transport demand, were demonstrated.

Any policy reform and the accompanying wrenching institutional changes in air transport, treated in isolation, are intrinsically difficult. Incumbent economic actors have invested in the status quo and abhor the uncertainty that reform brings. Under these circumstances the political market for air transport reform can improve considerably if a coalition of interests broader than air transport interests emerges in the reform process. This argument will suggest a potential linking of the move towards regional air transport liberalisation to other trade negotiations. The idea is that traditionally protectionist countries may adopt a more liberal approach to aviation if they expect an overall welfare increase from liberalisation across several sectors, with the tradeoffs embracing goods and services. The considerable differences among Asia Pacific countries in starting points and airline competitiveness, and the lack of a powerful regional institutional infrastructure, make this drive towards broad regional integration very unlikely in the short run (Button, 2002; Oum and Lee, 2002). The transition towards multilateral arrangements for international aviation will take time and requires a variety of preparatory steps. If progress toward international aviation liberalisation in the United States and European Union are any example, such steps to reform must be guided by learning-by-doing, flexible adaptation and opportunism.

Short-term paths to international aviation reform

Several steps can be taken that are likely to promote international aviation reform and also pave the way to long-term liberalisation and integration of airline markets:

- *Liberalisation of bilateral agreements*, whereby opportunities for specific market openings can be seized as countries renegotiate the bilateral ASAs with other countries. Examples of such provisions that can liberalise within the current framework include multiple designation, freedom in capacity and in fares, liberalising the third and fourth freedom rights restricted in many Asian countries, etc. If these provisions get incorporated in bilateral ASAs, a certain commonality may develop among the Asia Pacific international aviation governance structures, providing a likely basis for speeding up further market access.
- *A lead sector approach*, in which a particular air transport sub sector such as air cargo is liberalised first. The potential here is that cargo transport and logistics are crucial to many Asia Pacific countries as they maintain an international supply chain (offering time-definite

demand) tied to production and international trade. Improvements in efficiency deriving from such liberalisation of freight will have demonstration effects and over time help widen the liberalisation process.

- *Formation of alliances*, which have been used by US/EU airlines to bypass some of the serious limitations of bilateral arrangements, and which provide seamless online services inside the United States and European Union, and internationally. These alliances, including code-sharing, benefit consumers, allow airlines to increase market presence (without expanding their network of operations) and to gain “network value”, cost advantages and efficiencies in resource utilisation. The Star Alliance and One World illustrate this trend. Many Asia Pacific airlines are members of such alliances. Removing barriers to their effective development and to the creation of complementarity among the airlines in managerial and operational matters will offer benefits in the transition to more robust liberalisation. The potential for such benefits can be enhanced if cross-investments are allowed in this context. Button (2002) suggests that there would be such synergies between Japanese and Chinese air markets.
- *Regional Arrangements*, which involve groups of nations in the Asia Pacific with common interests coming together and negotiating building upon liberalisation gains already made to create a single “open skies” policies regime or other forms of open air transport markets. This approach may allow the participation of some countries from opening international markets, while allowing domestic market access regulation as a transitional measure. Other countries in the Asia Pacific may join this initial group later by agreeing to the international air transport arrangements in place. In that case, there will be an enlarging of the liberalised region from an initial core group of states — a case of what is described as phased multilateralism or plurilateralism.

Concluding comments

This chapter has focused on the history, current status, and likely prospects of the governance structures and international arrangements under which the rapidly expanding air transport services are offered in the Asia Pacific region. While airline services are internationally traded, the system of international arrangements governing cross-country air transport services (inherited from the

1944 Chicago Convention) was highly restrictive and limited to bilateral agreements between pairs of countries that tried to achieve reciprocity in outcomes (by balancing air traffic volumes among the national carriers). Even as open trade regimes developed in recent decades for various goods and services as a result of international agreements, air transport remained protected – witness the exclusion of “hard rights” of international air market access in GATT and NAFTA.

Robust economic growth, rising real disposable income, the relaxation of travel restrictions and increasing air transport reform and liberalisation have combined to stimulate the highest growth rates of air travel in Asia Pacific region, and the pace is likely to continue so that by the year 2010 the regional share of worldwide international scheduled passenger traffic is expected to reach 49.8%. The ability of the Asian Pacific region to capture the benefits of such expanding markets and to maintain and improve market share hinges on the regional airlines’ capacity to improve productive efficiency and operations, to develop efficient collection and distribution networks, and to offer competitive fares in increasingly integrated global aviation markets. The development of this capacity is, however, handicapped by the barriers to international competition in the extant regulatory regime (*i.e.* to free entry into and exit from air transport markets, public subsidies to airlines, etc.).

Consequently, there has been a growing movement in recent years towards reform of this restrictive international regulatory system in the region and elsewhere in the world. The factors underlying this move towards open and competitive aviation markets in the region derive from a) changes in the scale and composition of air transport demand, b) supply-side shifts in the form of technological changes, new services and entrants and new organisational mechanisms that improve efficiency and service variety and c) the growing inadequacy of existing international institutions and arrangements to promote the adaptation and restructuring of the regional airlines to emerging demand and supply conditions. If the Asia Pacific air transport industry is to respond effectively to these pressures, it must adapt by restructuring its networks, operations and institutional structures. Its capacity to do so depends again on major reform of existing international aviation governance structures – through either modifying existing institutional regimes (towards more liberal bilaterals) or erecting new regimes (regional or multilateral arrangements). As the region moves towards such reform of air transport international arrangements, the eventual outcome will be a liberalised market characterised by freedom of entry and exit, a well-operating price system and removal of infrastructure capacity constraints. In this kind of regime, international aviation in the Asia Pacific will

gain the flexibility to restructure itself into a robust competitor in the global marketplace, and at the same time increase consumer surplus. Indeed, within the Asia Pacific, carriers based in countries with more open international institutional structures are among the most competitive.

The early stimulus for reforming the aviation regulatory systems came from the United States, which deregulated its domestic market in the late 1970s. The North American airlines built hub-and-spoke-efficient collection and distribution systems, improved their operational efficiency and became more competitive. They are aggressively pursuing international markets, as the US government initiates liberal international aviation agreements such as more open bilaterals and transborder “open skies” agreements with European and Asian Pacific countries. The EU, starting later, has also moved to a free market situation within Europe and more liberal bilaterals.

The transition of the diverse group of Asia Pacific airlines towards open air market regimes is complicated by a playing field that is uneven due to differences in size and network patterns as compared to the US/EU mega carriers, and the longer regional history of protective regulations (which have weakened competitive incentives). Another issue is the easing of constraints of air transport infrastructure, especially the need to develop appropriate economic policies of infrastructure access.

Given the complexities of adaptation and restructuring towards more open international air transport markets in the large and diverse Asia Pacific region, a likely and probably sole viable approach to reform is gradualism. The experience of the European Union with the development and implementation of a common air transport policy (Button, 2002) and that of the US in its pursuit of open skies bilaterals suggest the advisability of a gradual institutional change with no preset sequence of changes. This approach allows learning-by-doing.

Further, the political market for air transport reform in a country can improve considerably if a coalition of interests broader than air transport interests emerges in the reform process. This argument will suggest a potential linking of the move towards regional air transport liberalisation to other trade negotiations. The idea is that traditionally protectionist countries may adopt a more liberal approach to aviation if they expect an overall welfare increase from liberalisation across several sectors, with the tradeoffs embracing goods and services. The chapter concluded with several steps that can be taken in the short run to pave the way to long-term liberalisation and integration of airline markets.

NOTES

1. Such knowledge-providing and enabling functions of IT in transport services have historical antecedents in the sextant and the chronometer which enabled global navigation in the 18th century, the telegraph that supported rail travel in the 19th century, and radio and radar in the 20th century.
2. A benchmarking survey by a group of distinguished academics led by Prof. Tae Oum developed and used a measure of “Variable Factor Productivity” (VFP), which strips out the less accurate capital inputs and emphasises labour and “soft cost” inputs — the latter to take into account the costs of buying outsourced services. While the average productivity index for the 50 top airports was 1.0, it was 1.16 for North American airports (with Atlanta and Charlotte scoring 3.28 and 2.76, respectively), and 0.69 for Asia Pacific airports – with Sydney at 1.32 and Singapore at 0.9 (Pilling, 2003).
3. Several kinds of aviation rights are specified in these bilaterals, estimated to number 2 000 among 160 countries in the late 1990s (Findlay, Forsyth, and Bora, 1996). The more coveted of these rights are a) the *fifth freedom rights* (which allow the foreign carrier, on landing in the home country while en route to or from a third country, to pick up and discharge traffic, and b) *cabotage rights*, which allow a foreign carrier to collect and discharge traffic travelling entirely within the home country.
4. In South Korea, for instance, supply on major air routes (on the only carrier, Korean Air) was so short as to require booking months ahead. For the popular tourist destination of Bali, the weekly seat availability jumped from 2 500 in the late 1970s to 25 000 in the liberalised environment of 1996 (Bowen, 1997).
5. In order for the consumers to benefit more fully, further relaxation of the regulations and more deeply discounted tickets are needed (Yamauchi and Ito, 1996).

BIBLIOGRAPHY

- Boeing (2004), *Current Market Outlook*, The Boeing Company.
- Bowen, John (1997), “The Asia Pacific Airline Industry: Prospects for Liberalization” in Christopher Findlay, C.L. Sien and Karmjit Singh (eds.), *Asia Pacific Transport*, Institute of Southeast Asian Studies, Singapore, pp. 123-153.
- Bowen, John and T.R. Leinbach (1996), “Development and Liberalization: The Airline Industry in ASEAN” in G.C. Hufbauer and C. Findlay (eds.), *Flying High*, Institute of International Economics, Washington, DC, pp. 79-97.
- Button, K.J. (2002), “Implementation Process of the European Common Air Transport Market and the Common Air Transport Policy”, Paper presented at the East West Center / KOTI Conference, Honolulu, 10-12 August.
- Button, K.J. and K. Johnson (1998), “Incremental Versus Trend-break Change in Airline Deregulation”, *Transportation Journal*, 37, pp. 25-34.
- Dempsey, P.S. and Kevin O’Connor (1997), “Air Traffic Congestion and Infrastructure Development in the Asia Pacific Region” in Christopher Findlay, C.L. Sien and Karmjit Singh (eds.), *Asia Pacific Transport*, Institute of Southeast Asian Studies, Singapore, pp. 23-47.
- Findlay, C., P. Forsyth and B. Bora (1996), “International Air Transport” in B. Bora and Christopher Findlay (eds.), *Regional Integration and the Asia Pacific*, Oxford University Press, Melbourne, pp. 128-139.
- Findlay, C., G.C. Hufbauer and Gautam Jaggi (1996), “Aviation Reform in the Asia Pacific” in G.C. Hufbauer and C. Findlay (eds.), *Flying High*, Institute of International Economics, Washington, DC, pp. 11-32.

- Gillen, D.W., R. Harris and T.H. Oum (2002), “Measuring the Economic Effects of Bilateral Liberalization of Air Transport”, *Transportation Research Part E: Logistics and Transportation Review*, 38, pp. 155-174.
- IATA (2004), IATA Cargo and Passenger Forecasts 2004-2008 (www.iata.org/pressroom/industry/stats/2004-12-15-03.htm).
- Kim, J. (1996), “The Regulation and Growth of Civil Aviation in South Korea” in G.C. Hufbauer and C. Findlay (eds.), *Flying High*, Institute of International Economics, Washington, DC, pp. 74-83.
- Lakshmanan, T.R. *et al.* (2001), *Trade and Transport Integration: Selected Case Studies*, World Bank Book Series in Directions in Development, World Bank, Washington, DC.
- Lakshmanan, T.R. and William P. Anderson (2001), “Infrastructure Capacity” in D. Hensher and K. Button (eds.), *Handbook of Transport System and Traffic Management*, Elgar, London.
- Lakshmanan, T.R. and William P. Anderson (2004), “Transportation in the 21st Century: Technical Innovation” in John T. Kim (ed.), *UNESCO-EOLAS Book on Traffic Engineering and Planning*, UNESCO, New York, Chapter 6.40.3.6.
- Morrison, Steven A. and Clifford Winston (1997), “Regulatory Reform of US Intercity Transportation”, Working Paper, Brookings Institution, Washington, DC.
- Morrison, Steven A. and Clifford Winston (1999), “Airline Deregulation in the US”, *Essays in Transport Economics and Policy: A Handbook in Honor of John Meyer*, Brookings Institution Press, Washington, DC.
- O’Connor, K. (1995), “Airport Development In Southeast Asia”, *Journal of Transport Geography* 3 (4), pp. 269-279.
- OECD (1997), *The Future of International Aviation Policy*, OECD, Paris.
- Oum, Tae and Y.H. Lee (2002), “The Northeast Asian Air Transport Network: Is There a Possibility of Creating an Open Skies in the Region?”, *Journal of Air Transport Management*, 8, pp. 325-338.

- Oum, Tae, J.H. Park and A. Zhang (2000), *Globalization and Strategic Alliances: The Case of the Airline Industry*, Pergamon Press.
- Oum, Tae and C. Yu (1998), *Winning Airlines: Productivity and Cost Competitiveness of the World's Major Airlines*, Kluwer Academic Press.
- Oum, Tae and C. Yu (2000), *Shaping Air Transport in Asia Pacific*, Ashgate, Aldershot, United Kingdom.
- Peltzman, Sam and Clifford Winston (2000), *Deregulation of Network Industries*, Brookings Institution, Washington, DC.
- Pilling, Mark (2003), "Peak performance", *Airline Business*, June, 19, p. 6.
- Tan, Joseph L.H. (1993), *Regional Economic Integration in the Asia Pacific*, Institute of Southeast Asian Studies, Singapore.
- Treathway, Michael (1997), "Impediments to Liberalization in Asia Pacific International Aviation" in Christopher Findlay, C.L. Sien and Karmjit Singh (eds.), *Asia Pacific Transport*, Institute of Southeast Asian Studies, Singapore, pp. 65-73.
- WTO (World Tourism Organization) (1994), *Global Tourism Forecasts to the Year 2000 and Beyond*, World Tourism Organization, Brussels.
- Yamauchi, Hiroataka (1997), "Air Transport Policy in Japan" in Christopher Findlay, C.L. Sien and Karmjit Singh (eds.), *Asia Pacific Transport*, Institute of Southeast Asian Studies, Singapore, pp. 106-120.
- Yamauchi, Hiroataka (2000), "Towards a More Liberal Sky in Japan" in Takatoshi Ito and Anne O. Krueger (eds.), *Deregulation and Interdependence in the Asia Pacific Region*, University of Chicago Press, Chicago, pp. 195-220.
- Yamauchi, Hiroataka and Takatoshi Ito (1996), "Air Transport Policy in Japan" in G.C. Hufbauer and C. Findlay (eds.), *Flying High*, Institute of International Economics, Washington, DC.

*Chapter 7***Education, Health and Culture***by**Gavin W. Jones***Professor, Asia Research Institute
National University of Singapore**

The Asia Pacific region contains a major share of the world's population (exactly a third if South-Central Asia is not included; 57% if it is). The extraordinary variety of ethnicities, cultures, languages and religions in the region, not to mention a wide spectrum of economic and social development levels, renders any search to identify a unifying thread, aside from the obvious one of geographic propinquity, a difficult one. No doubt there are commonalities of interest in the Asia Pacific region, but we would still have to conclude that we are dealing here with a situation of extreme diversity. This is why, if indeed the Asia Pacific region is to be regarded as an entity, it is probably only through the building up of sub-regional groupings such as ASEAN and the development of a sense of common purpose within these groupings, that eventually these sub-regional nuclei might cohere into something more representative of the whole region.

If asked for a concrete example of the building of a common purpose through a sub-regional grouping, the author could perhaps give a small-scale example drawn from his own experience. The ASEAN-Australian population programme, conducted over the 1979-86 period, covered a range of collaborative studies on population and development across ASEAN member countries; included were studies on health and family planning, ageing and other health-related matters. This programme was externally funded (by AusAID, or ADAB as it was then called). As an Australian demographer with wide contacts in the region, the author was appointed as a consultant to ADAB for this project, to attend annual meetings and serve in an informal go-between role in many programme activities.

What was particularly striking about the programme was the opportunities it provided on a sustained basis for people from the ASEAN member countries (at that time, there were only six of them) in the population field to build very close connections, friendships and collaborative activities. It really was the case that before then, most of the professional links for population researchers in the region were with those Western countries either with former colonial links or where graduate students went for study: for the Philippines, the United States; for Malaysia and Singapore, the United Kingdom; for Indonesia, the Netherlands, Australia or the United States; for Thailand, mostly the United States. The intra-ASEAN collaboration developed so strongly that when the ASEAN population programme had to be discontinued because Australian financial support ended, the collaboration continued in many different forms.

The emphasis in this chapter is on international arrangements affecting education, health and culture in the region. This seems to require a number of cross-cutting emphases on a) international agencies (World Bank, ADB, UNESCO, UNICEF, WHO, UNFPA, etc.); b) regional agencies (ESCAP as part of the UN, then ASEAN, SEAMEO, etc.) and ad hoc regional ministerial or expert group meetings called for particular purposes; c) bilateral arrangements between governments – and then on the way these influence the activities of private actors, such as universities, drug companies, film distributors, NGOs, etc.

Education

The wide differences in educational circumstances in the Asia Pacific region provide both a challenge to raise standards in the more disadvantaged countries and an opportunity to accomplish improvements through international co-operation. Even within Southeast Asia, such differences are marked in both educational enrolment ratios at all levels and in the quality of the education offered (Jones, 1999). And the more readily accessible figures do not tell the whole story. For example, in Lao People's Democratic Republic the net enrolment rate at the primary school ages of 6-10 was officially estimated to be 73% in 1996, up from 63% ten years earlier. But at the same time, 46% of primary school students were over-aged (World Bank, 1995), repetition rates were estimated at 30%, and probably only 30% of children completed primary school.

The cross-cutting levels at which international co-operation operates with regard to education in the Asian region include, first, the international agencies

(World Bank, ADB, UNESCO); second, regional agencies (SEAMEO in particular, and ASEAN); and third, bilateral relations between governments.

The role of the lending agencies – the World Bank and the Asian Development Bank – is immense, but their programmes are typically bilateral, which is almost inevitable given that they are loan programmes. The scholarships and grants programme in Indonesia, formulated after the economic crisis broke in 1997 as part of the social safety net programme, provided USD 390 million worth of loans over three years to poor students and schools serving poor students. It played a part, though just how important a part is hard to measure, in maintaining school enrolment ratios in Indonesia over this difficult period (Jones and Hagul, 2001). Similarly, in Thailand, in the early stages of the economic crisis, funds from lending agencies were set aside to provide scholarships for students obliged to drop out of school.

There is understandably a desire on the part of national governments to free themselves from the need to seek loans for educational activities, along with some resentment towards the lenders, expressed in relation to stringent monitoring and reporting procedures, claims of arrogance, etc. In reality that resentment stems from both these and other complex causes. The alacrity with which the Indonesian government turned down the offer of a new education loan by the World Bank in 2002 was symbolic. The Indonesian budget derived substantial revenue gains from a reduction in fuel subsidies, but this policy had led to popular demonstrations from those claiming that the poor would suffer from resultant increases in fuel prices. To counter this, the government announced that the revenue gained would be channelled into programmes to assist the poor, including a new scheme of scholarships and grants even larger in scope than the scheme funded by the banks. For this reason, the bank-funded programmes would no longer be necessary (Rahayu *et al.*, 2003).

UNESCO, while it has had to deal with much criticism from the United States and other Western countries over the years,¹ at least does not have to deal with the opprobrium flowing from being a lender. Each of the member countries of UNESCO in the region has its National Commission for UNESCO, normally located in the Ministry of Education or Ministry of Foreign Affairs. Countries in the region benefit in various ways from the activities in the UNESCO headquarters. For example, the UNESCO Institute of Statistics was set up in Montreal in 1999 to improve UNESCO's statistical programme. In collaboration with the OECD, and with funding from the World Bank, it is involved with a number of countries, including Asian countries such as Indonesia, Thailand, China, India, Malaysia and the Philippines, in the World

Education Indicators Program (WEI). This appears to be resulting in an improvement (greatly needed – see Jones, 2000) in the sophistication of educational indicators.² It is useful, for example, for Indonesia and the Philippines to know that total public and private expenditure on education is 1.2% of GDP in Indonesia and 5.9% in the Philippines (the latter above the OECD average of 4.9%). It is equally useful for them to be able to compare themselves with other countries over a whole range of useful measures such as intended instruction time for students at different ages, structure of public educational expenditures, and teacher salary differentials by length of experience (see UNESCO Institute for Statistics and OECD, 2002). They can ponder the reasons why per-student expenditure at the tertiary level is only twice as high as at the primary level in the Philippines but 13 times as high in Indonesia, and perhaps take appropriate action based on such information.

But the focus here will be more on the regional programmes of UNESCO, which in some ways parallel those of the Southeast Asian Ministers of Education Organization (SEAMEO). The educational arm of the UNESCO Regional Office in Bangkok, which claims to have embarked on a programme of reform and decentralisation since the appointment in 2000 of Koiichiro Matsuura as Director General (<http://www.unescobkk.org/about.htm>), comprises three main divisions:

- The Asia Pacific Programme of Education for All (APPEAL), mandated to focus on basic education, including pre-school and primary school levels.
- The Asia Pacific Programme of Educational Innovation for Development (APEID), which focuses on the secondary level and beyond.
- The administrative arm, known as the PSA (Planning and Systems Analysis Unit).

The second of these, APEID, has the following objectives:

- To identify and stimulate innovative activities and co-operative action among the member states, with a view to encouraging systematic experimentation and accelerating the adoption of educational innovations in response to problems of development.

- To assist member states in strengthening ongoing national programmes which are developing innovative, indigenous techniques for one or more aspects of development-oriented education, in terms of personnel, techniques and management capacity.
- To promote inter-country and inter-regional sharing of experiences and technical co-operation, particularly through exchange activities, advisory services and information.

The APEID programme is packed with seminars, workshops, expert group meetings and training courses. Two questions arise. First, do these activities mesh effectively with, or overlap with, activities of other agencies, particularly SEAMEO? Second, to what extent do the countries of the region feel an “ownership” of the programmes of UNESCO, as compared with those of SEAMEO? To examine these questions, we need first to examine briefly the activities of SEAMEO.

SEAMEO was established in 1965 as a chartered international organisation to promote co-operation in education, science and culture in the Southeast Asian region. It was directly created by the ministries of education in its member countries, and its basic operations are funded by the member countries, whose shares are determined by the ADB contribution index. It operates a number of SEAMEO centres (12 in all), whose budgets are underwritten by the countries hosting them. Examples are the Regional English Language Centre (RELC) in Singapore and the Regional Centre for Tropical Biology (BIOTROP) in Bogor, Indonesia. SEAMEO also has associate members (Australia, Canada, France, Germany, the Netherlands and New Zealand), and one “donor country” (Japan). Its Educational Development Fund accepts donations from its member countries, associate member countries and donor countries in support of educational and training needs in Southeast Asia.

Aside from the centres it runs, SEAMEO conducts a wide range of activities, including provision of scholarships for nationals of SEAMEO member countries to complete their studies at SEAMEO centres, internship programmes, partnership programmes, research fellowships, consultancy programmes, conferences, seminars and workshops, study visits, community involvement projects, a SEAMEO sister school network, and distance education packages. The scale of SEAMEO activities is substantial: by 2002, 50 988 professionals had participated in its training courses and 25 231 had attended its conferences, seminars and workshops (<http://www.seameo.org/about/achievements.htm>).

Every year, SEAMEO holds its council meeting, attended by the ministers of education of member countries, representatives of associate members, centre directors, observers from donor governments, foundations, and international organisations and agencies. UNESCO used to hold such ministerial meetings every five years, but these have been discontinued. It now holds sub-regional meetings (Central Asia, South Asia, Pacific islands, etc.). There is some attempt at collaboration between the two organisations – for example, at a recent SEAMEO Council meeting in the Philippines, UNESCO helped to organise a half-day session on school-based management. SEAMEO also holds a large congress every three years, which in 2004 will coincide with a large regional congress UNESCO plans to hold. There are plans to join forces to avoid overlap in the activities of these two congresses.

What of the educational activities of the ASEAN Secretariat? These are very limited because of the prior, and very active, role of SEAMEO. ASEAN has recently restructured its Committee on Education, but this restricts itself to promoting consciousness of ASEAN at the school and university levels, and hosting an ASEAN university network that promotes collaborative studies and research programmes among its 17 educational institution members. Student and faculty exchange programmes, scholarships for graduate students at ASEAN countries, and information networking among ASEAN universities are carried on to a limited extent (see Association of Southeast Asian Nations, 2003, pp. 86-87).

Bilateral governmental collaboration in the field of education takes many forms in the region. There are many programmes through which donors such as Australia, Japan and the United States provide support for educational programmes.³ Normally such programmes are developed bilaterally, although sometimes individual donor countries join a consortium led by an agency such as the World Bank, partly because they lack sufficient funding to support large projects alone, or because they have more limited capacity to carry out the project identification and assessment activities that go to make up a successful project. Bilateral programmes are developed in partnership with the recipient country, generally emphasising that country's priorities although the interests of the donor country also play a role. In recent times, there has been a flurry of interest on the part of some donors in seeing whether the terrorist threat could be ameliorated by engaging in programmes of support for Islamic *madrasahs* with the aim of softening the anti-Western rhetoric some of them offer as educational fare. Needless to say, this is a very sensitive area, and one where a perception that the donor agency has ulterior motives is likely to boomerang.

Mention should also be made of programmes of assistance for education conducted bilaterally, but under the rubric of “South-South” co-operation using outside funds. These programmes are based on the wide divergence in levels of development between countries in the region, providing scope for the more developed to assist the less developed. Thailand, a case in point, has developed a number of programmes to assist its poorer neighbours – Cambodia, Laos, Myanmar and Vietnam. Its Third Country Training Program offers the chance for participants from other developing countries, particularly those in the Asia Pacific region, to attend training courses in Thailand. It is fully funded by international organisations, such as WHO, ESCAP, UNDP and SIDA, but administered by Thailand’s Department of Technical and Economic Cooperation (DTEC) in collaboration with other Thai agencies (DTEC, 2002).

Turning to private sector collaborative arrangements in education, there has been a dramatic “internationalisation” of university offerings throughout the region. In Malaysia, twinning programmes with overseas universities have multiplied. There are two “tiers” to such programmes. First, four foreign universities (the first of them Australia’s Monash University in 1998) have set up branch campuses in Malaysia, where both local and foreign students can take the full range of courses these universities offer at their home base. Secondly, 36 private colleges out of a total of 516 have been approved to conduct 3 + 0 degree programmes in collaboration with overseas host universities. Students have the choice of studying in Malaysia, following either the UK, US, Australian, New Zealand or Canadian systems (www.studymalaysia.com). There are currently 30 000 international students, mostly from developing countries, studying in Malaysia’s 536 private higher educational institutions, and this is targeted to reach 50 000 by the year 2010. Malaysia’s Education Ministry is considering exempting such students from Malay and moral studies courses. In Thailand and the Philippines, graduate programmes taught in English have been opened to students from other countries – in the case of Thailand, such programmes (for example, the Masters in Population Studies at Mahidol University) have been targeted at foreign students from the start.

In August 2003 Singapore announced that it was hosting the world’s first online university, Universitas 21 Global, which has designs on exploiting the China and India market. This online university is a venture between American company Thomson Learning and Universitas 21, a network of 16 research-intensive universities. Its first programme, the Masters of Business Administration, opened with 27 students, and the university hopes to enrol 500 students by the end of 2003 (*Straits Times*, 6 August 2003).

Associations of Universities are in existence at different levels in the region. The ASEAN university network was already mentioned. Another is the Association of Pacific Rim Universities (APRU), founded in 1997, a consortium of 36 leading universities from 16 Pacific Rim countries. To be a member of APRU, candidate universities have to demonstrate their academic excellence, research intensity, and global outlook. Aside from China and Japan, which have six and five members respectively, other Asian countries including Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand have only one member university each, in each case (by most reckonings) the most prestigious university in the country.

The National University of Singapore is an example of a university in the region determined to position itself advantageously in a rapidly changing international setting. It has operational linkages with many prestigious universities such as MIT and UCLA. Its president is currently the chair of APRU. Its working collaboration with one of China's top universities – Fudan University – includes setting up a college in Shanghai to train Singaporeans in how to do business in China, and setting up a graduate school in eastern China's Suzhou Industrial Park (*Straits Times*, 31 August 2003). The NUS has recently established a number of new research institutes designed to attract top international researchers, including the Asia Research Institute, the Centre for Remote Imaging, Sensing and Processing, and the Tropical Marine Science Institute.

Language issues

There are important issues concerning the role of English as an international language, and the preservation and health of indigenous languages (Lindsay and Tan, 2003), which need to be addressed imaginatively by regional bodies. The dominance of English in the Asia Pacific region is overwhelming, having supplanted French even in the former Indochina region. Maintaining the health of national languages in co-existence with English is now the key issue. Globalisation poses real problems for countries aiming to promote their national language in their educational system, as the example of Malaysia illustrates. Efforts to entrench Bahasa Malaysia as the main medium of instruction at school and university over the 1970s and 80s have resulted in many graduates now having a poor command of English and therefore little chance of finding jobs in the country's major companies.⁴ It is not only Malaysia that is struggling with this issue. Sri Lanka, India and the Philippines, as the other countries of the region with the highest English standards but with strong sentiment for raising the status of indigenous languages, face similar problems. Singapore has, as

usual, found its own unique solution. It aspires to compete globally both in English and Mandarin. Despite the prevalence of “Singlish” in everyday conversation, it has to a large extent succeeded. The policy of replacing the ubiquitous Chinese dialects with Mandarin has paid off handsomely in lucrative business dealings with China, though at the cost of sometimes near-total incomprehension between grandparents and grandchildren in Chinese Singaporean families.

English may be the lingua franca in the region but there are other languages that cross borders, and these give rise to certain opportunities for fruitful co-operation. The Thai language enables collaboration between Thailand and Laos, whose language is very close to the northeastern dialect of Thai. The University of Khonkaen, in particular, is therefore able to play an important role in conducting workshops in Laos and providing other kinds of assistance to Laotian education. And the Indonesian and Malay languages are close enough for many Indonesian students with a level of English too low for study in the West to study in Malaysian universities, including at the PhD level.

But given the primacy of English and the great advantage of English literacy at the international level, the two Southeast Asian countries with the strongest English among the general population – Singapore and the Philippines – are those best placed to capitalise on this capacity. In Singapore, for example, study camps are conducted entirely in English, for wealthy Thai high school students, and some Malaysian parents in neighbouring Johore Bahru go to great lengths to have their children accepted in Singapore schools because of their higher standard of English (*Straits Times*, 1 September 2003). A private Philippines university with courses taught in English has recently been set up in the predominantly Christian Indonesian province of North Sulawesi (Sondakh and Jones, 2003, p. 282). And the Philippines, like India, is capturing an important share of “call centre” work being outsourced from countries such as the United States.

The question of how national languages are to be defended and protected in the era of globalisation remains a dilemma demanding attention. The issue is not confined to the tradeoffs in economic and business terms. As will be discussed below, creative writers, artists and performers have to weigh the advantages of working in the vernacular against the wider attention the works may receive if English is used.

Health

The Asian region has witnessed a dramatic decline in mortality over the past half-century, with life expectancy at birth increasing from 43 to almost 70 between 1950 and 2000 in East Asia, 39 to 63 in South Asia and 41 to 66 in Southeast Asia. Nevertheless, wide differences remain between countries, whether the indicator used is the infant mortality rate (73 in Cambodia; 5 in Singapore) or the maternal mortality rate (perhaps 400 per 100 000 live births in Cambodia and 300 in Indonesia; 44 in Thailand; 3 in Singapore).

These differences raise important issues for international collaboration. The quality of medical research and medical services varies enormously among countries of the region, implying that there is much that the more advanced countries can contribute to medical and public health services in the less advantaged countries. There is also an important aspect of self-interest involved. In these days of widespread travel and international business links across the region, the prevalence of communicable diseases in one country can easily result in these diseases being brought back to other countries by travellers.

The most dramatic example of the need for collaboration between countries of the region was the 2003 SARS outbreak, which will be dealt with in more detail below. But before turning to that outbreak, a quick overview is needed of the international collaborative arrangements in place to counter morbidity and mortality in the region.

As in the field of education, there are different levels of collaboration to be considered, covering the roles of international agencies, regional groupings, bilateral arrangements and private or commercial links. There are complex overlaps between these different levels – as can be seen, for example, in the field of health surveillance, where international agencies play a key role (WHO, the US NAMRU-2,⁵ I-net, APEC, etc.). WHO is dominant in setting guidelines and giving intellectual leadership in many aspects of health planning, and UNICEF is noted for innovative programmes related to infant and child health and maternal health. The World Bank and the Asian Development Bank are important as lenders, and bilateral arrangements support a number of health programmes. For example, the Australian Development Assistance Bureau (AusAID) has given assistance in the health field in a number of Asian countries over many years. Emphasis in its programmes in Indonesia has been on maternal and child health, reproductive health services and communicable disease control.

WHO's role in the health field appears to be more dominant than is UNESCO's in the field of education. This is perhaps because part of that role, accepted by others, involves imposing standards in matters of communicable disease control and other aspects of health that are literally "life and death" matters, whereas UNESCO's role relates to issues about which governments see less need for the imposition of standards from outside. Presently, WHO's negotiating clout is being used to help poor countries procure HIV-control medicines cheaply, although credit for the sharp fall in the cost of the required drug cocktail (from USD 10 000 to USD 300) must go mainly to competition from generic medicines, and further price falls are expected to result from a deal brokered by the Clinton Foundation. The WHO's expertise may be crucial, however, in creating the health care systems (including the use of volunteers in remote areas to deliver simplified drug regimens and monitor their effects) to deliver these drugs (*The Economist*, 29 November 2003, p. 82).

What of the regional groupings such as ASEAN? WHO can provide the expertise, as can the Centre for Disease Control (CDC) in Atlanta, for example. But ASEAN can provide the community within which regional collaboration in health amelioration efforts can thrive. It can also help identify and tap expertise within the region that is not always well known. This can minimise the need to rely on organisations such as the CDC.

ASEAN is doing more in the field of health than it is in education. Indonesia was the driving force in revitalising ASEAN health activities in recent years, while Dr. Sayudi was Minister of Health. There have been two ministerial meetings on health since 2000. The first focused on globalisation issues – health care delivery and equity – and the second on healthy lifestyles. Another will be held in 2004 in Malaysia. Every year, there is a meeting of senior officials at the level of secretaries general and directors general. They have developed a work programme emphasising HIV/AIDS, other communicable diseases (especially tuberculosis), food safety and pharmaceuticals (issues of access, etc.). Funds for these initiatives came from UNAIDS and the Rockefeller Foundation.

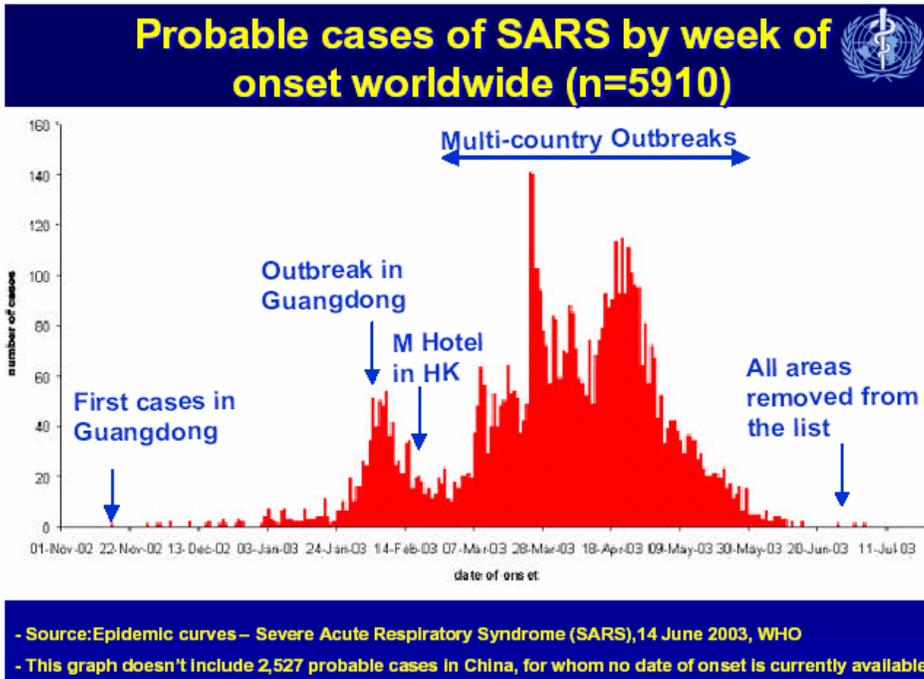
How effectively can regional groupings such as ASEAN collaborate with the WHO? There are self-imposed administrative obstacles on the part of WHO, in particular the complex relationships between WHO regional offices. These are in Manila (the Regional Office for the Western Pacific) and Delhi (the Regional Office for Southeast Asia). The highly idiosyncratic grouping of countries under these two offices⁶ means that the ASEAN region is split between them. This can have adverse effects in programmatic terms. For

example, the Manila office has a programme to “roll back malaria”. This involves countries including Laos, Cambodia, Vietnam and China. For this programme to be effective, Thailand needs to be involved, but it lies under the jurisdiction of the Delhi office. While ASEAN can assist WHO in consolidating these regional efforts, in principle it would appear to be better if WHO could overcome the bureaucratic lethargy or vested interests on the part of some of its member countries, preventing a modification in the grouping of countries under its different regional offices.

SARS

The SARS (Severe Acute Respiratory Syndrome) outbreak in Asia and beyond in early 2003 (see the figure for time trends in outbreaks of the disease) was a severe test case for international collaborative arrangements. Although the death toll was relatively restricted, uncertainty about the mechanism through which the disease spread, the fact that it could kill healthy individuals in their prime working years, and uncertainty over its possible increased virulence led to a situation of near-panic in areas where it struck the hardest, such as Hong Kong, parts of China, Singapore and Toronto. The secretive and irresponsible way in which the outbreak was dealt with in China severely dented China’s international image, and led to the sacking of the health minister and the mayor of Beijing – neither of whom, however, had been responsible for the decision to order a news blackout on the outbreak (*The Economist*, 24 April 2003).

Figure 1



Countries were forced to co-operate, because the tendency for the disease to be spread on long-distance airline flights necessitated a strong surveillance system for travellers, and clear policies on what was to be done with passengers who exhibited signs of the disease, or indeed other passengers who travelled on the same flight. Health ministers considered joint measures at a special ASEAN + 3 meeting in Kuala Lumpur on 25-26 April, followed by a special ASEAN (and ASEAN - China) leaders' meeting on SARS in Bangkok on 29 April. This unprecedented high-level attention to an emergency situation was followed up with another meeting of airport, quarantine and immigration officials of the 12 countries on 16 May, and a flurry of other high-level consultations through May and June.

The issues were both very immediate and very complex. Problems arose from the sovereign right of countries to unilaterally issue travel advice against other countries. Data collection was incomplete and a range of health declaration cards and screening procedures was used across countries. Border control measures were not standardised. There was a clear need for consistency

in screening procedures at entry and exit points. The 16 May meeting overturned some of the more hasty measures, such as deporting potential SARS cases, and instead instituted policies whereby the country of arrival referred the individual suspected of having SARS to health or quarantine authorities for appropriate medical treatment. This was a significant step forward, because deporting a potential SARS case would lead to a more complicated situation: the virus could spread among passengers on the aircraft returning the person to their country of origin, which could prompt a quarantine of everyone on the plane. The countries at this meeting affirmed that they would follow WHO guidelines in managing passengers suspected of carrying SARS.

That agreement symbolised the dominant role played by WHO in tackling the SARS outbreak. It was WHO that declared Vietnam SARS-free – much to Singapore’s chagrin because Singapore, for all its tough control programmes, was still experiencing new SARS cases. A few weeks later, newspaper headlines such as “WHO Takes Singapore Off Its SARS List” (*Bangkok Post*, 1 June 2003) were followed by the news of big discounts at Orchard Road shops and plans for a major riverside party. Singapore airport trumpeted the news of its SARS-free status with major celebrations targeting embarking and transit passengers. “We are tremendously relieved that WHO has taken us off the list of SARS-infested countries”, said the spokesman for a group representing hotel, tourism and trade industries. The celebrations were not unrealistic, because there is no doubt that the Singapore economy had been severely affected by SARS.

WHO played the role of undoubted world leader in fighting the SARS threat. It was the organisation that had to be satisfied before a country could be declared SARS-free. The economic future of countries depended on its decisions. A rebuke from WHO was enough to cause China to take steps towards greater openness in reporting bad news. Countries were content to let WHO take the lead in tackling the SARS threat. Other organisations got into the act – for example, the SARS outbreak led ASEAN to look at the feasibility of an ASEAN early warning system on new infectious diseases, and a disease surveillance website has been set up by the Ministry of Health in Indonesia. But these were sideshows compared with the role of WHO.

The Western Pacific Regional Office of WHO – the office covering most but not all of the countries affected by the SARS outbreak – argues that governments and WHO have to work together to deal with any future emergency of this kind. National governments need to strengthen their capacities for surveillance and outbreak response, to plan and manage resources

for outbreaks with the potential to persist over long periods, strengthen public health infrastructure and establish a national programme for infection control. They argue that WHO should be able to act quickly in outbreaks of international significance, strengthen its capacity in outbreak response, identify useful epidemiological networks that enhance outbreak preparedness and response, and serve as the nexus of the major epidemiological network (SARS Preparedness and Response Team, 2003).

The other key lesson of the SARS outbreak may have been that countries are willing to band together to fight a high-profile threat. This, however, just serves to show the inadequacy of the efforts to counter the real killers: AIDS, tuberculosis and malaria. These three diseases kill 6 million people every year, enough of them in Asia to render the mortality impact of SARS minuscule by comparison. The Global Fund to Fight AIDS, Tuberculosis and Malaria was set up at the G-8 Summit in 2001 as an initiative bringing governments, civil society and private corporations together in the fight against these diseases. This Fund has important implications for the Asian region, which serves to highlight another important point – that sometimes, global initiatives can have an equally great or greater impact on a region than regional initiatives.

The other major health threat in the region is drug addiction, and countering this requires collaborative arrangements at every level. Countering drug trafficking and drug abuse is not just a medical matter, but requires educational programmes and tough law enforcement as well as political agreements. The inclusion of Myanmar, a major source of drugs in the region, in ASEAN may provide some opportunities for more effective action to counter the drug trade, but so far there is little sign of progress.

The author has had more direct experience with population and family planning programmes in the region than with specifically health programmes. Although these are not mainstream health activities, they certainly have important health implications. An example will therefore be given from the population field – perhaps simply an isolated example with little wider relevance, but perhaps not – of the dilemmas facing regional groupings when a major player attempts to have its way.

The 2002 Asia Pacific Population Conference

The Asia Pacific Population Conference, held in Bangkok in December 2002, was another in a succession of decadal population conferences held under the auspices of ESCAP, in association with the United Nations Population Fund

(UNFPA). Though the purpose is to enable the countries of the ESCAP region to reach agreed positions on issues of population and development, the membership of the United States and France in ESCAP as powers with official responsibility for certain small Pacific Island states enables them to send official delegations, and in the case of the Bangkok conference provided a venue to showcase what might be termed “the Bush administration’s hegemonic aspirations writ small”.⁷ The United States delegation used its status within the conference to strenuously promote a line favoured by ideologues of the right, in relation to abortion. The Bangkok conference then turned into a fascinating example of success, within the ESCAP network, in holding the line against such pressure.

Understanding what went on at the Bangkok conference requires some knowledge of developments since the previous Asia Pacific Population Conference, held in Bali in 1993. At that conference, Asian countries focused on population and development issues, and adopted targets for lowering both mortality and fertility rates in the interests of more rapid economic and social development. However, in the International Conference on Population and Development held in Cairo in 1994, effective organisation and lobbying by women’s NGOs led to a shift of focus to women’s empowerment, and reproductive health and reproductive rights were accorded an unprecedented prominence despite the opposition of the Holy See and some Catholic and Muslim countries (McIntosh and Finkle, 1995). Many Asian governments were uneasy about the downgrading of the emphasis on influencing demographic trends in the interest of development, but accepted the new thrust and indeed subsequently modified their family planning programmes to incorporate the reproductive health emphasis. The fact that Indonesia subsequently adopted innovative peer counselling strategies in its official approach to adolescent reproductive health issues (Hull *et al.*, forthcoming) shows how the reproductive health emphasis strengthened over time, even in a country whose planners were initially sceptical.

By the time of the Bangkok conference, Asian countries had “internalised”, as it were, the reproductive health emphasis, and were therefore not happy to encounter a strong campaign by the United States delegation, stacked with “right to life” supporters, to strike out language contained in the Cairo Programme of Action, which according to that delegation tended to promote abortion and adolescent sexual activity. Despite strong pressure being placed by the United States on those Asian and Pacific delegations that argued most strongly for the maintenance of the language of the Cairo Programme of Action, and in some cases separately but simultaneously on their Departments

of Foreign Affairs, the Asian and Pacific countries stood firm in supporting the language of the Cairo Programme of Action. The cohesion of such a diverse group of countries in doing so was one of the most striking features of the Conference. Country delegation after country delegation, in statements from the floor, indicated their conviction that the Cairo consensus did not in any way promote abortion or adolescent sexual activity (Jones, 2003, pp. 23-25).

Different conclusions might be drawn from this case. One might be that the role of regional United Nations bodies such as ESCAP can be important in providing a venue for demonstrating the solidarity of member countries, in the face of efforts by countries physically located outside the region to impose their views in matters affecting health in ESCAP member states. By the same token, however, had there been less unanimity among the delegations at the Bangkok conference, it would have been possible for the United States to have a major impact on the final Programme of Action. And its delegation certainly did find it possible to force an inordinate amount of time to be devoted to the issues of abortion and adolescent sexuality at a conference supposedly dealing with much broader issues of population and development.

Culture

Cultural promotion has long been a key activity of ASEAN. Its Committee on Culture and Information (COCI) was set up in 1981, and immediately began organising annual ASEAN Festivals of Performing Arts. The first five of these presented only dance, but in 1986 the festival was split into the ASEAN Theatre Festival and the ASEAN Dance Festival, which alternated annually until the mid-1990s. These festivals were planned by government-appointed representatives, artists were sent as national delegations, and all performances were free. The festivals were not market-driven, but rather driven by the need to present national images regionally (Lindsay, 2003, p. 142).

Film festivals in the region have a different sponsorship and a different dynamic. The annual Singapore Arts and Film Festivals are privately sponsored (the Singapore Film Festival 2003 by Mediacorp, Arts Central and Swisshotel Stamford Singapore; the Singapore Arts Festival 2002 by Nokia, TIME Magazine and MSN Singapore). The Bangkok International Film Festival in 2004 is billed as Asia's premier film festival, where an estimated 150 films from around the world will be screened, and for the first time there will be an award for the Best ASEAN Film. In this case, sponsorship includes government instrumentalities (the Tourism Authority of Thailand, in close co-operation with the Thai Film Federation and Thai Airways International) and serves national

and commercial ends. At the same time, however, by bringing films from other countries of the region to audiences in the country where the festival is held, such film festivals no doubt serve to foster greater intra-regional understanding.

Language emerges as a complex issue in all aspects of the performing arts in the region – though less so for film festivals, where subtitling has long been practised. There are different levels to the problem, particularly the choice between national languages and English and the choice between indigenous regional languages and national languages.

This is an issue both with respect to presenting cultural performances to foreign audiences, and to presenting them in different linguistic regions within the same country. In Indonesia the dance-drama form, the *sendratari*, designed for tourism, was developed without narration or dialogue. The name *sendratari* is an acronym of seni-drama-tari (art-drama-dance). The form was originally developed in 1961 in central Java

with Javanese dance movement and gamelan accompaniment for the presentation episodes of the Ramayana at Prambanan temple The choice of the Ramayana is telling, as this epic is of less interest to the Javanese than the Mahabharata, but is widespread throughout Southeast Asia, and has become an important Asian performance emblem (Lindsay, 2003, pp. 137-138).

Indeed, the choice of the Ramayana was apparently stimulated by the visit of Indonesia's then minister of communications, telecommunications and tourism to Cambodia, where he witnessed such a performance at Angkor Wat.

There is a real conflict between providing rewarding outlets for those writing in local languages, and the need to enhance the ability of cross-cultural audiences to empathise with cultural performances depending on the spoken word, which may favour the use of English or the national language. The solution of promoting cultural performances that do not depend on language at all is clearly only a partial one.

If we turn our attention to news reporting, popular culture and youth culture, there has been considerable interest in promoting Asian-produced television news programmes to compete with the likes of CNN and CNBC Asia. Channel News Asia (CNA), launched in 1999 with a predominantly Singaporean staff, sought to present an Asian perspective in its newscasts, though it had difficulty defining what that Asian perspective was. One element

seemed to be that it would reflect greater insight into the Asian psyche through knowing Asia intimately, and another that it would concentrate less on the negative reporting on crisis and conflict that characterised Western media reporting on Asia. A recent study comparing CNA and CNN, however, found that CNA's news coverage of Asia is just as crisis- and conflict-driven as that of CNN, and concluded that "the reporting of Asian journalists tends to be influenced by the same set of values that dominate the journalism profession elsewhere" (Natarajan and Xiaoming, 2003, p. 312).

The real phenomenon in cross-cultural telecasting is clearly the commercial venture MTV Asia, launched in 1995 as an offshoot of MTV, a unit of the US media giant Viacom. MTV Asia reaches over 124 million households, has an enormous following among young people in the region, and is a pacesetter in taste formation. That it can get away with almost saturation advertising of condoms to young and mainly unmarried Indian or Indonesian audiences (as it did at one point) simply indicates the amount of commercial (and political?) clout it has.

MTV follows both age group segmentation and national market segmentation. Programmes on MTV Classic appeal to an older audience. Recognising the specificities of particular markets in Asia, MTV established MTV Southeast Asia in 1995, MTV India in 1996, and in 2001 and 2002 three new subdivisions – MTV Philippines, MTV Thailand and MTV Indonesia (Santana, 2003). The diet of American pop music with its sexy tracks on MTV is mixed cleverly with local segments, and presenters are also generic westernised Asians (often of mixed Asian-Western parentage) and those with more specifically national characteristics. The enormous following of this TV programming indicates the success of its light-hearted, iconoclastic approach, its "with it" image and its clever mixture of English language and local language segments in presentation. Any attempt by the more staid purveyors of pan-Asian cultural material to capture an audience would do well to be informed by the approach of this unabashedly commercial operation.

MTV has undoubtedly also affected the style of local TV programmes. Since it was not in Indonesia at the time, it can hardly be held responsible for the dramatic fall in ratings of the government channel (TVRI) in Indonesia when it was opened up to competition from commercial channels in the late 1980s. The dreary succession of reports of seminars and folk singing and dancing programmes from Indonesia's regions, as well as the lack of any sharp social or political commentary, had long sealed the fate of this channel should it ever be opened to competition. But the subsequent evolution of programming

by the lively commercial channels may well have been influenced by the success of MTV.

Conclusion

Just as in an ideal democratic system governments regulate and facilitate the dynamic activities of individuals and the groupings – commercial and other – into which they form themselves, so too perhaps in an ideal world international organisations would regulate and facilitate activities carried out by governments and by a range of private sector actors, including the powerful multinationals. As pointed out in this chapter, the role of the private sector is frequently very dynamic – whether it be in the competition by universities for foreign students, getting medicines into the marketplace in remote communities, or the role of private TV networks in purveying particular kinds of youth culture.

The problem is that the dynamism of the private sector can be used for good or ill, as evidenced by what some at least would see as the subversive cultural influence of Western media in the region – and, more malevolently, by the drug trade and human trafficking. Nor do governments always play a benevolent role, as is evident, for example, from the human rights abuses of the military government in Myanmar. But it is harder to reach agreement on the policing and regulating role of international organisations over national governments than it is to decide on the policing and regulating role of the government within a nation. Organisations such as ASEAN have chosen to avoid sharp criticism of the actions of member states in order to preserve the perceived advantage of keeping communication and collaboration links open.

In matters of infectious disease outbreaks, including SARS and bird flu, national governments are prepared to forsake their much-vaunted independence of action in the face of a common threat that can only be effectively tackled by international co-operation and stringent control requirements. The WHO has taken on the role of international regulator and standard-bearer in this context, with the strong support of affected countries.

Where the need is not perceived as urgent, there is less inclination to forsake national sovereignty in the interests of a common good. In the field of education, more could be done in facilitating student exchanges and awarding joint degrees if there were more clear-cut agreements on recognition of courses from other universities, grading systems, and in some cases the submission of

theses in non-English languages. Language issues are also part of the obstacle to more effective co-operation in cultural programmes.

NOTES

1. Singapore and Brunei are not members of UNESCO, Singapore having declined to rejoin when other countries that had left UNESCO in protest in 1984 rejoined.
2. However, presentation still leaves something to be desired. For example, in the Executive Summary of the UNESCO Institute for Statistics and OECD, 2002, Figure 5 shows differences in per-student expenditure by level of education without clarifying – either in the figure or in the text – whether this was only public expenditure or both public and private.
3. For example, education and training is the largest component of the current Indonesia Australia Development Cooperation program (46% of the total programme).
4. A rethinking is in process, as evidenced by the recent decision that school children in the upper secondary grades have to be taught mathematics and science in English as of 2003, and English will be used as the medium of instruction in science-based courses in local public universities in 2005 (Hashim, 2003, p. 97).
5. US NAMRU-2 is the US Naval Medical Research Unit No. 2, an infectious disease research laboratory established in Jakarta in 1970, working in co-operation with and under the auspices of the Indonesian National Institute of Health, Department of Research and Development.
6. To understand why WHO adopted the regional groupings it did requires going back to 1948, when the First World Health Assembly set up a committee to consider the delimitation of the geographical areas to be covered by the organisation. Two of the areas recommended by this committee were “Southeast Asia” and “the Far East”. Countries could choose to join either. The original five members of the Southeast Asian region were Afghanistan, Burma, Ceylon, India and Thailand. Indonesia was placed in the Western Pacific region but in 1950, at its own request, it transferred to the Southeast Asian region. On the other hand, Vietnam, Cambodia and Laos

were originally included in the Southeast Asian region, but later opted to join the Western Pacific region. Given the gradual entrenchment of the current understanding of the geographic extent of Southeast Asia (see Reid, 2003), it seems ludicrous for that appellation to include countries such as India but to exclude countries such as Vietnam and the Philippines.

7. For an analysis of the United States' hegemonic aspirations writ large, see Csapo, 2003.

BIBLIOGRAPHY

- Association of Southeast Asian Nations (2003), *2002-2003 Annual Report*, ASEAN, Jakarta.
- Csapo, Laszlo (2003), “The Beginning of the End of US World Hegemony: European and Asian Perspectives”, Academy of the Social Sciences in Australia, *Dialogue*, 22(3), pp. 33-48.
- DTEC (2002), *Thai International Cooperation Program, 2001 Report*, Department of Technical and Economic Cooperation, Bangkok.
- Hashim, Azirah (2003), “Language Policies and Language Education Issues in Malaysia” in Jennifer Lindsay and Tan Ying Ying (eds.), *Babel or Behemoth: Language Trends in Asia*, Asia Research Institute, National University of Singapore.
- Hull, Terence H., Eddy Hashmi and Ninuk Widyanoro (forthcoming), “‘Peer’ Worker Initiatives for Adolescent Reproductive Health Projects in Indonesia”, *Reproductive Health Matters*.
- Jones, Gavin W. (1999), “The Role of Education in ASEAN Economic Growth: Past and Future” in Wong Tai-Chee and Mohan Singh (eds.), *Development and Challenge: Southeast Asia in the New Millennium*, Times Academic Press, Singapore.
- Jones, Gavin W. (2000), “Global Human Development: The Education Agenda” in Academy of the Social Sciences in Australia, *Facts and Fancies of Human Development*, Occasional Paper Series 1/2000, Canberra, pp. 100-119.
- Jones, Gavin W. (2003), “The Fifth Asian and Pacific Population Conference: Towards a Repositioning of Population in the Global Development Agenda?”, *Asia Pacific Population Journal*, 18(2), pp. 21-32.

- Jones, Gavin W. and Peter Hagul (2001), “Schooling in Indonesia: Crisis-related and Longer-term Issues”, *Bulletin of Indonesian Economic Studies*, 37(2), pp. 207-231.
- Lindsay, Jennifer and Tan Ying Ying, eds. (2003), *Babel or Behemoth: Language Trends in Asia*, Singapore, Asia Research Institute, National University of Singapore.
- McIntosh, Alison and Jason L. Finkle (1995), “The Cairo Conference on Population and Development: A New Paradigm?”, *Population and Development Review*, 21(2), pp. 223-260.
- Natarajan, Kalai and Hao Xiaoming (2003), “An Asian Voice? A Comparative Study of Channel News Asia and CNN”, *Journal of Communication*, June, pp. 300-314.
- Rahayu, Sri Kusumastuti *et al.* (2003), “Special Assistance for Students (BKM): Is It A Suitable Replacement for the JPS Scholarship Program?”, SMERU Research Institute, No. 6, Jakarta.
- Reid, Anthony (2003), “Completing the Circle: Southeast Asian Studies in Southeast Asia”, Asia Research Institute Working Paper Series, No. 12, Singapore.
- Santana, Kenny (2003), “MTV Goes to Asia”, *Yale Global*, 12 August.
- SARS Preparedness and Response Team, World Health Organization, Western Pacific Regional Office (2003), “Severe Acute Respiratory Syndrome (SARS), A Challenge for the Region”, presented at the 54th session of the Regional Committee Meeting for the Western Pacific, 8-12 September.
- Sondakh, Lucky and Gavin W. Jones (2003), “An Economic Survey of Northern Sulawesi: Turning Weaknesses into Strengths under Regional Autonomy”, *Bulletin of Indonesian Economic Studies*, 39(3), pp. 273-302.
- UNESCO Institute for Statistics and OECD (2002), *Financing Education – Investments and Returns: Analysis of the World Education Indicators, 2002 Edition*, UNESCO and OECD.
- World Bank (1995), *Lao PDR Social Development Assessment and Strategy*, World Bank, Washington, DC.

Chapter 8

**Alleviating Environmental Degradation in the Asia Pacific Region:
International Co-operation and the Role of Issue Linkage***

by

Raghendra Jha
Professor and Executive Director
Australia South Asia Research Centre
Research School of Pacific and Asian Studies
Australian National University

I. Introduction

“People are no longer satisfied only with declarations. They demand firm action and concrete results. They expect that the nations of the world, having identified a problem, will have the vitality to act.”
Swedish Prime Minister Olof Palme, whose country hosted the Stockholm Conference, 1972

This call to action by Prime Minister Palme at what was the first major international conference to address global environmental problems has, unfortunately, remained substantially unanswered. Global (and Asia Pacific) negotiations in the time since the Stockholm Conference are yet to result in widely accepted plans for action on redressing environmental degradation. Discussions on such issues have centred on an elusive search for principles to guide the global regime (sustainable development and Agenda 21) rather than on the search for operational mechanisms that actually improve environmental quality through incentive-based mechanisms. Two key elements characterise the present global environmental regime. The first is a set of international principles

* The author is grateful to the John D. and Catherine T. MacArthur Foundation for financially supporting this research.

(somewhat short of a treaty) embodied in Agenda 21 and the Rio Declarations, which emerged from the 1992 Rio Summit. These principles reflect an attempt to build a global environmental regime based on declarations, not operational mechanisms. The second is a series of around 180 largely issue-specific environmental treaties (either global or involving subsets of countries) that cover a range of issues and agents including sharing of research, binding commitments on the use of instruments and emission levels, regional as well as global arrangements and property rights-type agreements, as well as joint reduction agreements as in the Kyoto Protocol.¹ A small number of more recent treaty arrangements (Montreal and Kyoto Protocols) move in the direction of internalisation.

One of the difficulties in articulating a common Asia Pacific position on the desired environmental regime is the large difference between the environmental concerns facing the various countries of the region. Details are provided in Section II. Jha and Whalley (2001) argue that a broad class of difference lies in the distinction between degraders and pollutants/emissions and their relative importance – particularly in the case of developing countries. Much of the literature has the tendency to equate environmental problems in developing countries with pollutants (or emissions). Much of the discussion to now has been influenced by data availability, including those collected by the Global Environmental Monitoring System (GEMS) supported by UNEP.² This focus on pollutants has meant that in much literature there is less emphasis on what others have called degradation defined as uninternalised externalities seen in soil erosion, congestion, open access resource and similar concerns, where physical emissions are less the problem. Jha and Whalley (2001) argue that to discuss environmental problems in developing countries (or to compare them with those in developed countries) without reference to these problems does not suffice. The effects of these degraders are large and pervasive, and their severity and interaction with economic processes often differ sharply from those of pollutants.

The paucity of data about environmental degradation in developing countries means that there are few reliable estimates of the social costs of such degradation. The studies that exist are limited in terms of both methodology and coverage. Even so, in reviewing some of this evidence, Jha and Whalley (2001) indicate that the costs of such degradation are large – perhaps in excess of 10% of GDP on an annual basis in some countries. They find that these costs are dominated by degradation rather than pollutant effects (perhaps three-quarters of the total effect). This factor would need to be taken into account in any environmental co-operation within the Asia Pacific region. If the balance of

costs is skewed more to degradation than to the effects of pollutants, degradation should perhaps receive more attention. The debate should not get overtaken by greenhouse gases or the Kyoto Protocol and international co-operation should help design environmental policy to redress these costs in the developing countries of the region in exchange for support for action on transnational pollution.

Another point is the relationship between economic growth, policy reform and environmental quality, and comparisons of the environmental situation either across economies or through time in light of our characterisation of the developing country environmental regime. To the extent recent literature focuses on differences in outcomes across countries or over time in terms of levels of various environmental indicators, the issue is whether degradation effects deliver a different picture. Jha and Whalley (2001) show that degradation impacts could well behave differently from pollutants. Soil erosion problems, for instance, seem to progressively recede as per capita income rises, since the population in agriculture falls and plot sizes rise; meanwhile, outward-oriented trade policies draw labour into urban areas from rural areas, adding to congestion in urban areas but reducing the pressure on agricultural land. Thus, whereas higher economic growth pursued through greater industrialisation could lead to higher emissions, the reduction in population pressure on agriculture would reduce degradation. This has implications for the validity of the environmental Kuznets curve (EKC)³. While authors contributing to this literature are clear in labelling their EKC analyses to be primarily of pollutant levels, users of this research naturally tend to think of the results as providing guidance on the wider environmental situation in the countries discussed. Without explicit reference to degradation effects, the picture can be incomplete. This has no doubt influenced the perception of the EKC as indicating that further economic growth in developing countries would lead to increases in emissions whereas further growth in developed countries would only help alleviate emissions and, therefore, influence the perceived terms of co-operation between developed and developing countries in environmental management. However, as Jha and Murthy (2003) demonstrate, once the set of pollutants is expanded to include degradation, the shape of the EKC undergoes considerable change and it is no longer possible to argue that continued economic growth by the developing countries would hurt the environment whereas continued economic growth in developed countries would alleviate environmental degradation. Hence, the terms of co-operation should go beyond conceiving of environmental disaster scenarios associated with the anticipated sustained rapid economic growth of the major economies in the region — including China and India.

Clearly the impetus for international co-operation would come from assessments of potential gain. From the point of view of the developing countries of the region, welfare gains from moving to full internalisation would seem to be the more appropriate comparative measure of severity of environmental problems across countries (or changes through time). If the costs are as high as those reported in Jha and Whalley (2001), then it would follow that internalisation gains relative to GDP are significant for developing countries (and probably larger than for developed countries). This raises the issue of why a higher degree of internalisation has not occurred. With an appropriate evaluation of benefits, developing countries would place high value on such internalisation and on mechanisms that would help them attain it. A first prerequisite for successful international environmental co-operation in the Asia Pacific is an internalisation mechanism for environmental externalities within developing countries.

This chapter emphasises the basis for environmental co-operation in the Asia Pacific region and identifies issue-linkage as an important characteristic of this process. Progress on international or trans-boundary environmental problems – in which at present the developed countries of the region have the most stake – would be facilitated by linkage with progress on issues in which developing countries have a more immediate stake. Local degradation effects have already been mentioned. It is argued in this chapter that welfare effects can be enhanced by expanding the list of potential issues for linkage with international environmental negotiation. Section II provides a brief overview of the state of the environment in the Asia Pacific region, underscoring the importance of the distinction between emissions and degradation. Section III assesses human vulnerability to existing environmental conditions in the Asia Pacific. Section IV emphasises the importance of designing mechanisms for internalising external effects – both within countries and trans-nationally – and assessing the impediments to such internalisation. Section V advances some suggestions for furthering such internalisation, and Section VI concludes.

II. The state of the environment in the Asia Pacific Region

The UNEP's views on key environmental issues confronting the Asia Pacific region are summarised in Table 1. Table 2 details the geographical distribution of environmental issues and their causes for South Asia, Southeast Asia, South Pacific region and North East Asia.

Table 1. **Key environmental issues confronting the Asia Pacific**

Land	Land degradation Desertification Land use change
Forests	Forest degradation Deforestation
Biodiversity	Habitat loss Forest loss and degradation Alien species
Freshwater	Water scarcity Pollution
Coastal and Marine	Degradation of coastal and marine resources Pollution due to mining and coastal development
Atmosphere	Air quality Ozone depletion Greenhouse gas emissions and climate change
Urban areas	Air pollution Waste management Water supply and sanitation
Disasters	Floods Droughts Volcanoes Earthquakes

Source: UNEP, *Global Environmental Outlook*, 2003, London and Sterling, VA, United States.

Table 2a. **Key environmental issues and causes in South Asia**

<i>Country</i>	<i>Key issues</i>	<i>Key causes</i>
Afghanistan	Soil degradation; overgrazing; deforestation desertification; loss of biodiversity; food security risks; natural disasters such as earthquakes and droughts.	Population growth; increased demand for bio-fuels, building materials, and agricultural lands.
Bangladesh	Marginalised populations forced to live on and cultivate flood-prone land; loss of biodiversity; limited access to deficits in urban drinkable water; water-borne disease prevention; water pollution, especially of fishing areas; marine-based arsenic pollution of drinking water; urban air pollution; soil degradation and run-off; deforestation; severe overpopulation: natural disasters (especially floods and cyclones which kill thousands of people and cause heavy economic losses every year); food security risks; industrial pollution; import of hazardous waste.	High population density and primacy of private transport in urban areas; urbanisation and infrastructure (including one of the world's 30 largest cities, Dhaka); increases in unmanaged tourism; green revolution/agrochemicals; high demand for bio-fuels; lack of effluent controls; over-exploitation and/or pollution on industrial groundwater.
Bhutan	Soil erosion; limited access to drinkable water.	High rates of urbanisation.
India	Deforestation; soil erosion; overgrazing; desertification loss of biodiversity; air pollution; water pollution; huge population base and large growth rate is overstraining natural resources; natural disasters such as floods, cyclones and landslides are common; high death rates and ailments associated with indoor air pollution.	High rates of urbanisation and deficits in urban infrastructure (including in four of world's 30 largest cities); reliance on private transport and vehicle emissions; increases in industrial effluents; marine-based tourism; green revolution/ agrochemicals and run-off; reliance on bio-fuels.

Iran	Air pollution, especially in urban areas; deforestation; overgrazing; desertification; oil pollution in the Persian Gulf; inadequate supplies of potable water; food security risks; natural disasters such as floods, earthquakes, and landslides are common.	Excessive pressure on forests and rangelands; high rates of urbanisation and deficits in urban infrastructure (including one of world's 30 largest cities, Tehran); inefficient public and private transport; vehicle emissions, refinery operations, and industrial effluents.
Maldives	Climate change; beach erosion; depletion of freshwater aquifers; degradation of marine habitats.	High population densities; increases in marine-based tourism; sea level rise.
Nepal	Deforestation; soil erosion and degradation; loss of transport; biodiversity; water pollution; natural disasters such as floods and landslides in rural areas; food security risks.	High rates of urbanisation; reliance on private transport; increased demands for timber; increased population density and cultivation of marginal lands.
Pakistan	Water pollution; seasonal limitations on the availability of natural freshwater resources; majority of the population lacks access to potable water; deforestation soil erosion; coastal habitat loss and degradation of marine environment; desertification; loss of biodiversity; natural disasters, mainly due to floods.	High rates of urbanisation and deficits in urban infrastructure; industrial wastes; population increases in coastal areas and rise in tourism; depletion of mangroves for aquaculture; over-fishing; increased demands for timber/bio-fuels; hunting/poaching; green revolution/ agrochemicals and runoff.
Sri Lanka	Deforestation; soil erosion; pollution by municipal and domestic waste; loss of biodiversity; coastal degradation; limited access to potable water; water-borne diseases prevalent.	Excessive pressure on forests; increases in marine-based tourism; poaching; sea level rise; deficits in urban infrastructure; water pollution by municipal and industrial waste, and agricultural run-off; extensive mining activity.

Source: UNESCAP and ADB, 2000.

Table 2b. **Key environmental issues and causes in Southeast Asia**

<i>Country</i>	<i>Key issues</i>	<i>Key causes</i>
Brunei Danussalam	Seasonal smoke and haze.	Trans-boundary pollution from forest fires in neighbouring countries.
Cambodia	Soil erosion; sedimentation; water pollution, deforestation; loss of biodiversity – threat to natural fisheries.	Unmanaged waste and effluent discharge into Tonlesap Lake; destruction of mangrove swamplands.
Indonesia	Deforestation; loss of biodiversity; water pollution; air pollution in urban areas; national and trans-boundary seasonal smoke and haze; land degradation; pollution of Malacca Strait.	Deficiencies in urban infrastructure – unmanaged industrial wastes and municipal effluents and waste; vehicular congestion and emissions; extensive land clearance and forest fires for pulp wood and oil palm production; extensive and unmanaged mining activities; national and trans-boundary industrial pollution (from Singapore and Malaysia), tourist developments in coastal regions beyond existing carrying capacity.
Lao PDR	Deforestation; loss of biodiversity; soil erosion; limited access to drinkable water; water-borne diseases prevalent.	Land clearance; shifting cultivation; inadequate water supply and sanitation infrastructure.
Malaysia	Urban air pollution; water pollution; deforestation; loss of biodiversity; loss of mangrove habitats; national and trans-boundary smoke/haze.	Vehicular congestion and emission; deficiencies in urban infrastructure – industrial and municipal effluents; extensive land clearance and forest fires for pulp wood and oil palm production; unmanaged coastal developments; tourist developments in coastal regions beyond existing carrying capacity.

Myanmar	Deforestation; loss of biodiversity; urban air pollution; soil erosion; water contamination and water-borne diseases prevalent.	Land clearance; excessive mineral extraction; vehicular congestion and emissions, deficiencies in urban infrastructure – unmanaged industrial and municipal effluents.
Philippines	Deforestation in watershed areas; loss of biodiversity; soil erosion; air and water pollution in Manila leading to water-borne disease; pollution of coastal mangrove habitats; natural disasters such as earthquakes and floods.	Illegal forest cutting; land clearance; rapid urbanisation and deficiencies in urban infrastructure – unmanaged industrial and municipal effluents; inadequate water supply and sanitation; tourist developments in coastal regions beyond existing carrying capacity.
Singapore	Industrial pollution; limited natural freshwater resources; waste disposal problems.	Seasonal smoke/haze; limited land availability for waste disposal.
Thailand	Deforestation; loss of biodiversity; land degradation and soil erosion; shortage of water resources in dry season and flooding in rainy season; conflict of water users; coastal degradation and loss of mangrove habitat; urban air pollution; pollution from solid waste, hazardous materials and hazardous waste.	Non-strategic and sporadic development and destruction of critical watersheds; unmanaged aquaculture developments; growth in tourist industries exceeding growth in tourism-carrying capacity, deficiencies in urban and rural infrastructure, particularly central draining – freshwater resources being polluted by domestic and industrial wastes and sewage runoff.
Vietnam	Deforestation and soil degradation; loss of biodiversity; loss of mangrove habitat; water pollution and threats to marine life; groundwater contamination; limited drinkable water supply; natural disasters such as floods.	Land clearance for industrial zones; extensive aquaculture and over-fishing; growing urbanisation and infrastructure deficiencies – inadequate water supply and sanitation, particularly in major cities of Hanoi and Ho Chi Minh.

Source: UNESCAP and ADB, 2000.

Table 2c. **Key environmental issues and causes in the South Pacific Region**

<i>Country</i>	<i>Key issues</i>	<i>Key causes</i>
Australia and New Zealand	Soil erosion; soil salinity; degradation of inland and marine waters; depletion of wetlands; desertification; depletion of fisheries; loss of biodiversity.	Overgrazing; poor farming practices; land clearance and deforestation; invasion of exotic species; over-fishing; overdevelopment of the coastal zone; shipping pollution.
Melanesian Countries (Papua New Guinea, Solomon Islands, New Caledonia, Vanuatu and Fiji)	Deforestation; land degradation/soil erosion; loss of biodiversity; water degradation and limited access to potable water; local depletion of coastal fisheries.	Commercial logging; land clearance; mining; climate change; population growth and deficiencies in urban and rural infrastructure; over-fishing.
Mid-sized open islands of Polynesia and Micronesia (Tonga, Samoa, American Samoa, French Polynesia, Palau, Guam and the Northern Mariana Islands)	Deforestation; soil erosion; loss of biodiversity; local depletion of coastal fisheries; degradation of inland and marine waters.	Expansion of commercial agriculture and agro pollution of run-off; population growth and expansion into marginal lands; indiscriminate collection of coral and shells; invasion of exotic species; over-fishing; hunting, particularly of native sea turtles.
Small island micro-states (Cook Islands, Kiribati, Tuvalu, Federated States of Micronesia, Marshall Islands, Niue, and Nauru)	Vulnerability to natural disasters; water degradation and limited access to potable water; coastal erosion.	Climate change; groundwater salinisation deficiencies in urban and rural infrastructure.

Source: UNESCAP and ADB, 2000.

Table 2d. Key environmental issues and causes in Northeast Asia

<i>Country</i>	<i>Key issues</i>	<i>Key causes</i>
PR China	Acidification of inland waterways and acid deposition; degradation of water supply; loss of agricultural land; loss of biodiversity; vulnerability to natural disaster, especially drought and flooding.	Over-reliance on low-grade coal; inadequate infrastructure for the management of municipal effluent; deforestation and soil erosion; poverty.
Japan	Excess volumes of industrial and municipal waste; pollution from dioxins, endocrine disrupters and other industrial hazards; increasing greenhouse gas emissions; vehicle emissions; loss of biological diversity.	Unsustainable consumption patterns; lack of emission control in waste incineration and industrial processes (national and trans-boundary); increasing vehicle ownership; habitat destruction due to development projects and invasion of alien species.
Russian Federation	Air pollution in hot spots and major cities; pollution of inland and marine waters; deforestation; loss of biodiversity; soil erosion and contamination; radioactivity.	Inefficient heavy industry and reliance on coal for power generation; deficiencies in urban infrastructure – unmanaged industrial wastes and municipal effluents and waste; urban congestion and inefficient vehicles; unsustainable agricultural practices and excessive chemical application; historical sites of nuclear weapons testing.
Rep. of Korea	Limited access to potable water; urban air pollution; environmental contamination; acidification of inland waterways and acid deposition.	High levels of uncontrolled atmospheric releases from industry; release of dioxins; endocrine disrupters and other industrial hazards; trans-boundary air pollution from neighbouring countries.
North Korea	Localised air pollution; water pollution and limited access to potable supplies; vulnerability to natural disasters, especially drought and flooding.	High levels of uncontrolled atmospheric releases from industry; deficiencies in urban infrastructure – industrial and municipal effluents; poverty.
Mongolia	Localised air pollution; soil erosion and desertification; loss of biodiversity; water pollution and limited access to potable supplies.	Overgrazing; deforestation; reliance on low-grade coal; promotion of rapid urbanisation.

Source: Compiled from WRI, 1996.

Table 3 distils the information in Table 2 for Asian developing countries and restructures it to underscore the need to make the distinction between degradation and emission/pollution in their context.

Table 3. A pollutant/degradation classification scheme for environmental externalities in Asian developing countries

1. Pollutants	
Toxic contaminants -	Organo-chlorines, dioxins, pesticides, grease and oil, acid and caustic metals; mainly discharges from mines, chemical producers, pulp and paper plants, and leather tanning factories
Untreated fluid waste -	Untreated sewage discharges into rivers, streams, open ditches – water-borne disease
Domestic solid waste -	Poorly managed solid waste spreads infectious disease, blocks urban drainage channels, with risk of flooding and water-borne disease
Smoke and burning -	Health-related effects (respiratory damage, heart and lung disease, cancer) from burning dung, wood, and crop residues; vehicle exhaust; coal burning; smoke
2. Degradation	
Soil erosion -	Sedimentary transfer of topsoil to neighbouring plots, river estuaries, hydro dams – silting, accompanied by leaching of soil
Soil quality -	Pesticide residue's impact on production of neighbouring plots
Open access resources -	Overexploitation of resources due to ill-defined property rights – firewood/forests; fisheries; shared aquifers and water tables
Congestion/traffic -	Time loss and elevated accident risk from poorly regulated traffic; lowered air quality in urban areas

Source: Jha and Whalley, 2001.

The chapter now briefly addresses specific environmental problems in the Asia Pacific region.

Land degradation

Land degradation problems of particular concern in Asia and the Pacific include erosion, compaction, acidification, declining soil and organic matter,

weed infestation, soil fertility depletion and biological degradation. Oldeman (1994) estimates that about 13% (or 85 million ha) of the land in Asia and the Pacific is degraded. Most of this is in Asia but it is estimated that 104 million ha were degraded in the Pacific sub-region, where large-scale clearance of forestland has caused a decline in soil structure and fertility and where invasive species are the predominant land cover on many islands. The most severe water erosion occurs in the Himalayas, Central Asia, China, the South Pacific and Australia; wind erosion affects Afghanistan, India, Iran and Pakistan most severely.

Chemical soil degradation is mainly caused by agricultural mismanagement. In parts of northern India and Bangladesh, soils have acidified and salinised, and have been losing nutrients. Large tracts of land in Cambodia, Malaysia, Thailand and Vietnam have been degraded by acid sulphates. Poor soil nutrient balances (between phosphorus, nitrogen and potassium) are common in Australia, Bangladesh, Nepal, Pakistan and Sri Lanka.

Saline soils cover 60 million ha of agricultural land in the region, and Australia in particular is facing severe land salinisation problems. Excessive extraction from groundwater and surface water resources and rising water tables brought about by faulty irrigation systems have increased the occurrence of surface water and soil salinity. Serious soil contamination affects the northern part of the region, Australia and New Zealand. The contaminants include cadmium (contained in fertiliser), hexavalent chromium, lead, arsenic, trichloroethylene, tetrachloroethylene and dioxine concentrates. Health issues from these contaminants are common. The major soil polluters in the region are now the chemical and electroplating industries in Japan and South Korea. Heavy metals are also present in agricultural land (as a result of fertiliser application) and near mines and refineries (due to chemical discharges). Soil contamination from lead and arsenic contamination is prevalent throughout South and Southeast Asia. Irrigation with untreated effluent has also caused contamination and soil acidification in many areas; in Mongolia, for instance, waste disposal and wastewater discharges are the principal causes of soil contamination (UNDP, 2000).

In addition, the stress on soil for cultivation is quite severe in South and Southeast Asia. Another major factor contributing toward land degradation in the Asia Pacific region is the extent of land utilisation (Table 4).

Table 4. Land Utilisation in 2000: Asia and the Pacific
Percentage of total land area

<i>Region</i>	<i>Area under crops</i>	<i>Area under pasture</i>	<i>Total</i>
Australia and New Zealand	6.5	52.7	59.2
Central Asia	10.0	63.2	73.2
Northwest Pacific and East Asia	12.7	45.1	57.8
South Asia	36.3	14.5	50.8
Southeast Asia	20.5	3.9	24.4
South Pacific	2.6	1.1	3.7

Source: UNEP, *Global Environmental Outlook*, 2003, London and Sterling, VA, United States.

The densely populated region of South Asia uses more than one-third of its total land for cultivation. Reasons for land problems include underpricing of resources, and subsidisation of agricultural inputs such as fertilisers have played a part in maintaining pressure on land. A major policy failure leading to land degradation is insecure land tenure, although in some cases fragmentation of holdings has increased to such an extent that there is overexploitation of land holdings.

A related problem is that of desertification. Of the 1 977 million ha of drylands in Asia, more than half are affected by desertification (UNCCD, 1998).

Forests

Land degradation problems are directly related to land-use practices, particularly agricultural expansion and intensification. In Thailand, for example, forest cover has declined from 56% to 24% of total area between 1965 and 1997. In Japan, arable land has been converted to residential use.

Asia and the Pacific region accounts for 18.8% of the global forests. Within the region, the Northwest Pacific and East Asia has the largest forest area (29.3%) followed by Southeast Asia (29.1%), Australia and New Zealand (22.3%), South Asia (11.7%), South Pacific (4.8%) and Central Asia (2.7%). Changes in forest areas between 1990 and 2000 are noted in Table 5.

**Table 5. Change in forested land 1990-2000 by sub-region:
Asia and the Pacific**

	<i>Total land area (million ha)</i>	<i>Total forest 1990 (million ha)</i>	<i>Total forest 2000 (million ha)</i>	<i>% of land forested in 2000</i>	<i>Change 1990-2000 (million ha)</i>	<i>% change per year</i>
Australia and New Zealand	795.0	164.9	162.5	20.4	-2.4	-0.1
Central Asia	391.6	16.6	19.3	4.9	2.7	1.6
Northwest Pacific and East Asia	1 147.8	195.2	212.7	18.5	17.4	0.9
South Asia	640.3	86.3	85.3	13.3	-1.0	-0.1
Southeast Asia	434.5	234.7	211.4	48.7	-23.3	-1.0
South Pacific	53.9	36.4	35.1	65.2	-1.2	-0.4
Total Asia and the Pacific	3 463.2	734.0	726.3	21.0	-7.7	-0.1

Source: UNEP, *Global Environmental Outlook*, 2003, London and Sterling, VA, US.

Deforestation and degradation are critical issues. They threaten biodiversity, ecosystem stability and the long-term availability of forest products as well as depleting the natural resource base underpinning many national economies (UNESCAP and ADB, 2000). Population pressure, heavy dependence on fuel wood, timber and other products, as well as the conversion of forests to agricultural, urban and industrial land are the underlying factors for deforestation in the region. Lack of properly defined property rights have led to overgrazing and shifting cultivation. In addition, as forests have become degraded, so fire, pests, disease and natural disasters have caused greater damage.

More than 40% (and the highest diversity) of the world's mangroves grow along the coasts of South and Southeast Asia. A further 10% grow in the Pacific. More than 60% (some 11 million ha) of Asia's mangroves have already been converted to aquaculture and more have been cleared to make way for rice

farming or urban and industrial land use. Those that remain are exploited for timber, fuel wood, tannin and food items (UNESCAP and ADB, 2000). The depletion of forests for fuel wood is common in South Asia. Fires are a major cause in Southeast Asia, as is commercial logging. In the Pacific islands commercial logging is also a problem.

Species diversity in the region is extremely high. Indonesia is thought to support more species, with more endemic species, than any other country in the world, closely followed by several others including Australia and China. Deforestation is adding to loss of biodiversity. Major river systems are drying, groundwater is increasingly overexploited and pollution is a major concern (Fuggle and Smith, 2000); as a result, biodiversity impacts are likely to be substantial. Analysis of the World Commission on Dams (WCD, 2000) has shown that the environmental, hydrological and economic arguments used to support dam construction are often flawed. Table 6 presents an overview of the threat to biodiversity in the Asia Pacific region and Table 7 the extent of protection given to biodiversity locations.

Table 6. Number of threatened vertebrates: Asia and the Pacific

	<i>Mammals</i>	<i>Birds</i>	<i>Reptiles</i>	<i>Amphibians</i>	<i>Fishes</i>
Critically endangered ^a	68	60	13	15	48
Endangered ^b	167	95	27	22	46
Vulnerable ^c	291	368	66	30	153

Notes: a: Critically endangered is defined as subject to an extremely high risk of extinction in immediate future.

b: Endangered is defined as subject to a very high risk of extinction in immediate future.

c: Vulnerable is defined as high risk of extinction in medium term.

Does not include marine species recorded by ocean area.

Source: UNEP, *Global Environmental Outlook*, 2003, London and Sterling, VA, United States.

Table 7. **Protected areas**

Australia and New Zealand	108.42 million ha	13.64%	3 231 sites
Northwest Pacific and East Asia	89.78 million ha	7.79%	1 041 sites
Southeast Asia	48.69 million ha	11.20%	1 506 sites
South Asia	28.41 million ha	4.44%	675 sites
Central Asia	10.45 million ha	2.69%	195 sites
South Pacific	1.25 million ha	2.31%	141 sites

Source: UNEP, *Global Environmental Outlook*, 2003, London and Sterling, VA, United States.

Freshwater

The Asia Pacific region accounts for about 36% of the global run-off. Even so, water scarcity and pollution are key issues and the region has the lowest per capita availability of freshwater: renewable water resources amounted to about 3690m³ per capita/year in mid-1999 for the 30 largest countries in the region (WRI, 2000). In absolute terms, China, India and Indonesia have the largest water resources, more than one-half of the region's total. However, several countries including Bangladesh, India, Pakistan and Korea already suffer from water scarcity or water stress. More will do so as populations and consumption increase. Agriculture is the biggest consumer (86%), with smaller amounts going to industry (8%) and domestic use (6%) (UNDP, 2000).

Over the years, water pollution has emerged as a major issue. Pollutants include pathogens, organic matter, nutrients, heavy metals and toxic chemicals, sediments and suspended solids, silt and salts. South Asia – particularly India – and Southeast Asia are facing severe water pollution problems. Rivers such as the Yellow River (China), the Ganga (India) and Amu Darya and Syr Darya (Central Asia) top the list of the world's most polluted rivers (World Commission on Water, 1999). In cities in the developing countries of the region, most water bodies are now heavily polluted with domestic sewage, industrial effluents, chemicals and solid waste.

Water pollution has affected human health. In the Pacific Islands, especially in some atoll communities, use of polluted groundwater for drinking and cooking has led to health problems such as diarrhoea, hepatitis, and occasional breaks of typhoid and cholera. Groundwater in districts of West Bengal, India, and in some villages of Bangladesh, for example, is contaminated with arsenic at levels as much as 70 times higher than the national drinking water standard of 0.05 mg/litre. According to one report, “With the majority of the country’s 68 000 villages potentially at risk, UN scientists estimate that the arsenic may soon be killing 20 000 Bangladeshis a year” (Pierce, 2001).

Inadequate water supply and poor sanitation cause more than 500 000 infant deaths a year as well as a huge burden of illness and disability in the region (UNEP, 1999). Some 8-9% of the total Disability Adjusted Life Years (DALYs) are due to diseases related to inadequate water supply and poor sanitation in India and other countries (World Bank, 2000). Cholera is prevalent in many countries, particularly those where sanitation facilities are poor such as Afghanistan, China and India (WHO and UNICEF, 2000).

Of the global population without access to improved sanitation or water supply, most live in Asia (WHO and UNICEF, 2000). In the Southwest Pacific, water supply and sanitation appear to be quite good, with 93% of the population having access to improved sanitation and 88% to improved water supply. However, these figures are probably biased upwards because of the inclusion of Australia and New Zealand. Only an estimated 48% of the Asian population has sanitation coverage (WHO and UNICEF, 2000) — less than in any other region of the world. The situation is worse in rural areas, where only 31% of the population have improved sanitation, compared to 79% for the urban areas.

Coastal and marine area pollution

In the past 30 years, depletion of coastal resources such as fisheries, mangroves and coral reefs has emerged as a critical issue in Asia and the Pacific. Urbanisation, industrialisation and tourism are the major reasons for this. It is estimated that more than 60% of Asia’s mangroves have already been converted to aquaculture farms (UNESCAP and ADB, 2000). Besides encroaching on mangroves, aquaculture has led to the release of nutrients, pathogens and potentially hazardous chemicals into marine waters. In India, prawn farms have been constructed in low-lying coastal areas, depriving farmers of agricultural land, causing salinisation of groundwater in coastal villages and polluting waterways with excess nutrients. Overexploitation of fish stocks and poor aquaculture practices are of concern in Bangladesh (UNEP,

2001), India (ADB, 2000), Pakistan, Sri Lanka, many Pacific Island countries and some other countries.

Coral reefs are under stress in many areas, especially those near shallow shelves and dense populations. More than half the world's coral reefs are located in the Pacific Island countries, and large areas are already degraded. The causes range from global, large-scale changes in the ocean environment and global warming to tourism and recreation, high population density and economic development in coastal areas in the past 15 years. Most coral reefs in South Asia were adversely affected by coral bleaching in mid-1998. Increasing water temperatures and increased levels of dissolved carbon dioxide in seawater have resulted in the widespread death of stony corals throughout the tropics (Wilkinson, 2000).

Pollution has considerably degraded the coastal and marine environment, including estuaries of the region, over the past 30 years. Increased wastes from land-based urban, industrial and agricultural activities as well as from offshore oil and gas exploitation are discharged untreated in the coastal region. The most significant sources of pollution include oil from ships, sewage and other domestic waste, and industrial effluents. The shipping of oil coupled with increased emphasis on offshore oil exploration makes the northern Indian Ocean vulnerable to oil pollution. The enhanced use of agrochemicals on land and discharge of chemicals into seawater is a common problem. An estimated 1 800 tonnes of pesticides enter the Bay of Bengal every year (Holmgren, 1994). The Sea of Japan has highly untreated or partially treated sewage, operational leaks, discharge of hydrocarbons and waste dumping, and the Soviet Union dumped nuclear waste for decades. Tourism is another contributory factor. Sediment load in the coastal zone of South Asia is high, mainly as a result of soil erosion caused by poor land-use practices and construction activities. Annually about 1.6 billion tonnes of sediment reach the Indian Ocean from rivers flowing through the Indian subcontinent. Coastal erosion is severe in many areas including the Andaman Coast, the Gulf of Thailand, Japan and the Pacific Islands.

Atmosphere

Air pollution levels in the most populated cities in Asia are among the highest in the world, producing serious human health impacts and affecting aquatic and terrestrial ecosystems. Transport is often a very significant contributor. The other sources include industrial emissions, burning of solid and liquid fuels for power generation, and burning of biomass and other fuels such

as charcoal for household use. Although the number of cars per capita is relatively low in the Asian developing countries, the total size of the motorised fleet has been growing sharply. During 1975-92 the number of motorised vehicles in Sri Lanka doubled, whereas in India the number of cars has been doubling every seven years for the past 30 (ADB, 2000). Indoor air pollution is often a more severe health hazard than outdoor air pollution. Most rural inhabitants in the region use twigs, grass, dried animal dung, crop residues, wood charcoal and kerosene as household fuels. Coupled with inadequate ventilation, this results in highly contaminated indoor air. Health effects include acute respiratory infection in children, chronic obstructive lung disease, adverse pregnancy outcomes and lung cancer in women. Acute respiratory diseases are prevalent in the rural and/or hilly areas of Afghanistan, Bangladesh, Bhutan, India, Nepal, Pakistan and Sri Lanka where indoor air pollution is high.

Two particular forms of air pollution – the Asian (atmospheric) brown cloud and the ozone layer – are briefly discussed below.

The Asian brown cloud

In Spring 1999 scientists working on the Indian Ocean Experiment project (INDOEX) discovered a dense brownish pollution haze layer covering most of South and Southeast Asia and the tropical region of the Indian Ocean. The researchers tracked the haze over an area of about 10 million km², and believe it forms over much of the Asian continent. The haze is a mixture of pollutants, mainly soot, sulphates, nitrates, organic particles, fly ash and mineral dust, formed by fossil fuel consumption and rural biomass burning. It reduces the sunlight reaching the tropical Indian Ocean by as much as 10%, with a larger reduction over the Indian subcontinent. Simulations with global climate models indicate that the haze could have major impacts on the monsoon circulation, regional rainfall patterns and the vertical temperature profile of the atmosphere (UNEP, 2001). UNEP (2001) and Nakicenovic and Swart (2000) document that the anthropogenic aerosols released in the time of the atmospheric brown cloud are projected to become the dominant component of anthropogenic aerosols worldwide in the next 25 years.

Haze problems are also prevalent in the region due to forest fires in Southeast Asia. The most serious episode occurred in 1997, when the effects of forest fires in Indonesia extended to neighbouring countries including Brunei Darussalam, Papua New Guinea, the Philippines, Singapore and Thailand.

Ozone depletion

Data from Australia and New Zealand show that ultraviolet levels there appear to be rising by about 10% per decade. India and China are the largest regional producers and users of CFCs. The Multilateral Fund of the Montreal Protocol and GEF have been helping the region meet the goals of the Montreal Protocol.

Per capita use of commercial energy increased annually by 1.9% in South Asia and 3% in East Asia and the Pacific during 1980-98 (World Bank, 2001). CO₂ is the main anthropogenic greenhouse gas. Methane emissions are also high in South Asia, accounting for almost 50% of the global anthropogenic emission of CH₄. Areas under most threat from climate change include marine ecosystems, coastal systems, human settlements and infrastructure (IPCC, 1998). Countries in the Northwest Pacific and East Asia sub-regions and the Pacific Island countries may be particularly vulnerable to phenomena such as sea level rise because many of their human settlements and industrial facilities are located in coastal or low-lying areas.

Urban areas

Air pollution is common – particularly in developing country cities. In countries such as India, Indonesia, Nepal, Malaysia and Thailand, vehicles with two-stroke engines, such as motorcycles and three-wheel taxis, comprise more than half of all motor traffic and pollute heavily. Poor maintenance of vehicles, poor fuel quality and poor road conditions also contribute. The burning of biomass such as firewood and agricultural wastes is a further source of air pollution in many poor areas.

In Australia and New Zealand there is a high dependence on private motor vehicles which leads not only to the need to clear land for roads but also to increasing emissions of carbon dioxide, lead, zinc and copper.

Much of the solid waste generated in urban centres remains uncollected and is either deposited in surface waters and empty lots or burned in streets. This problem has worsened considerably in the past 30 years.

Serious health and environmental problems can be caused by poor waste disposal. In the Pacific Islands freshwater is scarce, and solid waste disposal methods that contaminate water are frequently a source of intestinal diseases

and ear and eye infection. In India an outbreak of the bubonic plague in 1994 was the result of inadequate solid waste disposal.

For most cities, providing an adequate and safe supply of water for domestic and industrial uses is a major problem. The sewage system in many major cities still cannot support a high-density urban environment, with the result that sewage is often discharged directly to drains or waterways or disposed of in individual septic tanks that are poorly maintained.

Sanitation services are less developed than water supply; 23% of urban residents still lack adequate sanitation, according to a sample of 38 Asia Pacific countries for the year 2000. Another major urban environmental problem is flooding and land subsidence. Bangkok, Mumbai and Calcutta are all prone to flooding in the monsoon season.

Disasters

About 75% of the world's major natural catastrophes between 1970 and 1997 occurred in the Asia and Pacific region, mostly in poverty-ridden developing countries (UNESCAP and ADB, 2000).

The highest number of deaths occurred in South Asia (the sub-region with the highest population density and the lowest per capita income) and the lowest number in Australia and New Zealand (the sub-region with the lowest population density and the highest per capita income).

TABLE 8. ASIA PACIFIC DISASTERS IN 1972-2000

	<i>Number killed (thousands)</i>	<i>Number affected (thousands)</i>	<i>Damage (USD 1 000)</i>
South Asia	761	2 164 034	60,881
Southeast Asia	73	284 074	33,570
Northwest Pacific and East Asia	606	1 447 643	317,174
Central Asia	3	4 895	986
Australia and New Zealand	1	15 761	21,900
South Pacific	4	4 061	3 139
Total	1,447	3 920 467	437 649

N.B.: Central Asia figures relate to 1992-93 to 2000.

Source: UNEP, *Global Environmental Outlook*, 2003, London and Sterling, VA, United States.

Environmental degradation and change are becoming increasingly important in relation to both the occurrence and impact of natural disasters. Deforestation, for example, is now frequently linked to severe flood events and landslides. Overexploitation of water resources has already resulted in sub-regional environmental disasters such as the drying up of the Aral Sea in Central Asia.

Rapid population growth, urbanisation and weak land-use planning are some of the reasons why poor people move to fragile and high-risk areas that are more exposed to natural disasters. Moreover, the rapid growth of industries in urban areas has induced rural-urban migration.

III. Human vulnerability to environmental problems

The existing literature has emphasised increasing human vulnerability to environmental problems. McMichael (2001) documents the increasing dependence of human health on the environment. According to WHO (1997):

- a) Deteriorating environmental conditions are a major contributory factor to poor health and poor quality of life. Mismanagement of natural

resources, excessive waste production and associated environmental conditions that affect health pose major challenges to sustainable development.

- b) Impoverished populations living in rural and peri-urban areas are at greatest risk from degraded environmental conditions. The cumulative effects of inadequate and hazardous shelter, overcrowding, lack of water supply and sanitation, unsafe food, air and water pollution and high accident rates, as well as greater susceptibility to disasters, have serious effects on the health of these vulnerable groups. Poor environmental quality is directly responsible for some 25% of all preventable ill health, with diarrhoeal diseases and acute respiratory infections heading the list.
- c) Two-thirds of all preventable ill health due to environmental conditions occurs among children.
- d) Air pollution is a major contributor to a number of diseases, and to a lowering of the quality of life in general.

Overall it is estimated that 25-33% of the global burden of disease is attributable to environmental factors (Smith, Corvalan and Kjellstrom, 1999). Murray and Lopez (1996) estimate that environment-related premature death and illness account for 18% of the total burden of diseases in the developing world. This comprises contributions from water supply and sanitation (7%), indoor air pollution (4%), vector-borne diseases (3%), urban air pollution (2%) and agro-industrial waste (1%). WHO (2002) estimates that every year environmental hazards kill three million children under the age of five. Of these, 40-60% are due to acute respiratory infection resulting from environmental factors. Microbiological contamination of the sea by sewage pollution has precipitated a health crisis of massive proportions globally. Bathing in polluted seas is estimated to cause some 250 million cases of gastroenteritis and upper respiratory disease every year, with an estimated annual cost worldwide of about USD 1.6 billion. Some of these people could be disabled over the longer term, suggesting that the global impacts of marine pollution are comparable to those of diphtheria and leprosy.

Some authors have argued that food security is also affected by environmental factors. Agricultural growth as a consequence of the Green Revolution has also had an adverse impact on the environment in terms of

nutrient mining, increases in soil salinity, waterlogging, depletion of underground water and the release of nitrogen into watercourses.

Human well-being is inextricably linked to ecosystems through the goods and services that the ecosystems provide. These include both marketed goods and services, such as food or forest products, and non-marketed ones such as water flow regulation. Suchak (2002) puts the cost of environmental damage to India in 1992 at USD 11 867 billion a year or 4.5% of GDP. A breakdown of the estimated costs shows that urban air pollution costs India USD 1.3 billion a year, and water degradation has associated health costs of USD 5.7 billion a year. Land degradation causes productivity losses of around USD 2.4 billion and deforestation leads to annual losses of USD 241 million. In Japan the damage to agricultural crops caused by tropospheric ozone amounts to an estimated USD 166.5 million yearly in the Kanto region alone. The potential economic losses of non-marketed ecosystems goods and services and the impact on human vulnerability are likely to be even higher than for marketed goods and services. Equally, little attention is paid to the high economic cost of more gradual environmental degradation and loss of natural resource potential.

As argued above there are few systematic data on the costs of such degradation; estimates, where they exist, employ varying and mutually non-consistent methodologies. Even so, Table 9 summarises evidence of the economic costs of such degraders/pollutants and Table 10 reports on time loss due to tariff congestion in select Asian cities.

Table 9. **Some estimates of environmental costs in selected Asian countries**

China

- ❖ Productivity losses due to soil erosion, deforestation and land degradation, water shortages and destruction of wetlands in 1990 put at USD 13.9-26.6 billion annually or 3.8-7.3% of GDP
- ❖ Health and productivity losses from pollution in cities in 1990 put at USD 6.3-9.3 billion, or 1.7-2.5% of GDP

India

- ❖ Total environmental costs of USD 13.8 billion in 1992, or 6% of GDP; urban air pollution costs USD 1.3 billion; health costs from water quality at USD 5.7 billion; soil erosion costs at USD 2.4 billion; deforestation costs put at USD 214 million. Traffic-related costs, pollution costs from toxic wastes, biodiversity losses excluded.

Indonesia

- ❖ Health costs of particulate and lead levels above WHO standards in Jakarta put at USD 2.2 billion in 1989, or 2.0% of GDP

Pakistan

- ❖ Health impacts of air and water pollution and productivity losses from deforestation and soil erosion put at USD 1.7 billion in the early 1990s, or 3.3% of GDP

Philippines

- ❖ Health and productivity losses from air and water pollution in the Manila area put at USD 0.3-0.4 billion in the early 1990s, or 0.8-1.0% of GDP

Thailand

- ❖ Health effects of particulate and lead levels in excess of WHO standards put at USD 1.6 billion, or 2% of GDP
-

Source: Agarwal (1996), ADB (1997), and UN (1998).

Table 10. **Estimates of time losses due to traffic congestion in Asian cities, 1994**

<i>City</i>	<i>Annual cost of time delays (USD millions)</i>	<i>Cost as % of local (city-wide) product</i>
Bangkok	272	2.1
Kuala Lumpur	68	1.8
Singapore	305	1.6
Jakarta	68	0.9
Manila	51	0.7
Hong Kong	293	0.6
Seoul	154	0.4

Source: WRI (1996) and UN (1998).

These and other reports such as those by Jha and Whalley (2001) indicate a continuing and unrelenting human assault on the environmental and natural resource systems that sustain all life on the planet. As daunting as current conditions are, they pale into insignificance when compared with ultimate results of further exploitation of the environment. Thus Angel and Rock (2000) write that “Most of Asia is in the midst, not at the end, of an urban-industrial led development transition unparalleled in its scale and intensity.” Urban population in Asia has been doubling in size every 15-20 years and will increase by another 69% by 2025. Roughly 80% of the industry that will be operating in 2020 (primarily in urban areas) has yet to be built. If trends continue, by 2010 Asia will produce more sulphur dioxide than Europe and the US combined, and by 2020 the Asia region will become the world’s largest source of greenhouse gases (Douglass and Ling, 2000). Hence existing trends are unmistakably pointing in the direction of a fundamentally unsustainable environmental future in the *Business-as-usual* case (UNEP, 2003).

IV. Barriers to internalisation: locally and globally

The discussion so far has emphasised that incomplete internalisation – at the local, trans-boundary and international levels – is perhaps the single most important contributor to environmental problems in the Asia Pacific region. In view of the high costs associated with such lack of internalisation it is pertinent to inquire into the reasons why such internalisation is not forthcoming.

A complex set of (familiar) reasons is behind the lack of progress toward internal industrialisation in the developing countries of the region. These include weak and ill-defined property rights over resources, inefficient enforcement (Prasad, 2004), large transactions costs, poor technology of surveillance and poor governance. However, the experience of the developing countries in this regard is not very different from those of developed countries. Developing countries have often been thought of as following the development experience of the developed countries with a compressed lag. OECD countries have grown over some 200 years and transformed from primary agricultural to primarily high-technology service providers. Developing countries are following this experience at varying speeds and in different ways, but the transition time is clearly shorter. Korea, for instance, may have transformed itself from a country with lower income per capita than India in the mid 1950s to a lower income OECD country in 40 years. However, whereas the OECD countries during their years of rapid industrialisation could follow a policy of “grow now and clean up later”, the developing countries of today are under considerable strain to clean up. These pressures come from donor governments, international organisations and developed country NGOs, and sometimes carry the threat of punitive action. At the height of OECD country industrial revolutions, effectively no environmental controls were in place.

Thus developing countries in the region are subject to the twin pressures of having to raise per capita incomes rapidly and yet clean up during the process. What should be their response? Following developed country experience would seem to indicate adopting few environmental controls, and that with income growth environmental quality will improve. Indeed, a great fear is that attempts to heighten environmental regulation will only serve to slow growth, and hence slow eventual achievement of higher environmental quality through growth. On the other hand, with problems of compliance one can argue that perhaps developing countries have no choice but to follow the older developed country industrial revolution experience of largely benign neglect.

There are key differences in the developing country experience in this area compared to the industrial revolution of old. First, the time periods involved are compacted, and hence the flow of environmental damage per year during industrialisation is larger. Second, the shocks which hit the economies are also much more severe than was true of the old industrial revolutionisers. These latter economies simply did not experience population growth rates of 3% per year plus massive growth in urban vehicle densities, or other elements contributing to today's environmental ills in the developing world. Not only is the process more compact, the severity of damage time adjusted probably exceeds that experienced in the OECD one hundred years ago. Third, even though weakly administered, there are abatement technologies which can be and are being employed, and even though there is political opposition, environmental management is taking root.

The process of internalisation of environmental external effects has gone much further in developed OECD economies. For instance, in the OECD countries we observe a strong decoupling of emissions of local air pollutants from economic growth. OECD countries have also achieved a strong decoupling between energy use and economic growth over the past 20 years, with the economy growing by 17% between 1980 and 1998 and energy use falling by the about the same percentage. Water and resource use continued to grow but at a rate slower than GDP growth, reflecting a weak decoupling of the two. Thus decoupling of emissions in OECD countries and generally the developed countries has been accomplished through a combination of technological change and a strong environmental policy. The latter consists of “greening” of fiscal policy, removing subsidies to environmentally harmful activities and the use of economic instruments to internalise environmental cost. For example, a number of EU policy initiatives – the Broad Economic Policy Guidelines 2001, among others – have promoted a gradual but steady and credible change in the level and structure of the tax rates until external costs are fully reflected in prices. Such initiatives are attempting to cope with most of the fundamental structural problem in all developed countries: the unsustainable patterns of production and consumption. In the energy markets these guidelines aim to uses taxes and other market-based instruments to rebalance prices in favour of reusable energy sources and technologies. Other EU initiatives in this direction are the European Climate Change Programme (ECCP), the directive establishing an EU framework for emissions trading, and the Integrated Product Policy (IPP) – all of which aim at realigning price relations and stimulating investments in new technologies that promote sustainable development. Member states are encouraged to improve market functioning by addressing market failures such as externalities through “increased use of market-based

systems in pursuit of environmental objectives as they provide flexibility to industry to reduce pollution in a cost effective way, as well as encourage technological innovations” (UNEP, 2003, pp. 326). The tax instruments are promoted as the most efficient means of decoupling economic growth from pollution, as they alter price relations and thereby also drive changes in technology and consumer behaviour (preference) that lie behind the growth-environmental relationship. As exemplified by the energy and transport sectors, the EU decoupling policy consists of demand management through full cost pricing and development of more environmentally friendly alternatives by promoting technological innovations. The United Nations Economic Commission for Europe has repeatedly called upon its members to raise the prices of various energy sources to their full economic costs and adapt economic instruments to internalise the costs to human health and the environment associated with energy production and consumption. The aim is to decouple emissions from energy use and energy use from economic growth.

Commensurate progress in these areas in the case of developing or transition countries has been lacking, although some progress has been achieved. Thus since 1990 all economies in transition have made efforts to restructure their energy and transport sectors along market principles and to raise energy prices closer to economic and international levels. However, because of the political sensitivity of energy pricing and the lagging reforms in many transition economies, a gap of 20-85% continues to persist between energy prices in economies in transition. For example, electricity prices for households in Eastern Europe are only 50% of those of the European Union; for industrial consumers, electricity prices are closer to their economic and international levels, being 20% lower than those of the EU. Subsidies on electricity for agriculture continue to be extremely high in India (Jha and Thapa, 2003).

Although gains from internalisation (at the international level) are jointly shared and are substantial, why are custodians of assets not able to agree to manage and conserve assets in return for payment by those who benefit from such practices? From the viewpoint of the developing countries, given the large cost estimates for their environmental problems, it is likely that these countries will continue to pursue a much more activist environmental policy. However, given the greater cost of local degradation issues, such efforts will have a dominant focus on degradation over pollution. International external effects are more likely to be emphasised in any international environmental co-operation. To make such co-operation more attractive to the developing countries of the region, concessions would have to be made to enable them to address their

domestic environmental concerns – in particular, environmental degradation. In fact, an enlightened international environmental policy would link the issue of support for domestic internalisation policies in developing countries to co-operation in international environmental agreements such as those on greenhouse gases.

There are several other reasons for this observed lack of internalisation at the international level. First, it is difficult to put together negotiations between groups who have an interest in the management practices used for environmental resources. For instance, governments may agree to conserve forests but may find it difficult to pursue this if encroachments into forests are done primarily by the poor. Similarly, in OECD countries there may be a willingness to pay for environmental protection in poorer countries, but any attempt to estimate this (by survey methods, for instance) will be subject to free riding. The benefits from environmental protection abroad are a public good which is hard to finance through voluntary action. A related problem is that individual countries can free ride on the environmental quality improvement by other countries. Hence some countries may hang back from multilateral negotiation in which they need to pay a price to achieve environmental quality improvements that others will benefit from. This has been emphasised by Barrett (1994). Environmental enforcement also has an important time-inconsistency dimension. OECD countries may strike deals with countries to meet environmental targets such as forest cover or species populations over a number of years. But if payment for these concessions takes place immediately, more money could potentially be repeatedly requested for environmental compliance. On the other hand, if payment is postponed until the end of the agreement, countries that conserve environmental assets have no assurance of getting paid.

This lack of internalisation denotes an institutional failure. In fact the international institutional architecture reflected in the present global environmental regime, and some 35 years in evolution, does not take as its starting point the design of mechanisms that seek to achieve internalisation of environmental externalities across countries. No agency attempting to achieve Coase's internalising deals across countries recognises the many problems in deal-making to improve environmental quality. The modern economics literature shows why private negotiation cannot easily complete the deals needed for international environmental internalisation, why intermediary agencies are needed, why scientific standard-driven arrangements produce only low-level environmental outcomes – in short, why a new global or at least regional (at the Asia Pacific level) agency for the environment is needed.

Progress in these areas has been scanty and faltering. International environmental negotiations in the region are still in their infancy. In fact the present global economic institutions still reflect their 1940s origins and focus primarily on trade and finance as the dominant economic linkages between countries, rather than physical linkages.

The central global environmental problem is the relative lack of internalisation of cross-border and global externalities. We need an institutional form that seeks to achieve internalisation internationally, and one that does this by facilitating Coasian deals based on the perceived interests of the participants. At least since Coase (1960) it is known that bargaining between the parties to an externality would serve to achieve internalisation – no Pigou-type tax was needed. Coase argued that the issue of who should pay the additional costs of internalisation was a matter of property rights – who has the rights to what? Bargaining between the parties to an externality would serve to internalise it, with payments of compensation for damage to those having the legal rights to pursue redress and payment to induce reduction of damage by those parties having no such rights. Economic analysis is silent on the issue of who should have such rights. Also in the presence of an externality, bargaining (or Coasian deals) may already have been entered into and imposition of taxes or other measures could actually worsen the allocation of resources. Coase's discussion was largely centred upon narrowly defined externalities. In the case of global externalities the number of people affected is in the millions and the transaction costs of such bargaining (which Coase approximated to zero) are likely to be large. In fact we have seen some of the reasons why such bargaining may be hard to put in place. However, there is need for an international mechanism to facilitate such bargaining on this large scale. Other ancillary functions that need to be addressed are allowing for verification of completion of contracts and acting as a financial guarantor. While the WTO is cast within a bargaining framework, it is restricted since no cash is involved and the rules of the WTO Charter (via GATT 1994) constrain bargaining (such as the MFN rule).

V. Institutional mechanism to facilitate environmental co-operation in the Asia Pacific region?

The principal argument of this chapter is that there is an urgent need to develop institutional mechanisms to facilitate deal-making to achieve internalisation of environmental externalities at the trans-national level. Experience to date indicates that this is not possible unless the bargaining set is enlarged to ensure that there are adequate gains for all participants. Thus there is a need for issue linkage in the area of environmental negotiation. Jha *et al.*

(2002) indicate some areas where such issue linkage is possible and, indeed, could be welfare-improving for Asian developing countries. The issues with which international environmental negotiations could be linked include aid to developing countries to underpin their domestic internalisation efforts, trade concessions by developed countries, and cash transfers.

How large is the potential gain from issue linkage in the area of environmental negotiation? This issue requires much more careful analysis than it has been afforded so far. Seminal work on this was done by Perroni, Whalley and Wigle (1999). They construct a simulation model to compute the gains from trade negotiations as the opportunity set is enlarged. They point out that since the early 1990s the link between trade and the environment has been an important issue of contention between developed and developing countries. Developed countries have argued that restrictions are needed on certain types of trade in order to safeguard the environment, whereas developing countries have viewed this as a new type of restriction on their exports and have, hence, opposed these measures. Instead, they seek financial incentives for adopting growth-reducing environmental measures. Perroni, Whalley and Wigle (1999) argue that this is not the only policy option available. For one, there may be trade-environment linkages in international negotiations. Another alternative is issue linkage across trade and environment with side payments. These policy alternatives are compared in a two-region numerical simulation model. The two regions are the North and the South. The North is represented by the OECD countries and the South by 28 key developing countries with substantial environment assets. Five countries from the Asia Pacific region belong to this “South” group: India, Indonesia, Malaysia, Myanmar and Papua New Guinea. The model is benchmarked to 1990 and projected over a 100-year time horizon. Alternative North-South negotiation scenarios are modelled. A trade war would favour the North and would cause considerable economic damage to the South. If trade negotiations were not linked with environmental concessions, both North and South benefit with the South eliminating all tariffs whereas the North would get to keep some of them. If joint trade and environment negotiations take place, the North would completely eliminate its tariffs, whereas Southern environmental management improves significantly. Some trade barriers would remain in the South as a concession by the North for better environmental management. Thus this exchange generates gains for both the North and the South but it is not sufficient to eliminate tariffs in the South. That can be attained if the set of negotiation instruments is expanded to include side (cash) payments. The “right” amount of cash transfer would lead to elimination of tariffs by the South and maximise potential global welfare gains. Thus there are significant gains associated with enlarging the scope for negotiations to link the

twin issues of trade and environment and enlarge the set of instruments to include cash transfers.

Hence there appears to be some evidence of substantial gains from issue linkage in the area of environmental negotiation. Perhaps there is room for an initiative in this direction within the Asia Pacific region.

What is the institutional preparedness of the countries within the region to put into effect such issue linkage? Two environmental camps presently exist in the West. One component has been opposed to trade liberalisation as it associates this with environmental decay. Wallach (1999) furnishes a statement of this position. A second component argues that trade liberalisation and economic growth should succeed only if it fully accounts for environmental conditions. This position has some powerful supporters, including the UN Secretary General, Kofi Annan. Both environmental camps draw their strength from strong public support for environmental quality. As Peritore (1999) indicates, public polls in both developed and developing countries indicate a populace increasingly frustrated with the inability and/or unwillingness of governments to halt environmental deterioration.

In the Western countries public support and the mobilisation of NGOs is step-by-step, creating a system of corporate legitimisation transcending boundaries and beyond state-centric regulation of commerce (either domestic or international). It is contingent upon commercial organisation meeting universal standards of acceptable practice (Newell, 2000). The corporation's compliance with social and environmental norms is viewed as being just as important as its compliance with legal requirements.

There is some evidence that leading multinational companies recognise the changing nature of legitimacy. That evidence is in their policies to maintain uniformly high environmental standards in their facilities *regardless* of the countries in which these facilities are located. ISO standards are being increasingly adopted by firms all over the world (Chang-Xing, 1999 and Jha, Markandya, and Vossenaar, 1999). Many Western European countries are leading efforts to identify and require new product standards, especially in relation to the environment.

These efforts are slowly becoming recognised and accepted in the United States as well. However, there is little evidence that developing countries are picking up on the changes. Their aversion to linking trade and environment in the extant manner is well known. A common reason given for this linkage is the

fear of losing a comparative advantage in the export market. The fear is based on a twofold concern. First, many Asian countries are suspicious of protectionist interests in the West masquerading as environmentalists or human rights advocates (Verbruggen *et al.*, 1998). Further, Asian societies decry the double standards that are being applied to them, forcing them to adopt environmental standards much stricter than those that applied to Western countries in their economic development process. These are well-founded concerns; however, given the urgency of the environmental situation, a way forwards needs to be found.

Asian States have frequently resorted to the principle of state sovereignty to justify their defensive posture toward an environment-trade linkage. ASEAN, for example, has argued forcefully for the right of developing countries to permanent sovereignty over their natural resources, and have rejected the view that the world is a global common, to be dealt with collectively. It can be argued, however, that the claim of state sovereignty can be a transparent mask for pursuing self-interest by existing regimes. Herein lies an important difference between OECD and the developing countries of Asia. Whereas the thrust for environmental action is increasingly concentrated in the hands of non-governmental agencies in the case of developed countries and this gets reflected in their approach to regional organisations as institutions, some Asian States view these organisations as institutions to enhance state capabilities, not transcend them. Morrison *et al.* (1997, p. 34) wrote: “the central purpose has been to consolidate the stability, security, and prosperity of the present states and state system, not to subsume sovereignty in larger entities.” This state-centric approach becomes even more pronounced when dealing with forces outside the region. Thus there is a conflict in their negotiating position with the developed countries in which there has been an emphasis on reducing internal state sovereignty.

To enable the developing countries in the region to transcend such entrenched positions, gains from issue linkage should be demonstrated. Deal-making to obtain environmental concessions from the developing countries in return for assistance in internalising local environmental externalities, as well as trade concessions and side payments, could be pursued. A possible institutional mechanism in support of such issue linkage is a regional (Asia Pacific) environmental organisation along the lines of the World Environmental Organisation, discussed in Jha *et al.* (2002), Lodefalk and Whalley (2002), and Whalley and Zissimos (2000, 2001, 2002).

VI. Conclusions

This chapter has argued that the most important environmental challenge within the Asia Pacific region is that of uninternalised externalities. While developed countries have put in place mechanisms of governance and regulatory structures that internalise most of their domestic environmental external effects, the same cannot be said of domestic environmental external effects of developing countries and trans-national environmental external effects, although these are some of the most pressing environmental problems facing the countries in the region. Whereas developing countries are paying a high price for uninternalised domestic externalities, they and the developed countries have an important stake in finding internalisation solutions to trans-national environmental externalities. The chapter argues that absence of linkage among these issues and other outcomes of keen interest to developing countries (viz. trade negotiations and the possibility of side payments) has made progress in this area impossible. Hence there is a case for institutional innovation to facilitate Coasian deal-making among these countries through issue linkage.

NOTES

1. For a description of these treaties see the website <http://sedac.ciesin.columbia.edu/entri/index.jsp>.
2. This includes data on a range of environmental indicators including BOD, airborne SO₂ concentrations, heavy metal levels (lead, arsenic, mercury and cadmium), untreated human waste and other air and water quality indicators.
3. For a review see Panayotou (2003) and recent literature on trade and environment by Copeland and Taylor (1994), Antweiler, Copeland and Taylor (1998), and Coxhead and Jayasuriya (2003).

BIBLIOGRAPHY

- ADB (Asian Development Bank) (1997), *Emerging Asia – Changes and Challenges*, Asian Development Bank, Manila.
- ADB (2000), *Asian Development Outlook*, Oxford University Press, New York.
- ADB (2001), *Asian Environment Outlook 2001*, Asian Development Bank, Manila.
- Agarwal, A. (1996), “Pay-offs to Progress”, *Down to Earth* (Centre for Science and Environment, New Delhi), 5(10), pp. 31–9.
- Angel, D. and M. Rock, eds. (2000), *Asia’s Clean Revolution: Industry, Growth and the Environment*, Greenleaf Publishing, Sheffield, UK.
- Antweiler, W., B.R. Copeland and M.S. Taylor (1998), “Is Free Trade Good for the Environment?”, National Bureau of Economic Research Working Paper No. 6707, August.
- Barrett, S. (1994), “Self-Enforcing International Environmental Arrangements”, *Oxford Economic Papers*, 46(4), pp. 878–94.
- Bendell, J., ed. (2000), *Terms of Endearment: Business, NGOs and Sustainable Development*, Greenleaf Publishing, Sheffield, UK.
- Chang-Xing, D. (1999), “ISO-14001: The Severe Challenge for China” in W. Wehrmeyer and Y. Mulugetta (eds.), *Growing Pains*, Greenleaf Publishing, Sheffield, UK.
- Coase, R. (1960), “The Problem of Social Cost”, *Journal of Law and Economics*, Vol. 3.
- Copeland, B.R. and M.S. Taylor (1994), “North-South Trade and the Environment”, *Quarterly Journal of Economics*, 109, pp. 755–87.

- Coxhead, I. and S. Jayasuriya (2003), *The Open Economy and the Environment*, Edward Elgar, Cheltenham, UK.
- Douglass, M. and O. Ling (2000), “Industrializing Cities and the Environment in Pacific Asia: Toward a Policy Framework and Agenda for Action” in D. Angel and M. Rock (eds.), *Asia’s Clean Revolution: Industry, Growth and the Environment*, Greenleaf Publishing, Sheffield, UK.
- Fuggle, R. and W. Smith (2000), “Large Dams in Water and Energy Resource Development in the Peoples’ Republic of China”, World Commission on Dams, Cape Town, Accessed at: http://www.dams.org/studies/cn/cn_exec.htm.
- Hayes, P. and L. Zarsky (1994), “Environmental Issues and Regimes in Northeast Asia”, *International Environmental Affairs*, 6(4).
- Holmgren, S. (1994), *An Environmental Assessment of the Bay of Bengal Region*, BOPG/REP/67, Bay of Bengal Program, Madras.
- IPCC (1998), *The Regional Impacts of Climate Change: An Assessment of Vulnerability*, International Panel on Climate Change, Geneva.
- Jha, R. and K. Murthy (2003), “An Inverse Global Environmental Kuznets Curve”, *Journal of Comparative Economics*, 31(2), pp. 352–68.
- Jha, R., M. Panda and A. Ranade (2002), “An Asian Perspective on a World Environmental Organization”, *World Economy*, 25(5), pp. 643–57.
- Jha, R. and C. Schatan (2001), “Debt for Nature: A Swap Whose Time Has Gone?”, United Nations: ECLAC, *Estudios Y Perspectivas* 4, Mexico City.
- Jha, R. and P. Thapa (2003), “Infrastructure and Electricity Sector Reforms in India”, *Indian Economic Reforms*, Palgrave-Macmillan, London, pp. 334–54.
- Jha, R. and J. Whalley (2001), “The Environmental Regime in Developing Countries” in C. Carraro and G. Metcalf (eds.), *Behavioural and Distributional Effects of Environmental Policy*, University of Chicago Press for NBER, Chicago, pp. 217–49.

- Jha, V., A. Markandya and R. Vossenaar (1999), *Reconciling Trade and the Environment: Lessons from Case Studies in Developing Countries*, Edward Elgar, Northampton, MA.
- Lodefalk, Magnus and J. Whalley (2002), “Reviewing Proposals for a World Environmental Organization”, *World Economy*, 25(5), pp. 601–17.
- McMichael, A. (2001), *Human Frontiers, Environments and Disease: Past Patterns, Uncertain Futures*, Cambridge University Press, Cambridge.
- Morrison, C., A. Kujima and H. Maull (1997), *Community Building in the Pacific Asia*, Trilateral Commission, New York.
- Murray, C. and A. Lopez (1996), *The Global Burden of Disease*, Harvard University Press, Cambridge, MA.
- Nakicenovic, N. and R. Swart, eds. (2000), “Special Report of the Intergovernmental Panel on Climate Change on Emissions Scenarios”, Cambridge University Press,
<http://www.grida.no/climate/ipcc/emission/index.htm>.
- Newell, P. (2000), *Climate for Change: Non-state Actors and the Global Politics of the Greenhouse*, Cambridge University Press, New York.
- Oldeman, L. (1994), “The Global Extent of Soil Degradation” in D. Greenland and T. Szaboles (eds.), *Soil Resistance and Sustainable Land Use*, Commonwealth Agricultural Bureau International, Wallingford,
<http://www.isric.nl/GLASOD.htm>.
- Panayotu, T. (2003), “Economic Growth and the Environment”, Working Paper, Harvard University.
- Pierce, F. (2001), “Death in a Glass of Water”, *The Independent*, UK, 19 January <http://www.arsenicfilters.com/glass.htm>.
- Peritore, P. (1999), *Third World Environmentalism: Case Studies from the Global South*, University Press of Florida, Gainesville.
- Perroni, C., J. Whalley and R. Wigle (1999), “Trade and Environment: Bargaining Outcomes from Linked Negotiations”, CSGR Working Paper No.27/99, University of Warwick.

- Prasad, P. (2004), “Environmental Protection: The Role of Liability System in India”, *Economic and Political Weekly*, 39(3), pp. 257–69.
- Smith, K., C. Corvalan and T. Kiellstrom (1999), “How Much Global Ill Health Is Attributable to Environmental Factors?”, *Journal of Epidemiology*, 10(5), pp. 573–84.
- Suchak, Y. (2002), *Development and Environment Issues with Special Reference to Gandhian Perspective*, Gandhian Institution, Bombay Sarvodaya Mandal, http://mkgandhi-sarvodaya.org/kavita_suchak.htm.
- UN (1998), *UN Human Development Report 1998*, Oxford University Press, New York.
- UNCCD (1998), *The Social and Economic Impact of Desertification in Several Asian Countries: Inventory Study*, Interim Secretariat of the Convention to Combat Desertification, Geneva.
- UNDP (2000), *Human Development Report 2000*, Oxford University Press, Oxford and New York.
- UNEP (1999), *Vital Water Graphics: An Overview of the State of the World’s Fresh and Marine Waters*, UNEP, Nairobi, Kenya.
- UNEP (2001), *Annual Report*, Division of Technology, Industry and Economics, Kobe, Japan
- UNEP (2003), *Global Environmental Outlook*, UNEP, London and Stirling, VA.
- UNESCAP and ADB (2000), *State of the Environment in Asia and Pacific 2000*, Economic and Social Commission for Asia and the Pacific and Asian Development Bank, United Nations, New York, <http://www.unescap.org/enrd/environ/soe.htm>.
- Verbruggen, H. *et al.* (1998), “Environmental Protection Measures: Barriers for South-North Trade?”, Working Paper No. 18, International Institute for Environment and Development, London.
- Wallach, L. (1999), *Whose Trade Organization: Corporate Globalisation and the Erosion of Democracy*, Public Citizen, Washington, DC.

- WCD (2000), *Dams and Development: A New Framework for Decision-making*, Earthscan, London,
<http://www.damsreport.org/wcd/overview.htm>.
- Whalley, J. and B. Zissimos (2000), “Trade and Environment Linkage and a Possible World Environmental Organization”, *Environment and Development Economics*, 5(4), pp. 510–16.
- Whalley, J. and B. Zissimos (2001), “What Could a World Environmental Organization Do?”, *Global Environmental Politics*, 1(1), pp. 29–34.
- Whalley, J. and B. Zissimos (2002), “Internalisation-based World Environmental Organization”, *World Economy*, 25(2), pp. 619–42.
- WHO (1997), *Health and the Environment: Five Years After the Earth Summit*, World Health Organization, Geneva.
- WHO and UNICEF (2000), *Global Water Supply and Sanitation Assessment 2000 Report*, Geneva and New York,
http://www.who.int/water_sanitation_health?Globassessment/Glassessment7pdf
- WHO (2002), “Environmental Hazards Kill At Least 3 Million Children Aged Under 5 Every Year”, <http://www.who.int/inf/en/pr-2002-12.html>.
- Wilkinson, C., ed. (2000), *Status of Coral Reefs of the World*, Australian Institute of Marine Science, Townsville.
- World Bank (2000), *Health and Environment: Environment Strategy Paper*, World Bank,
[http://lnweb18.worldbank.org/essd/essd.nst/Globalview/healthcareenv.pdf/\\$file/healthandenv.pdf](http://lnweb18.worldbank.org/essd/essd.nst/Globalview/healthcareenv.pdf/$file/healthandenv.pdf).
- World Bank (2001), “Montreal Protocol: Successful Partnerships to Ozone Protection – The Case of China, Vol. 1 of 1”, World Bank Report No. 30423, Washington, DC.
- World Commission on Water (1999), *World’s Rivers in Crisis — Some Are Dying, Others Could Die*, World Water Council,
<http://www.worldwatercouncil.org/visoin/6902B03438178538C125683A004BE974.htm>.

WRI (World Resources Institute) (1996), *World Resources 1996–97*, Oxford University Press, New York.

WRI (2000), *World Resources 2000-2001: People and Ecosystems: The Fraying Web of Life*, Washington, DC.

*Chapter 9***Towards a Regional Rapid Response Co-operation Group
in the Asia Pacific***by*

Clarita R. Carlos
Department of Political Science,
University of the Philippines

Introduction

In 1995, the author conducted a study attempting to measure the level and scope of Philippine participation in selected issue areas of the Association of Southeast Asian Nations (ASEAN) (Carlos, 1996). A scoring procedure was devised for that study to indicate the areas in which advances in co-operation are occurring and the areas in which they are lagging. The study concluded that co-operation on drug enforcement and scientific matters rated highest in the first group and co-operation on social development and selected environmental issues were clearly in the second.

Those findings may have reinforced what the theoreticians in the field of regional integration – David Mitrany, Ernst Haas, Leon Lindberg, Joseph Nye and others – have contended. These academics premise regional co-operation/integration on the diminishing role of the nation state as a result of modern technologies of transportation, communication and warfare. They have also correctly observed that the task of protecting citizens and their way of life can no longer be performed within the territorial confines of the state. It must shift to a new and larger arena which is “beyond the nation state” – in this case, the region.

Last year’s outbreak of the Severe Acute Respiratory Syndrome (SARS), which affected many countries in the region, and the ongoing avian flu, which is seriously affecting the economies of 10 countries, has brought home more

clearly the need not only for a rapid response but also for a co-ordinated, comprehensive approach as more and more countries confront the widening challenge.

The purpose of this chapter is to propose a regional rapid response co-operation arrangement to meet that challenge. This proposed group would be designed to do more than respond rapidly to humanitarian crises arising from natural disasters like floods, earthquakes and the like. It could also be tasked with environmental challenges such as the haze emanating from Indonesia that affected several countries in the area, as well as health issues as indicated earlier – SARS, AIDS, avian flu and mad cow disease, among others. Finally, it would also rise to the many security challenges collectively labelled transnational crimes, which include money laundering, human trafficking, small arms smuggling, piracy, and terrorism in its various forms.

The proposed group is intended to build on the existing infrastructure of governmental organisations like ASEAN and other non-governmental groups. However (Carlos, 2002), the bureaucracy dynamics of the 10 member countries and the decision-making processes of “consensus taking” have seriously slowed down progress toward the level and scope of co-operation so urgently needed in the many crises confronting the region (Carlos, 1996).

Co-operation among the countries of the region is no longer new; the following section presents a brief history of the many experiences of the countries in the area. This history is important because part of the reason such schemes are successful are the “habits of co-operation” engendered not only among its élite but also among the various functional groups in the region. Thus, the Regional Rapid Response Co-operation Group proposed here will be nurtured from its inception by these previous and present co-operation entities.

History of regional security co-operation in Southeast Asia

Regionalism in Southeast Asia has undergone three stages of development since 1945 (Lyon, 1992, pp. 25-26). The first phase, from the end of the Second World War to the second half of the 1950s, was marked by the formation of security organisations and alliances, such as the Southeast Asia Treaty Organization (SEATO). This was initiated by extra-regional powers, primarily the United States and the United Kingdom. The second phase, from the latter part of the 1950s to the mid-1960s, was the period when some Southeast Asian states attempted to create regional co-operation arrangements independent from external powers, such as the Association of Southeast Asia (ASA) and

MAPHILINDO (an acronym formed from the first few letters of Malaya, the Philippines, and Indonesia). Those two organisations were short-lived, but they paved the way to establishing the Association of Southeast Asian Nations (ASEAN) in 1967. The creation of ASEAN signalled the beginning of the third phase of the evolution of Southeast Asian regionalism.

SEATO

SEATO was an alliance founded in September 1954, at the conclusion of the Southeast Asia Defense Treaty, also known as the Manila Pact, by the United States, the United Kingdom, France, Australia, New Zealand, Pakistan, Thailand and the Philippines. It was established at the instigation of US Secretary of State John Foster Dulles who designed SEATO as a principal component of US containment strategy towards the Soviet Union and China during the cold war. It included provisions for collective defence in case of an armed attack, *i.e.* communist aggression, on any of the Southeast Asian countries, including those in the Indochina region.

SEATO foundered not long after its inception because it “carried too many strings and offered too few advantages” (McCloud, 1995, p. 295). It earned the name “Paper Tiger” because it failed to realise its full measure on various occasions. For instance, when Laos asked for military assistance to stave off communist advance in its territory, SEATO was not able to respond. SEATO was further undermined when US Secretary of State Dean Rusk and Thai Foreign Minister Thanat Khoman issued a joint statement in March 1962 declaring that the “Treaty obligations did not depend on the prior agreement of all parties because the obligations were individual as well as collective” (Liefer, 1996, p. 9). The US guaranteed support to Thailand in the event of communist aggression with or without the support of the other SEATO signatories. Moreover, the United States did not invoke the Manila Pact when it went to war in Vietnam. Instead, it formed an *ad hoc* grouping of allies that would provide support for its military intervention in Vietnam. The withdrawal of Pakistan and France weakened SEATO still further and the alliance disintegrated in 1977.

Association of Southeast Asia (ASA)

The ASA, comprised of the Federation of Malaya, the Kingdom of Thailand and the Republic of the Philippines, was established on 31 July 1961 as a “free association of Asian countries having as its objective the promotion, through joint endeavor, of the well-being and the economic social and cultural progress of the region” (Ramos, 1986, p. 12). The concept of ASA was born in

January 1959, when Prime Minister Tunku Abdul Rahman of the Federation of Malaya visited the Philippines. In the joint communiqué issued by President Carlos P. Garcia and the Tunku, the two leaders called for a study of “ways and means to elevate the standard of living and improve the material welfare of their peoples” (Ramos, 1986). Subsequently, low-level preliminary meetings between Philippine and Malayan representatives were conducted to deliberate on the nature and form of a regional grouping that would facilitate the forging of closer relations among Southeast Asian countries. In August 1960, it was announced that the proposed regional organisation would not be a political coalition, nor would it be anti-communist. Moreover, its activities would be modest, focusing mainly on functional co-operation in the economic, social, cultural, and scientific fields (Ramos, 1986). Finally in 1961, ASA was launched with the signing of the Bangkok Declaration.

ASA’s institutional infrastructures included an annual foreign ministers’ meeting, high-level working parties, functional committees and national secretariats. In the first three years of its existence, ASA successfully engaged in various collaborative endeavours in different areas, primarily the exchange of technical information, experts and trainees; joint research; promotion of trade and customs; waiver of visas; exchange of information on primary commodities; exchange of radio and television programmes and information; and cultural and educational exchange (Ramos, 1986, p. 13).

ASA did not survive because of the deterioration of Philippines-Malaya relations following the creation of the Federation of Malaysia. On 9 July 1963, in accordance with the British merger plan, North Borneo or Sabah and Sarawak were officially united with the Federation of Malaya and Singapore to form the Federation of Malaysia. The incorporation of Sabah into the federation adversely affected Philippines-Malaysia relations because the Philippines claims Sabah as part of its territory on historical and legal grounds. The claim was first articulated in 1961 when the merger plan was still being formulated and was officially raised with the British government by President Diosdado Macapagal through a diplomatic note in June 1962 (Gonzales-Macaïsa, 1999, p. 87). Britain, however, refused to discuss the claim and adopted what Fred Warner, then head of the British Foreign Office’s Southeast Asia Department, called the “tactics of delay and prevarication until responsibility for the territory [of North Borneo] could be handed over to Greater Malaysia” (Jones, 2002, p. 104). Malaysia then rejected the claim, thereby prompting the Philippines to withhold recognition of and sever diplomatic relations with the new state. It was only in May 1964 that consular relations between the two countries resumed.

The immediate impact of this standoff was suspension of ASA activities. Attempts were made to revive ASA following President Ferdinand Marcos' public announcement of his government's intention to extend recognition to Malaysia. On 2 March 1966, the ASA Standing Committee met in Bangkok and decided that a Foreign Ministers meeting would be scheduled "on the written understanding that this would take place after Philippine recognition of Malaysia and not before" (Ramos, 1986, p. 14). The revival of ASA was cut short by the establishment of a new regional organisation in 1967.

The relevance of ASA lay not so much in its relatively successful co-operation in functional areas but in its role as a medium of consultation among the three member countries, especially between Malaysia and the Philippines. This was best stated by Foreign Affairs Secretary Narciso Ramos in a speech delivered on 13 May 1966, where he said that: "ASA has shown itself to best advantage not in the field of technical or economic or cultural agreements" (Ramos, 1986, p. 14), though the achievements in these fields had been significant. "How valuable ASA is can be illustrated by the fact that it played a helpful role in preventing the worsening of relations between the Philippines and Malaysia by providing a regular channel of communication. It also provided Thailand with an unexampled opportunity to act as behind-the-scenes mediator" (Ramos, 1986, p. 15).

MAPHILINDO

In July 1962, President Diosdado Macapagal proposed the formation of a Malayan Confederation of the Philippines, the Federation of Malaya, Singapore, Sarawak, Brunei, and Sabah. But what eventually came out of President Macapagal's proposal was the formation of MAPHILINDO, a loose confederation of Malaya, the Philippines and Indonesia, which aimed to ease Malaya's tense relationship with both Indonesia and the Philippines. At the heart of these strained bilateral relations was the creation of Malaysia. The Philippines, though not directly opposed to the plan, was at odds with Malaya because of the Sabah question, as discussed above. Indonesia, on the other hand, expressly objected to the plan and adopted a policy of confrontation from 1963 to 1965 against Malaya, because it believed that the new Federation would just be an extension of British neocolonialism in the region. In January 1963, former Indonesian Foreign Minister Subandrio stressed that Indonesia had to adopt such a policy because Malaya itself was behaving as "the henchman of neo-Imperialism and neo-Colonialism pursuing a policy hostile to Indonesia" (quoted in Jones, 2002, p. 126).

In the months preceding the formal proclamation of Malaysia, attempts were made to find diplomatic solutions to the Malaya-Indonesia impasse. One of these was the Tokyo meeting between Malayan Prime Minister Tunku Abdul Rahman and Indonesian President Sukarno held from 31 May to 1 June 1963. In a communiqué issued after the meeting, the two leaders declared that both governments would “refrain from making acrimonious attacks and disparaging references to each other” and would work towards the resolution of their differences “in a spirit of friendliness and goodwill” (quoted in Jones, 2002, p. 157). This paved the way for the foreign ministers’ meeting in Manila that took place on 7 June and was attended by the representatives of Malaya, the Philippines and Indonesia.

The concrete result of the ministerial meeting was the adoption of the Manila Accord, which contained references to President Macapagal’s proposal of MAPHILINDO and affirmed the adherence of the three governments to the principle of self-determination. The Manila Accord also conveyed the intention of the Philippines and Indonesia to welcome the creation of Malaysia if a United Nations ascertainment process establishes that the people of the Borneo territories support the merger plan. The heads of governments of the three countries endorsed the Manila Accord during the Manila Summit held from 30 July to 15 August 1963 and further explored the prospect of establishing MAPHILINDO. On 6 August the three heads of governments issued the Manila Declaration, in which they agreed to “take initial steps towards the establishment of Maphilindo by holding frequent and regular consultations at all levels to be known as Mushawarah Maphilindo” (quoted in Agoncillo, 1990, p. 539).

MAPHILINDO did not prosper because of the conflicting goals of the member countries. Malaya’s participation was driven by its aim to alleviate its strained relationship with Indonesia and the Philippines, and ultimately to garner the support of the two countries for the Malaysia scheme. The Philippines hoped to offset its failure in negotiating with Britain regarding the Sabah question through the Confederation, while Indonesia supported MAPHILINDO expecting that this would strengthen Manila’s support for its confrontation policy with Malaysia.

Association of Southeast Asian Nations (ASEAN)

ASEAN was established in 1967 with the following key objectives: 1) to accelerate the economic growth, social progress and cultural development in the region; 2) to promote regional peace and stability through abiding respect for

justice and the rule of law; 3) to promote active collaboration and mutual assistance on matters of common interest in the economic, social, cultural, technical and administrative spheres. ASEAN originally comprised five countries, namely Indonesia, Malaysia, the Philippines, Singapore and Thailand. Later, it expanded its membership to include Brunei Darussalam, Vietnam, Myanmar, Laos and Cambodia. Brunei Darussalam was granted membership on 8 January 1984, Vietnam on 28 July 1995, Laos and Myanmar on 23 July 1997 and Cambodia on 30 April 1999.

ASEAN emerged from the ashes of the confrontation between Indonesia and Malaysia. It was set up against the backdrop of territorial disputes (as exemplified by the Philippines-Malaysia row over Sabah) and the cold war. Although the political security dimension of ASEAN co-operation has been traditionally downplayed by its members, the establishment of ASEAN was really prompted by security concerns. The primary rationale of the Association's formation was to defuse intra-state tensions in Southeast Asia in order to promote a habit of co-operation among mutually distrustful and antagonistic countries. Its unstated political goal was the prevention of the "balkanisation" of the region through co-operation in the economic, social, cultural, scientific and technical areas.

According to Amitav Acharya (2002, p. 69), the founding fathers of ASEAN wanted to transform Southeast Asia into a security community defined in the Deutschian sense, *i.e.* a "group of states whose members share 'dependable expectations of peaceful change' in their mutual relations and rule out the use of force as a means of problem-solving". The founding members reckoned that once they agreed not to go to war against each other, they would be able to effectively address their internal security threats and, hence, advance economic progress. The goal was to promote national resiliency in each of the ASEAN member countries, to achieve regional resiliency.

ASEAN security co-operation was therefore anchored on these two ideas of national and regional resiliency promoted by President Suharto of Indonesia. National resilience is "an inward-looking concept, based on the proposition that national security lies not in military alliances or under the military umbrella of a great power, but in self-reliance deriving from domestic factors such as economic development, political stability and a sense of nationalism" (Acharya, 2002, p. 72-73). Once national resilience is attained, regional resilience would then follow because "if each member nation can accomplish an overall national development and overcome internal threats, regional resilience can result in

much the same way as a chain derives its overall strength from the strength of its constituent parts” (Acharya, 2002, p. 72-73).

ASEAN was also established to protect the national sovereignties and independence of member countries in the face of the great power rivalry that was the cold war. The founding members wanted to spare themselves from experiencing the same fate as that of the Indochina countries, where rivalry between the United States and the Soviet Union was transported and played out with devastating consequences. The outbreak of the Vietnam War, which was really a proxy war between the United States and the Soviet Union, emphasised the debilitating effects of foreign power meddling and cold war politics.

ASEAN was formed to provide a mechanism that would enable the countries of the region to assume responsibility for the security of Southeast Asia independently of external powers. This outlook is made evident in the ASEAN Declaration, which speaks of the strong determination of the Association’s founding members “to preserve their national identities in accordance with the ideals and aspirations of their peoples”, free from foreign intervention in any form or manifestation.

This is reiterated in the Zone of Peace, Freedom and Neutrality Declaration (ZOPFAN, 1971) which states that the ASEAN states “are determined to exert initially necessary efforts to secure the recognition of, and respect for, Southeast Asia as a Zone of Peace, Freedom and Neutrality, free from any form or manner of interference by outside Powers”. The realisation of ZOPFAN was supposed to minimise or eliminate the “rivalry, competition, domination, and exploitation by big powers” (Solidum, 1991, p. 153) of the ASEAN countries. This proved to be a rather quixotic goal for the ASEAN countries because the dynamics of the cold war made it almost impossible for them to completely shun external powers from getting involved in their own and the region’s affairs. Moreover, the member countries had diverging interpretations of ZOPFAN. They were also fundamentally anti-communists, with most of them maintaining an alliance with either the United States or the United Kingdom.

In a study conducted in 1981, the author described the changing of China’s policy towards ASEAN as a function of its relationship with the United States. Thus, before the pingpong diplomacy of US President Richard Nixon, China was very much averse to ASEAN’s creation, seeing it as a mere extension of US engagement in the region. However, as US-China relations thawed out, there was a concomitant Chinese positive reaction to ASEAN (Carlos, 1982).

In sum, the founding of ASEAN was both a reaction to the domestic instability in the five original member countries primarily brought about by separatism and communist insurgencies, and a response to the volatile regional geopolitical environment of the 1960s.

ASEAN institutions

ASEAN is a loose regional intergovernmental organisation that aims to foster fraternal relations among neighbouring countries through co-operation in various areas of common interest. At its founding in 1967, ASEAN was intended to serve as a medium for co-operation and confidence-building among mutually suspicious states and not for regional integration. It is, in fact, an association that gives highest priority to the preservation of national sovereignty and the promotion of national interest. This is reflected in the fact that ASEAN does not have a centralised decision-making structure. It is basically driven by numerous meetings and consultations at various levels of government.

Officially, the highest authority of the Association is the Meeting of ASEAN Heads of Government, or the ASEAN Summit, that formally meets every three years and informally at least once in between. *De facto*, it is the ASEAN Ministerial Meeting (AMM) that functions as the highest decision-making body and is considered as the *primus inter pares* among all ASEAN institutions (Soesastro, 2001, pp. 278-279).

The AMM, established by the 1967 Bangkok Declaration, is an annual convention of ASEAN foreign ministers tasked with formulating policy guidelines and co-ordinating the programmes and activities of the Association. The AMM's everyday activities are being performed by a Standing Committee composed of the Foreign Minister hosting the AMM, the ASEAN Secretary-General, and the Directors-General of the ASEAN National Secretariats. Through the years, several ministerial meetings have already been institutionalised, including the ASEAN Economic Ministers Meeting (AEMM) and the ASEAN Finance Ministers Meeting (AFMM), among others. To oversee ASEAN's external relations with its dialogue partners, the ASEAN Committees in Third Countries, consisting of the heads of the diplomatic missions of ASEAN member countries in the host country, were formed. At present, there are 15 such committees in various capitals in the Asia Pacific and Europe.

The Agreement signed at the 1976 Bali Summit provided for the ASEAN Secretariat, headed by a Secretary-General, which is mandated "to provide for

greater efficiency in the coordination of ASEAN organs and for more effective implementation of ASEAN projects and activities”. This limited mandate of the Secretariat was enlarged in 1992 with the strengthening of the role and elevation of the position of the Secretary-General of the ASEAN Secretariat – re-designated, in accordance with the 1992 Manila Protocol, as the Secretary-General of ASEAN, with the mandate to initiate, advise, co-ordinate and implement ASEAN activities. But this did not, however, change the elemental nature of ASEAN as a loose intergovernmental framework largely dominated by foreign ministers.

The rather fluid ASEAN framework is sustained by various principles and procedural norms that are collectively called the ASEAN Way. Its main features are non-interference in the domestic affairs of member states, the processes of consultation (*musyawarah*) and consensual decision making (*mufakat*), and a preference for soft institutionalism and peaceful settlement of disputes.

According to Michael Antolik (1992, p. 125-126), the ASEAN Way is based on the three principles of restraint, respect, and responsibility. Restraint is reflected in the ASEAN members’ strict adherence to the non-interference principle. Respect is operationalised through consultation and dialogue during which members present their views and positions on various concerns, after which a consensus is sought. Because of the consensus decision-making rule, highly divisive issues are rarely discussed in ASEAN, if at all. It is deemed futile to discuss issues where consensus is not possible. ASEAN practically works on the basis of the lowest common denominator. Responsibility is manifested when member countries consider each other’s sensitivities by, for example, consciously taking into account the possible effects of domestic policies on one another.

The loose ASEAN framework and the ASEAN Way are maintained because they provide occasions for “face-saving”, deemed important in preserving solidarity and cohesion in the Association. While these two factors have been instrumental in ASEAN’s success in its early years of existence, several critics have noted that they have become ineffective given the present security and economic environment.

ASEAN milestones

Since 1967, no open conflict has erupted between ASEAN member countries. The relative peace that has ensued in the region since the Association’s inception provided a fertile ground for economic development.

The high economic growth experienced by the major Southeast Asian countries in the early 1990s is partly attributed to ASEAN's successful management of conflicts among states. ASEAN considers this one of its major achievements. The Association also takes pride in its role in the resolution of the Cambodian conflict and in the establishment of the ASEAN Regional Forum.

In the Cambodian conflict, ASEAN sponsored resolutions calling for a comprehensive political settlement in Cambodia at the UN General Assembly. With France and Indonesia at the chair, the Paris Conference on Cambodia held on 23 October 1991 produced the Comprehensive Political Settlement of the Cambodia Conflict, which paved the way for the establishment of the Cambodian Supreme Council and the holding of elections administered by the United Nations Transitional Authority on Cambodia.

The creation of the ASEAN Regional Forum (ARF), a multilateral consultative forum for security issues in the Asia Pacific region, was another high point in ASEAN security co-operation. It introduced a new kind of multilateralism underpinned by the principle of open regionalism and co-operative security.

The ARF was ASEAN's response to the uncertainties of the post-cold war security environment brought about by the changing balance of power in the region; the resurgence of outstanding intra-ASEAN territorial disputes; and the South China Sea rival claims and domestic instability (Acharya, 2002, p. 198). The ARF draws upon the ASEAN model of institutionalism – one that adheres to the norms of non-interference in the internal affairs of states, renunciation of force as a tool for conflict resolution, pacific settlement of dispute, informality, and the consensus decision-making process.

Up until the 1997 Asian financial crisis, some scholars viewed ASEAN as a successful regional organisation second only to the European Union. However, ASEAN's failure to come up with an immediate, coherent, and collective response to the financial crisis tarnished its reputation. Indeed, the growing salience of interdependence issues such as the financial crisis and some non-traditional security threats is putting pressure on ASEAN co-operation frameworks.

In the security aspect, the increasing pervasiveness of transnational crimes such as terrorism, for instance, is challenging the principles of sovereignty, territoriality and non-intervention that ASEAN countries all hold sacred. It also puts into question the modes of ASEAN security co-operation, *i.e.* the

preference for soft institutionalism and the habit of sweeping contentious issues under the rug.

Hence in 1998 there arose a debate on whether or not to redefine the ASEAN Way. Concepts such as constructive engagement, constructive intervention, flexible engagement and enhanced interaction, all of which call for a more flexible interpretation of the non-interference principle, were put forward by Thailand and the Philippines. In the end, ASEAN settled with “enhanced interaction” that “implied that while non-intervention remained the norm for the region, states could voice their concerns over how and what is happening in one country could affect them or the region” (Kraft, 2000, p. 34).

At the Sixth ASEAN Summit held in 1998 in Vietnam, it was agreed that a review of ASEAN’s overall organisational structure shall be conducted “in order to further improve its efficiency and effectiveness, taking into account the expansion of ASEAN activities, the enlargement of ASEAN membership, and the regional situation”.¹

During the ASEAN Ministerial Meeting held in June 2003, Indonesia formally proposed the establishment of an ASEAN security community (ASC). While it is true that the underlying rationale of ASEAN’s existence was to address economic development as a bedrock of security, co-operation on security since 1967 has not been as robust compared to other areas of co-operation.

ASEAN has not actually ventured into conflict resolution, as may be evidenced by the fact that there are outstanding intra-ASEAN disputes that have yet to be resolved. And although the Treaty of Amity and Cooperation provides for the creation of the High Council, supposedly a dispute settlement mechanism, this has not yet been invoked despite the existence of some irritants in intra-ASEAN relations.

The Ministry of Foreign Affairs, Indonesia maintained that “ASEAN should work to transform itself from a strictly ‘conflict management’ entity into a ‘conflict resolution’ institution”, to make it more relevant and responsive to the new security challenges facing the region.

Acting on the Indonesian ASC proposal, the ASEAN leaders signed the Declaration of ASEAN Concord II, dubbed as the *Bali Concord II*, during the 9th ASEAN Summit held in October 2003 in Bali. The Bali Concord II provides for the creation of an ASEAN Community “comprising three pillars, namely

political and security cooperation, economic cooperation, and socio-cultural cooperation that are closely intertwined and mutually reinforcing for the purpose of ensuring durable peace, stability and shared prosperity in the region.” To operationalise the ASC, ASEAN would have to strengthen already existing norms and institutions and, where necessary, establish new ones. Whether or not the ASEAN leaders have the political will to do so remains to be seen.

Having seen the various co-operation experiences of this region, it may be instructive to look at the European Union experience, as it tackles similar challenges confronting its members. This extensive section has been appended as an annex for readers not familiar with the workings of the EU.

Proposing a Regional Rapid Response Experts Co-operation Group (RRRECG)

The Asia Pacific’s security environment. The Asia Pacific region is faced with both traditional and non-traditional security challenges. The North Korean nuclear question, the South China Sea rival claims and the cross-strait relations between Taiwan and China are seen as three of the conflict areas in the region that have yet to be resolved.

Interlaced with these are several transnational threats such as trafficking in illegal drugs, people smuggling that includes trafficking in women and children, sea piracy, terrorism, arms smuggling, money laundering, international economic crime and cyber crime. In recent years, the Asia Pacific region saw the expansion and diversification of these transnational crimes (TNCs) because of the technological breakthroughs that are paving the way for deeper interconnectedness and interdependence among peoples and states around the world. While this international order has been instrumental in bringing about vast opportunities for development worldwide, it has also facilitated the transit of illegal drugs, dirty money, counterfeit goods, arms and nuclear materials from one territory to another.

The situation has posed serious problems for states and their people. One of these is the transformation of organised crime from a national security issue to a transnational problem that threatens national and international peace. International terrorism and sea piracy, for instance, are transnational crimes that are increasing in the region at an alarming rate.

The terrorist attacks in the United States on 11 September 2001 made international terrorism the number one issue because of the enormous damage they brought about and the high degree of sophistication with which they were carried out.

Although terrorism has long been a security problem in the Asia Pacific region, it gained sustained worldwide attention only after the attacks, primarily because 11 September introduced a new brand of terrorism. According to Arabinda Acharya,² new terrorism as exemplified by 9/11 differs from the pre-modern and modern brands of terrorism in terms of motivation, structure, and weapons employed. Acharya noted that today's terrorists are highly mobile and that they work within a networked structure that transcends borders. They are highly trained and have access to unconventional weapons. While terrorists in the past engaged in discriminate acts of violence aimed at producing just enough bloodshed for clear political goals, today's terrorists seek to wreak mass destruction and casualties for a set of political demands that are neither that coherent nor that negotiable.

There is also a very strong religious dimension, in the sense that groups like Al-Qaeda use religion to justify their acts and to rally support for their cause. The new terrorism has become a major threat to regional and global security, as was made clear by the spate of bombings in Southeast Asia, particularly in Bali and Jakarta, Indonesia that followed the 11 September attacks.

Southeast Asia is, however, no stranger to terrorism. Since the independence of many Southeast Asian countries from colonial rule, a number of disgruntled groups within each nation have engaged in terrorism to further their cause. Terrorist acts were a tactic used to try to overthrow governments or secede from existing states. "Terrorism and militancy in Southeast Asia has taken, and still takes, various forms. In the past there was communist terrorism, sectarian militancy, separatism, ethnic militancy, and (arguably) even state terrorism."³

Recent incidents of terrorism in the region, however, are fuelled mainly by the growing inequality between the rich and poor, the increase in poverty, and the social, economic and political marginalisation of many sectors of society.

Another phenomenon associated with recent incidents of terrorism in the region is the rise of so-called radical Islam. Although the majority of moderate Muslims have strongly branded its ideology and means as un-Islamic, radical

Islamic groups have added a religious dimension as mentioned above, as well as the infusion of anti-Western sentiments – the West is perceived as a threat to their way of life and as the “evil” in the world. This led to stronger resolve among their believers and the broadening of their influence to a number of Muslim groups throughout Southeast Asia.⁴ The reported links of the region’s radical Muslim groups with other radical groups and organisations such as Al-Qaeda has certainly made them more dangerous to the overall security of the region.

Piracy and armed robberies at sea are another major threat to the security of the Asia Pacific region, specifically in the Strait of Malacca and South China Sea. In its quarterly report, the International Maritime Bureau (IMB) found that the Indonesian waters remain the world’s most dangerous, with the bulk of pirate attacks between January and March 2003 taking place there.⁵

Securing the Strait of Malacca, one of the world’s busiest sea lanes, is crucial because 50% of the world’s oil shipments by sea pass through it from the Gulf to East Asia. Piracy attacks pose a danger not only to international commercial shipping, but also to maritime environments in cases where they are committed against vulnerable vessels such as gas and chemical tankers. The recent IMB quarterly report found that the incidence of pirate attacks in the Malacca Straits against small tankers is alarming. If such attacks go unchecked, it is feared that environmental disasters will not be far behind.⁶

Aside from transnational crimes, the Asia Pacific region is also occasionally confronted with trans-boundary disasters. The most recent environmental disaster that severely affected several Southeast Asian states was the smoke haze incident that occurred in 1997, already noted in an earlier section. The haze, caused by land and forest fires, originated in Sumatra and Kalimantan and spread to Brunei Darussalam, Malaysia, Singapore, the Philippines and Thailand. Although the haze has been present since the 1990s, it only gained serious regional attention in 1997 and 1998, years in which the problem was unprecedented in terms of severity and magnitude, thereby compelling the ASEAN states to try to come up with regional solutions. The economic losses of the affected Southeast Asian states reportedly amounted to USD 9 billion in terms of losses in agricultural production, tourism, and other economic enterprises. It also resulted in respiratory illnesses across the region.⁷

Southeast Asia has also experienced the rapid deterioration of the environment due to air, water and soil pollution brought about by a combination of overpopulation and economic pressures. Other regional environmental

problems are acid rain, climate change, deforestation, and coastal and marine pollution. Disposal of radioactive waste is also a problem since a number of countries in the region – China, Japan and South Korea – rely heavily on nuclear power. Some European countries have also been monitored as disposing their nuclear wastes in the region.

The region also saw the emergence of infectious disease outbreaks such as HIV/AIDS, SARS and the Avian Influenza. These infectious diseases have greatly affected health, travel, trade and business in the region, threatening the stability of economies and regional security. No single national government or bureaucracy can tackle the aforementioned challenges. The regional group being proposed is meant to address these. Thus, the concept of security has been widened to embrace the whole issue of human security.

Towards a new concept of security

Indeed, today's security challenges are no longer limited to war, invasion and other forms of external aggression that threaten the viability and integrity of the state. Threats to security now include issues that directly impinge on the right of every individual to live life in dignity. Hence, there is a need for a new concept of security to replace the traditional idea that is state-centric – human security.

The notion of human security is increasingly gaining relevance and acceptance in view of the rise of new security issues. Human security as defined by the United Nations Development Program (UNDP) as “freedom from fear and freedom from want”. It refers to “the security of the people – their physical safety, their economic and social well-being, respect for their dignity and worth as human beings, and the protection of their human rights and fundamental freedoms” (International Commission on Intervention and State Sovereignty, 2001, p.14). Because it is comprehensive and people-centred, it can be a helpful framework for analysing and addressing issues that directly affect the well-being of individuals.

Transnational crimes, trans-boundary disasters and regional environmental problems and health threats, among others, challenge not only the traditional notions of security, but also and even more so the fundamental underpinnings of the Westphalian state system. The notions of sovereignty and territoriality, for instance, are gradually being eroded as the demarcation between what is domestic and foreign begins to blur. As noted earlier, the traditional capacity of the state to protect its citizens is called into question as it becomes, by itself,

powerless in the face of transnational threats perpetrated mostly by non-state actors. The state's prime position in the national as well as international arena is thus diminished.

“States have become almost outmoded organizations: the world is attempting to deal with a twenty-first century phenomenon using structures, mechanisms and instruments that are still rooted in eighteenth- and nineteenth century concepts and organizational forms.” (Godson and Williams, 1998, p.1).

Transnational threats defy the Westphalian concept of the sovereign state that is territory-bound, primarily because they require co-ordinated international or regional solutions. This of course runs counter to the fundamental concept of territoriality, sovereignty and its corollary principle of non-interference in the internal affairs of another state.

The traditional ways of maintaining national security through military means can no longer effectively address the requirements of the radically changed security situation.

What is now needed is an approach that combines military and civilian responses in a co-ordinated and timely manner. The necessity for a civilian response lies in the fact that many of the security issues that the region has to grapple with are now highly specialised and technical. An example of this is cyber crime, where computer experts in the region would be of much help rather than the military or even the police.

Asia Pacific responses to transnational threats

The Asia Pacific states are attempting to move towards this kind of approach in combating transnational crimes and other trans-boundary problems. But there are apparent weaknesses in their initiatives, primarily because most if not all of them are still trapped in the territorial/sovereignty cocoon. Nevertheless, there have been attempts to come up with bilateral and regional responses to common security problems.

The ASEAN states, for example, have long been trying to address the issue of transnational crimes collectively. In fact, the ASEAN initiative against TNCs, though limited to drug abuse and trafficking at the outset, dates back to 1976 when the Declaration of Principles to Combat the Abuse of Narcotic Drugs was signed. Since then, under the rubric of functional co-operation, the Association has already embarked on a number of programmes on preventive

education and information, law enforcement, treatment and rehabilitation, and research aimed at curbing drug abuse and trafficking in the region (ASEAN Secretariat, 1995, p. 25).

In the 1990s, the ASEAN agenda on TNC was expanded to include other trans-boundary problems, *e.g.* terrorism, human trafficking, piracy, money laundering and cyber crime, that have become so pervasive in the region. The framework for ASEAN co-operation against TNCs is anchored in the ASEAN Declaration on Transnational Crime, which was adopted by the ASEAN Ministers of Interior/Home Affairs in 1997. The Declaration recognises the “need for clear and effective regional modalities” to combat TNCs, “especially on the aspect of information exchange and policy coordination”.

In 1999, as mandated in the Declaration, the Second ASEAN Ministerial Meeting on Transnational Crimes (AMMTC) adopted the Plan of Action to Combat TNC and the Institutional Framework for ASEAN Cooperation on Combating TNC. The AMMTC also approved, in principle, the creation of an ASEAN Center for Combating TNC (ACTC). The Plan of Action sets out a regional strategy in the prevention and neutralisation of transnational crimes, focusing on intensified co-operation in the field of information exchange, legal and law enforcement matters, institutional capacity-building and training.

To complement initiatives at the regional level, the Plan of Action also calls for enhanced extra-regional co-operation with relevant partners. Under the agreed framework, on the other hand, the AMMTC serves as the highest policy-making body of ASEAN on issues regarding TNCs and is tasked with the supervision of TNC-related activities of other ASEAN bodies such as the ASEAN Chiefs of National Police (ASEANAPOL), the ASEAN Senior Officials on Drug Matters (ASOD), the ASEAN Finance Ministers Meeting (AFMM), the ASEAN Directors-General of Immigration Departments and Heads of Consular Affairs Divisions of the Ministries of Foreign Affairs (DGICM), and the ASEAN Senior Law Officials Meeting (ASLOM). The Senior Officials Meeting on Transnational Crime (SOMTC) was also established as the implementing and co-ordinating hand of the AMMTC. The AMMTC meets at least once every two years, while the SOMTC convenes once a year.

After the 9/11 attacks, countering terrorism became a priority agenda in ASEAN. In the 2001 7th ASEAN Summit, the *Declaration on Joint Action to Counter Terrorism* was adopted. In that document, ASEAN leaders expressed their condemnation of the 9/11 attacks and vowed “to counter, prevent and

suppress all forms of terrorist acts in accordance with the Charter of the United Nations and other international law.” The declaration identified practical measures to be implemented to strengthen ASEAN’s counter-terrorism efforts.

These are:

1. Review and strengthen our national mechanisms to combat terrorism.
2. Call for the early signing/ratification of or accession to all relevant anti-terrorist conventions including the International Convention for the Suppression of the Financing of Terrorism.
3. Deepen co-operation among our front-line law enforcement agencies in combating terrorism and sharing “best practices”.
4. Study relevant international conventions on terrorism with a view to integrating them with ASEAN mechanisms on combating international terrorism.
5. Enhance information/intelligence exchange to facilitate the flow of information, in particular on terrorists and terrorist organisations, their movement and funding, and any other information needed to protect lives, property and the security of all modes of travel.
6. Strengthen existing co-operation and co-ordination between the AMMTC and other relevant ASEAN bodies in countering, preventing and suppressing all forms of terrorist acts. Particular attention would be paid to finding ways to combat terrorist organisations, support infrastructure and funding, and to bringing the perpetrators to justice.
7. Develop regional capacity-building programmes to enhance the existing capabilities of ASEAN member countries to investigate, detect, monitor and report on terrorist acts.
8. Discuss and explore practical ideas and initiatives to increase ASEAN’s role in and involvement with the international community, including extra-regional partners within existing frameworks such as the ASEAN + 3, the ASEAN Dialogue Partners and the ASEAN Regional Forum (ARF), to make the fight against terrorism a truly regional and global endeavour.

9. Strengthen co-operation at bilateral, regional and international levels in combating terrorism in a comprehensive manner and affirm that at the international level the United Nations should play a major role in this regard.⁸

In May 2002, ASEAN adopted a Work Programme to Implement the ASEAN Plan of Action to Combat Transnational Crime. It outlined various measures and lines of action aimed at combating seven transnational crimes, namely: illicit drug trafficking, trafficking in persons, sea piracy, arms smuggling, money laundering, terrorism, and cyber crime. Regarding counter-terrorism, some of the activities that are to be undertaken include the following:

1. Compilation and dissemination of relevant laws and regulations of ASEAN member countries.
2. Compilation and dissemination of bilateral and multilateral agreements and information on relevant international treaties where feasible.
3. Development of multilateral or bilateral legal arrangements to facilitate apprehension, investigation, prosecution, extradition, inquiry and seizure, in order to enhance mutual legal and administrative assistance among ASEAN member countries where feasible.
4. Enhancement of co-operation and co-ordination in law enforcement and intelligence sharing.
5. Development of regional training programmes.

The ARF is another forum where the issue of terrorism is tackled multilaterally. The ASEAN Regional Forum Statement on Measures Against Terrorist Financing adopted at the 9th ministerial meeting identified concrete actions aimed at halting the flow of money to terrorist groups. These include freezing of assets of terrorists, implementation of international standards aimed curbing abuses of the financial system, exchange of information and outreach, and technical assistance. The establishment of the Inter-Sessional Meeting on Counter-Terrorism and Transnational Crimes (ISM-CT/TC) was also agreed on that occasion. During the first meeting of the ISM-CT/TC, convened in Malaysia in March 2003, the ARF Statement on Cooperative Counter-Terrorist Action on Border Security was adopted. It outlines different measures that the ARF participants commit to undertake to regulate the movement of people and goods across borders. These include:

- “Encourage multilateral co-operation on border security among ARF members to combat terrorism.
- Encourage ARF consideration and adoption of new measures for border security proposed by the International Civil Aviation Organization (ICAO), the International Maritime Organization (WCO) and other relevant organizations.
- Provide, where necessary and possible, technical assistance and capacity-building infrastructure to states that need help in developing laws, training, and/or in acquiring the equipment to enhance border security.
- Enhance ARF participants’ efforts to share information useful on terrorism and transnational organized crimes such as illegal arms trafficking, drug trafficking, people smuggling, and money laundering, where feasible domestically and internationally as a vital component in the fight against terrorism.”⁹

The Asia Pacific Economic Forum (APEC) has also started taking action against transnational crime by establishing the Counter Terrorism Task Force (CTTF) in February 2003. The CTTF is tasked with co-ordinating capacity-building and technical assistance programmes, engaging with international and regional organisations, and facilitating APEC co-operation on counter-terrorism issues.

While these intergovernmental regional organisations have signified their willingness and commitment to fight terrorism collectively through the various declarations they have adopted, they have been rather slow in implementing their plans. ASEAN provides an example.

Following the 9/11 and Bali bombing attacks, the Association has made several declarations that enunciate its willingness to fight terrorism at the regional and extra-regional level. On the operational level, however, crucial counter-terrorism efforts in the region are being conducted mostly on an *ad hoc* basis either bilaterally or multilaterally. The trend seems to be that ASEAN serves only as a venue for consultation among ASEAN officials leading to the formulation of supposedly region-wide counter-terrorism strategies. The implementation process, however, is not necessarily undertaken under the direct auspices of ASEAN and does not have to involve all member countries.

On information exchange, for instance, intelligence-sharing on terrorism-related information has been conducted largely at the bilateral level. There has been sharing of crucial intelligence information between Malaysia, Singapore, Indonesia and the Philippines that greatly contributed to the successful apprehension of a number of suspected terrorists. Exchanges of information and intelligence between the Philippines and Singapore, for example, have produced positive results. They facilitated the arrest of 15 alleged terrorists in Singapore¹⁰ in 2002 and of Fathur Rahman al-Ghozi, an Al-Qaeda bomb expert, in the Philippines on 15 January 2002.¹¹

A multilateral arrangement has also been established with the conclusion of the “Agreement on Information Exchange and Establishment of Communication Procedures” on 7 May 2002 by the Philippines, Indonesia and Malaysia. On 30 July 2002, Cambodia acceded to the agreement, followed by Thailand in November 2002.¹² This was, however, a Philippines initiative.

ASEAN has not been able to concretely pursue its counter-terrorism agenda, or in general its anti-TNC Work Programme, as quickly as it should because it is limited by its own decision-making processes. The ASEAN Way, which puts primacy on national sovereignty and its corollary of non-interference in the domestic affairs of member states, limits the implementation of counter-terrorism initiatives that entail surrender of sovereign rights of states. It has also produced only weak co-operation mechanisms and institutions.

The institutional framework of ASEAN co-operation on matters regarding transnational crimes, for instance, is loose and has very limited powers. The ASEAN Ministerial Meeting on Transnational Crimes (AMMTC) and the Senior Officials Meeting on Transnational Crime (SOMTC), for example, are just consultative and policy-making bodies having no compliance mechanisms. As a result, the implementation of initiatives and measures formulated by the AMMTC proceeds rather slowly.

Take the case of the establishment of an ASEAN Center for Combating TNC (ACTC). The AMMTC agreed in principle to establish such an institution as far back as 1999 when they adopted the Plan of Action to Combat TNC and the Institutional Framework for ASEAN Cooperation on Combating TNC. But until now it has not been done.

How, then, should the Asia Pacific states proceed in securing its peoples from non-traditional security issues?

Towards a functional approach to human security in the Asia Pacific

Given the history of co-operation in the region, a framework created along functional lines might be the best alternative. By establishing a functional agency/body mandated to address various needs that transcend political boundaries, the issue of sovereignty and territoriality is de-emphasised as habits of co-operation take root. Multilateral ventures then become more operational and productive. These multilateral arrangements would in the long run bind states in a web of interdependence and commonalities.

As David Mitrany stresses, functionalism would contribute to “the expansion of such positive and constructive common work, of common habits and interests, making frontier lines meaningless by overlaying them with a natural growth of common activities and common administrative agencies” (Mitrany, 1966, p. 63). The functional approach, therefore, provides an avenue for compromise between the need to preserve one’s sovereignty and the need to co-operate with other states to counter common problems. It gives the states the opportunity to work together to achieve a common good.

The creation of a regional body designed along functional lines is the most appropriate response to the security challenges of the region. This may be called the Regional Rapid Response Experts Co-operation Group and would be composed of a multinational, Asia Pacific-wide group of natural and social scientists and disaster management experts and medical experts such as doctors, virologists and clinicians.

The experts comprising the group would come from various sectors – *inter alia*, non-governmental organisations (NGOs), government organisations and academia. A highly trained pool of law enforcement agents including, where required by the task, a military component would complement the RRRECG.

For purposes of flexibility, the RRRECG is envisioned as an organisation fundamentally independent from any of the existing intergovernmental organisations in the region such as ASEAN and the ARF. However, based on the EU’s experience, it is important that the RRRECG establish modalities of consultation and co-operation with these organisations, governments and other relevant bodies in order to maximise resources and avoid duplication of work. As EU had to co-ordinate with NATO in order to enhance the capabilities of its rapid reaction force, the RRRECG has to work out an arrangement with ASEAN or the ARF to enhance inter-organisational co-operation in terms of

access to resources. It also has to establish modalities of co-operation with Asia Pacific governments, especially in law enforcement and military matters.

The rapid response group would provide timely responses to regional human security challenges, specifically those related to transnational crimes and natural, technological and human, caused disasters. The ultimate goal of the RRRECG is to contribute to the prevention and mitigation of such crises. To fulfil the said objectives, it would have the capability to provide timely and accurate early warning information and risk analysis on emerging human security issues, including disaster management activities.

The RRRECG is envisioned to be deployed upon the request of a particular state or international organisations such as the United Nations, ASEAN and the ARF.

The activities of the RRRECG would be divided into two: those that are to be performed in the routine non-crisis phase and those that are to be conducted during the operational or crisis stage. In the routine non-crisis phase, meetings among the member experts would be institutionalised. The aim is to facilitate exchanges of information and expertise on issues covered by the RRRECG. In this regard, it might be practical to divide the experts into various working groups/committees that would look into specific security problems. During the operational stage, the experts, together with the appropriate law enforcement agents, would be deployed where necessary to provide on-site advice.

Like the EU's ESDP, the RRRECG would have particular institutions to oversee its day-to-day operations and those during crisis times. The permanent structure of the RRRECG will have to be conceptualised in accordance with the specific functions it would be performing. Consultations among stakeholders and possible members/participants of the RRRECG would have to be conducted in the process.

There must be a regional co-ordinating body that should be in charge of the RRRECG activities, including the crucial task of maintaining a database on all information related to disaster management and TNCs.

Challenges

The implementation of the proposal to create an RRRECG is expected to meet several challenges, to wit:

Membership. To be effective, the RRRECG must recruit the number of experts proportionate to the number of security issues it would be addressing. Because of the great diversity of the transnational issues that would be covered by the RRRECG, problems might arise in the recruitment and maintenance of experts. There is also the question of the type of membership that the rapid response group will be adopting. Will it be on an institutional or individual basis? The merit of institutional membership lies in the fact that institutions have assured resources that can be tapped in the implementation of RRRECG activities. The downside is that institutions have their own programmes and priorities that might at one point or another be incompatible with those of the RRRECG. With individual membership, the advantage is that the RRRECG would have, to a certain extent, direct and exclusive control over its members.

RRRECG's military/police component. Providing the RRRECG with these components suggests that there would also be a sort of regional rapid response military or police force. Considering that the RRRECG is envisioned as a non-governmental organisation, there may be difficulties in implementing this because the idea of creating a rapid response force necessarily entails the definition of the roles/tasks that either or both the military and the police in each member country will undertake to interface with the experts' team in the region. A system may be devised so that the differences in the level of defence spending and military capabilities among the member countries will be addressed.

But in the absence of an EU-like rapid reaction force, the RRRECG may opt to forge *ad hoc* arrangements with particular governments that would allow joint operations by it and a police and/or military contingent from relevant countries. In the process, various issues have to be addressed:

- What situations warrant RRRECG operations with military/police participation? Who will determine those?
- What will the working relationship of the RRRECG be *vis-à-vis* the military/police during the actual operation?
- To whom will the military/police component be responsible?

Funding. For the RRRECG to function effectively it must have sustainable financial resources. The RRRECG may devise a contribution plan for different kinds of membership – government, non-government, individual, to establish a fund for its operation.

Initiation. Who will initiate the process of creating a Regional Rapid Response Experts' Co-operation Group? It is suggested that the initiative come from the non-government sector since the RRRECG is supposed to be a non-governmental organisation. But who among the multitude of NGOs in the Asia Pacific will spearhead the process? And how shall it be done? On this issue, the experience of the Regional Working Group for an ASEAN Human Rights Mechanism might be instructive. The Working Group was established in 1996 primarily to lobby with ASEAN governments at the regional and national levels for the establishment of an ASEAN Human Rights Mechanism. The Working Group was formed after a series of regional meetings and workshops on human rights in which representatives of governments and non-governmental organisations participated following the 1993 World Conference on Human Rights. It is organised into national working groups composed of representatives of government institutions, parliamentary committees, academia and NGOs. The Working Group conducts dialogues with ASEAN officials during the Association's ministerial meetings and organises human rights workshops and other education activities.

The RRRECG proposal may be presented in a regional Track II forum where the prospective major stakeholders are present. After which, a core group composed of representatives from various Asia Pacific states may be formed to formulate the strategic plan for the establishment of the group.

Conclusion

The challenges confronting the Asia Pacific region require regional solutions. While various regional intergovernmental organisations and non-governmental organisations are in one way or another engaging in initiatives to counter common security threats, the Asia Pacific still needs more rapid and more effective ways of ensuring human security for its peoples. Existing organisations have their own inadequacies that limit them from embarking on more effective endeavours aimed at addressing the pressing challenges of the region within a short period. Many of the challenges of the region require rapid response. Unfortunately, the decision-making mechanisms and the inertia of the national bureaucracies underlying the various governmental groupings like the ASEAN and the ARF are not adequate for quick, timely response.

The Regional Rapid Response Experts' Co-operation Group being proposed, designed along functional lines, is envisaged to contribute effectively to the prevention and mitigation of the present security threats in the region.

This chapter has attempted to provide the broad outlines of what such a group should look like.

Annex

THE EUROPEAN UNION EXAMPLE

Like the experience in the Southeast Asia, Western European multilateral organisations started out in functional areas, *i.e.* economic and technical areas. In 1952, the European Coal and Steel Community [ECSC] was formed to integrate the coal and steel industries of Belgium, West Germany, Luxembourg, France, Italy and the Netherlands. In 1957, the European Atomic Energy Commission (Euratom) and the European Economic Community (EEC) were formed under the Treaty of Rome.

Euratom was established to “coordinate nuclear power development by pooling research, investment, and management” (Goldstein, 1994, p. 397) while the EEC was created to pave the way for the establishment of a Common Market. Through co-operation in “low politics”, that is, in relatively non-contentious matters, it was hoped that Western Europe would be saved from wars. The idea was to create a “cross-cutting economic linkages that would eventually bind states together politically” (Goldstein, 1994, p. 396). In 1967, these three structures were combined to form the European Community.

During the Cold War, the security of Western Europe was underwritten primarily by the United States through the North Atlantic Treaty Organization (NATO). “Over a forty-year period, NATO established an effective collective defence arrangement which would either make alternative security structures superfluous or, as particularly perceived by the United States, make the establishment of separate or autonomous security organizations intolerable” (Sperling and Kirchner, 1997, p. 29).

There have been attempts in the past to forge a European security identity independent from the United States, but none of these succeeded in obtaining a dominant position in Europe. For instance, at the height of the debate over the issue of rearming West Germany in the 1950s, France proposed the formation of a European Defence Community (EDC). France was strongly opposed to West German rearmament while the United States pushed for it. To overcome the impasse, France proposed the EDC where German forces were to be integrated into a European army. “The essential

purpose of the EDC was to make it possible for Germany to rearm and provide German military units for a European army in which they would be merged with similar contributions from other countries” (Goodspeed, 1967, p. 631). The EDC allayed the fears of France of a resurgent Germany because the integration of a German army into the EDC was at the force level, thereby denying German politicians control over a German army (Dorman and Treacher, 1995, p. 9).

The treaty providing for the creation of the EDC, which was signed by the six ECSC states in 1952, did not enter into force because of the disinclination of the French National Assembly to relinquish control over the French army and Britain’s refusal to join such a force (Goldstein, 1994, p. 396). In lieu of the EDC, the Western Union created in 1948 was transformed to become the Western European Union (WEU), envisioned “to become the means by which a defensive alignment of European nations can regulate the production of its own armament” (Goodspeed, 1967, p. 631). It also became the medium for Germany’s rearmament and admission into NATO.

The WEU was moribund for the most part of the cold war period. It was formally revived in 1984 with the signing of the Rome Declaration but this effort did not make much headway, as NATO remained the cornerstone of European security. In the early 1970s, on the other hand, the European Community endeavoured to co-ordinate their foreign policies through the development of the European Political Cooperation (EPC). This has had little success because of some inherent weaknesses – its adherence to the consensus principle, preference for non-binding and declaratory actions, and the absence of a compliance mechanism.

The failure of the various initiatives for defence and security integration in Europe was partly due to American opposition. While the United States in principle supported European integration for various reasons, it did not in reality want to see a European pillar that could challenge US leadership and pre-eminence within the alliance.

The end of the cold war changed the security perceptions of Western European states and the United States. The US perspective on the idea of creating a European foreign policy and institutional defence frameworks also shifted significantly. It began to see the advantages of having a European pillar in NATO, including the prospect of instituting an equitable burden-sharing arrangement with Europe. As some Western European states became well positioned economically to assume responsibility for their own security, they began thinking of defining a definite security role for the WEU and the EU.

The security environment also underwent changes with the emergence of new forms of threats such as the ethnic conflicts and instability in Central and Eastern Europe and other non-traditional security issues, which left the cold war security arrangements in Europe inadequate. Hence, questions on the utility of NATO arose – its *raison d’être* being gone with the disintegration of the Soviet bloc.

In December 1990, the Council of Ministers of WEU met in Paris and discussed the role that the WEU was going to play in the post-cold war security environment in and outside Europe. Subsequently, several proposals came about discussing how the WEU could cope with the changes in the security arena. One of these was the joint declaration on European Security and Defence presented by Britain and Italy, which elaborated on the idea of the WEU being the defence component of the European Union and the European pillar of NATO.

This proposal entailed the creation of a “European rapid reaction force” that would be at WEU and NATO’s disposal. There was opposition to the proposal as France, Germany, and Spain considered it too NATO-centred. France, for example, preferred the formation of a European Army not under NATO’s control. The stalemate was settled with the signing of the Declaration on Western European Union in Maastricht in 1992. The Declaration states that the “WEU will develop as the defence component of the European Union and as a means to strengthen the European pillar of the Atlantic Alliance.” It will also “formulate common European defence policy and carry forward its concrete implementation through further development of its own operational role...” To this end, the WEU committed to establish the structures necessary for the fulfilment of its goal, such as¹³

- “WEU planning cell;
- Closer cooperation complementary to the Alliance in particular in the field of logistics, transport, training and strategic surveillance;
- Meetings of the WEU Chiefs of Defence Staff;
- Military units answerable to WEU...”

In that same year, the WEU Ministerial Council met in Bonn. There they came up with the *Petersberg Declaration* outlining the type of military units that their members would make available to the WEU and the cases that warrant EU military action. Paragraph II/2 states that the WEU members are ready to contribute “military units from the whole spectrum of their conventional forces for military tasks” carried out under the authority of the organisation. And aside from its common defence obligations under Article 5 of the Washington Treaty and Article V of the modified Brussels Treaty, the military units of WEU member states could be employed for what came to be known as the Petersberg tasks.

These are:

- “Humanitarian and rescue tasks;
- Peacekeeping tasks;

- Tasks of combat forces in crisis management, including peacemaking.”

Like the WEU, the EC/EU had to adapt to the post-cold war environment by strengthening its political stature in world affairs in ways commensurate with its economic power. It was in this context that the idea of creating a common foreign and security policy (CFSP) complemented by a real capacity to act militarily if need be was born and given serious thought. The 1992 Maastricht Treaty that created the European Union paved the way for the establishment of CFSP, which aims to:

- “Safeguard the common values, fundamental interests and independence of the Union;
- Strengthen the security of the Union and its Member States in all ways;
- Preserve peace and strengthen international security;
- Promote international cooperation;
- Develop and consolidate democracy and the rule, and respect for human rights and fundamental freedoms.”

The EU intends to operationalise the CFSP in co-ordination with the WEU in terms of elaborating and implementing its decisions and actions that have defence implications. The Treaty of Amsterdam which was signed in 1997 further stated that the CFSP “shall include all questions relating to the security of the Union, including the progressive framing of a common defence policy...which might lead to a common defence, should the European Council so decide.”

The development of CFSP had, however, been sluggish. While it was institutionalised through the Maastricht Treaty in 1991, the EU did not earnestly address its defence component until 1998. The reasons are many. First, there exists a divide between the NATO and the non-allied states within the EU. Second, the EU states differ in terms of threat perceptions, military capabilities, and political status. Third, there are diverging perspectives among EU countries on the future security relations between the United States and Europe, with France favouring an independent European defence identity and Britain adhering to a NATO-oriented security outlook.

The efforts at closer defence integration gained headway with the holding of the Franco-British Summit in St-Malo on 4 December 1998. In that Summit, French President Jacques Chirac and British Prime Minister Tony Blair issued the St-Malo Declaration which stated that the “Union must have the capacity for autonomous action.”¹⁴ The Declaration provided a new impetus for the development of the CFSP, specifically the progressive framing of a common defence policy as provided in Article 7 of the Treaty of Amsterdam.

In the June 1999 European Council held in Cologne, the EU governments resolved that the “European Union shall play its full role on the international stage,” and towards this end, “the Union must have the capacity for autonomous action, backed up by credible military forces, the means to decide to use them, and a readiness to do so, in order to respond to international crises without prejudice to actions by NATO.”¹⁵ With this the Common European Policy on Security and Defense (CEPSD) under the CFSP pillar was established. The importance of the ESDP as an integral part of the CFSP was best explained by Javier Solana, the EU’s High Representative for CFSP, in a speech delivered in Berlin in December 1999, in which he said that:

“In an age of increasing globalization, many are insecure, feeling threatened by events over which they consider they have little if any control. We cannot respond to this by pretending these problems do not exist. Transnational problems require transnational solutions. The development of an effective ESDP is an important contribution. It will give us the ability, where appropriate and whenever necessary, to show that the Union is not prepared to stand idly by in the face of crises. Nor always to let others shoulder responsibility. It will be sign that the European integration dreamed by Europe’s founding fathers has come of age.”

Since Cologne, several major steps have already been taken to implement the ESDP, including the establishment of political, military, and civilian bodies, as well as the setting of headline goals for military capabilities.

In the Helsinki European Council held in December 1999, the EU states built on what was agreed in Cologne, stressing their resolve to acquire autonomous capacity to take decisions and initiate military operations covered by the Petersberg tasks, where NATO as a whole is not engaged. In this regard, they agreed:¹⁶

- Co-operating voluntarily in EU-led operations, Member States must be able, by 2003, to deploy within 60 days and sustain for at least 1 year military forces of up to 50 000-60 000 persons capable of the full range of Petersbergs;
- New political and military bodies and structures will be established within the Council to enable the Union to ensure the necessary political guidance and strategic direction to such operations, while respecting the institutional framework;
- Modalities will be developed for full consultation, co-operation and transparency between the EU and NATO, taking into account the needs of all EU Member States;

- Appropriate arrangements will be defined that would allow, while respecting the Union’s decision-making autonomy, non-EU European NATO members and other interested States to contribute to EU military crisis management;
- A non-military crisis management mechanism will be established to co-ordinate and make more effective the various civilian means and resources, in parallel with military ones, at the disposal of the Union and the Member States.

The EU’s rapid reaction force

The EU’s rapid reaction force is not designed to be a standing European army. The military headline goal set in Helsinki is actually a “process of multiple earmarking of existing forces to create synergies between them, identify and remedy gaps, and develop further interoperability” (Clarke and Cornish, 2002). The military aspect of ESDP is set to be able to perform the full spectrum of the Petersberg tasks, *i.e.* humanitarian and rescue tasks, peacekeeping, and tasks of combat forces in crisis management, including peacemaking. It is also designed to be capable of conducting at least two kinds of simultaneous operations:¹⁷

1. “A single corps sized crisis management task while retaining enough assets to conduct a small-scale operation such as a non-combatant evacuation operation (NEO).
2. A long-term operation at less than maximum level of effort while conducting another operation of a limited duration.”

In this regard, the EU committed to develop its military capabilities in terms of deployability, sustainability, interoperability, flexibility, mobility, survivability, and command and control. Following the European Council meeting in Helsinki, the Capabilities Commitment Conference (CCC) was held in November 2000; during the conference EU member countries drew up a catalogue of forces of national contributions for the rapid reaction force. The earmarked forces and assets amounted to 100 000 troops, 400 combat aircraft, and 100 naval vessels. At the Laeken Summit held in December 2001, the EU stated that it is “now capable of performing some crisis-management operations”. The tentativeness of the declaration was based on the fact that the Headline Goal Task Force (HTF) has identified 38 critical deficiencies in national military capacities (as committed in the CCC) *vis-à-vis* the operational requirements for the Petersberg tasks as specified in the confidential Helsinki Headline Goal Catalogue. These include:¹⁸

- Attack Helicopters/Support Helicopters
- Nuclear, Biological, and Chemical (NBC) Protection

- Unmanned Air Vehicles (UAV)/Surveillance and Target Acquisition (STA) Units
- Medical Role 3/Medical Collective Protection Role 3
- Special Operations Forces (SOF)
- Carrier Based Air Power
- Suppression of Enemy Air Defence (SEAD)
- Air-to-Air Refuelling (AAR)
- Combat Search and Rescue (CSAR)
- Cruise Missiles/Precision Guided Munitions
- Theatre Ballistic Missile Defence
- Deployable Communication Modules
- Headquarters (OHQ, FHQ, CCHQs)
- Theatre Surveillance and Reconnaissance Air Picture
- Strategic ISR IMINT Collection
- UAV (HALE, MALE and tactical UAVs)
- Early Warning and Distant Detection Strategic Level
- Strategic Air Mobility/Outsized Transport Aircraft, General Cargo Aircraft
- Roll-On-Roll-Off Vessels (RO-RO)/ General Cargo Shipping

To address these shortfalls, the European Capability Action Plan (ECAP) was launched. The ECAP, composed of national experts divided into 19 panels, was tasked with identifying possible solutions to 21 of the 38 capability shortfalls identified in the Helsinki Progress Catalogue. On 1 March 2003, the ECAP panels presented their reports specifying options to enhance capabilities through procurement and non-procurement initiatives.

At the May 2003 Capability Conference held in Brussels, the EU Ministers of Defence declared that the “current military assessment of EU capabilities is that the EU has now operational capability across the full range of Petersberg tasks, limited and constrained by recognised shortfalls.”¹⁹ The EU Defence Ministers also mandated ECAP to establish Project Groups “focused on the implementation of concrete projects, including solutions through acquisition or other solutions such as leasing, multinationalisation and considering possibilities for role specialisation.”²⁰

At the European Council in Thessaloniki in 2003, the EU agreed to establish the European Defence Agency the following year, an intergovernmental agency that will be entrusted with defence capabilities development, research, acquisition, and armaments.²¹

To further strengthen the EU’s ESDP instruments, the EU decided to incorporate the crisis management functions of the WEU into the Union at the Nice European Council (December 2000).

Berlin Plus

The efforts to establish a European defence identity have always engendered debates across the Atlantic, and even within Europe. The revitalisation of the WEU as the European pillar of NATO, for instance, brought about the debate on the WEU-NATO relations which was propelled by two incompatible views. “On the one hand, the WEU states wanted a capacity to take military actions if and when NATO were not inclined to act – by implication, that meant abstention by the United States. On the other hand, the United States and some other allies were concerned that few if any European states would provide the resources needed for a full-fledged WEU, in addition to NATO – there were simply not enough resources to create two sets of military forces” (Hunter, 2002, p. 13).

This was resolved by the introduction of WEU-NATO arrangements in the 1994 Meeting of the North Atlantic Council in Brussels, which was concluded in Berlin in 1996. The 1994 Declaration of the Heads of State and Government Participating in the Meeting of the North Atlantic Council states that NATO is ready “to make collective assets of the Alliance available, on the basis of consultations in the North Atlantic Council, for WEU operations undertaken by the European Allies in pursuit of their Common Foreign and Security Policy.” It also committed to “support the development of separable but not separate capabilities which could respond to European requirements and to contribute to Alliance security.” This became the basis for WEU-EU co-operation.

The introduction of the ESDP renewed the debate about the relationship of NATO *vis-à-vis* the EU. Following the St-Malo Summit, the US Secretary of State conveyed the US position on the ESDP, saying that “we enthusiastically support any such measures that enhance European capabilities”²² on the condition that it would not entail

the de-linking/decoupling of the ESDP from NATO, the duplication of efforts, and the discrimination of non-EU members of NATO.²³

In response to these concerns, at the Helsinki European Council meeting, the EU guaranteed that it will conduct dialogues, consult, and co-operate with NATO, including its non-EU members, the countries that are candidates for accession to the EU, and other prospective partners in EU-led crisis management. The EU in turn committed to develop modalities for full consultation, co-operation and transparency between itself and NATO. At the Feira European Council Meeting, the EU delineated the modalities for consultation with and/or participation of non-EU European NATO members and other countries that are candidates for accession to the EU in its crisis management operations.

The modalities that have been outlined cover two situations: the routine non-crisis phase and the operational phase which is divided into two stages, *i.e.* the pre-operational phase and the operational phase “*stricto sensu*”. In the routine non-crisis phase (peacetime), meetings would be held between the 15 EU members and the 15 countries concerned, *i.e.* the non-EU European NATO members and the accession candidates. At least two meetings would also be conducted between the EU members and the six non-EU European NATO members (15 + 6 format). In the event of a crisis, the EU will pay particular attention to consultation with the six non-EU European NATO members if the use of NATO is being considered. During the operational phase “*stricto sensu*”, the non-EU NATO members can participate should they wish to do so in an operation that entails the utilisation of NATO assets and capabilities. They will have the same rights and obligations in the everyday conduct of that operation as the EU participating member states.

As regards EU-NATO relations, there has been progress in the implementation of the Berlin Plus arrangements, based on NATO’s declaration at the 1999 Washington Summit that it stands ready “to define and adopt the necessary arrangements for ready access by the European Union to the collective assets and capabilities of the Alliance, for operations in which the Alliance as a whole is engaged militarily as an Alliance.”²⁴ These arrangements build on the 1994 and 1996 arrangements arrived at in Brussels and Berlin, respectively.

In December 2002, the permanent arrangements on EU-NATO consultations and co-operation were concluded. The primary features include assured EU access to NATO planning capabilities and the presumption of availability of the pre-identified collective assets and capabilities of NATO. This development paved the way for EU-NATO strategic partnership.

On 11 March 2003 the EU-NATO confidentiality agreement was concluded, thereby allowing the EU to take over NATO’s Allied Harmony operation in Macedonia on 31 March 2003.

Institutional framework

The following political and military bodies were established within the Council between October 1999 and March 2000 to provide political guidance and strategic direction to ESDP operations (Howorth, 2000, pp. 16-17):²⁵

- *Political and Security Committee (PSC)*. The PSC is composed of national representatives at ambassadorial level and is tasked with monitoring crisis situations and offering policy recommendations to the European Council. In the event that the EU is to launch actual military operations, it will exercise political control and strategic direction of such operations. The PSC convenes twice a week in Brussels.
- *European Union Military Committee (EUMC)*. The EUMC is composed of Chiefs of Defence, represented by their military delegates. The EUMC meets at the level of the Chiefs of Defence as and when necessary. It is tasked with providing military advice to the PSC and giving direction to the military staff. The Chairman of the EUMC, who is a four-star officer, has a close working relationship with the HR-CFSP and attends the European Council meetings when decisions with defence implications are to be taken.
- *High Representative for CFSP (HR-CFSP)*. The HR-CFSP combines the functions of the Secretary-General of the European Council and Secretary-General of the WEU.
- *European Union Military Staff (EUMS)*. The EUMS is tasked to provide military expertise and support to ESDP, including the conduct of EU-led military crisis management operations. Specifically, it performs early warning, situation assessment and strategic planning for the whole range of Petersberg tasks, including the earmarking of national and international European forces.
- *European Union Satellite Centre (SATCEN)*. The SATCEN is tasked to provide information and analysis based on satellite imagery to EU member countries. Generally, it conducts security surveillance of areas of interest to the EU as well as maritime and environmental surveillance; and provides support for treaty verification, arms and proliferation control, counter-terrorism, and EU, NATO, and Eurocorps exercises.
- *European Union Institute for Security Studies (EUISS)*. The EUISS is an independent agency under the CFSP. It conducts research and debate on security and defence issues of importance to the EU, provides forward-looking analysis to the European Council and the High Representative for

CFSP, and promotes the development of transatlantic dialogue on all security issues.

Civilian aspects of crisis management

At the June 2000 European Council held in Santa Maria da Feira, Portugal, the EU Member States pinpointed four priority areas on which the EU will concentrate in terms of enhancing civilian capacities. These are the police, the justice system, civil administration, and civil protection. Efforts have been made to enhance this civilian component with a view to equipping it with a rapid reaction capability and enabling it to address crises by:²⁶

- “Acting to prevent the eruption or escalation of conflicts;
- Consolidating peace and internal stability in periods of transition;
- Ensuring complementarity between the military and civilian aspects of crisis management covering the full range of the Petersberg tasks.”

In this regard, they set the headline goal for police capabilities agreeing that by 2003, they would be able to provide up to 5 000 police officers for international missions on crisis prevention and crisis management. They also decided to identify and deploy up to 1 000 police officers within 30 days. The EU’s rapid reaction civilian component can be deployed upon the request of a lead agency such as the UN or the OSCE, “or, where appropriate, in autonomous EU actions.”²⁷

Progress in the fulfilment of the Feira headline goal for police capabilities has been swift, as members’ contributions were bigger than the number requested. As a result, the EU was able to take over from the UN’s International Police Task Force (IPTF) in Bosnia-Herzegovina.

Institutional framework

- *Committee for Civilian Aspects of Crisis Management.* The Committee was created by Council decision adopted on 22 May 2000. It is to serve as the advisory body to the PSC and the co-ordinating organ of other parties involved in this field.
- *Co-ordinating Mechanism.* The co-ordinating mechanism, fully interacting with the Commission services, was formed within the Council Secretariat. It works closely with the interim Situation Centre/Crisis Cell created by the High Representative. The co-ordinating mechanism has already set up a database on civilian police capabilities and is currently collecting data on rule of law experts.

ESDP operations

In 2003, the EU launched three operations that involved more than 2 000 police and military personnel performing many tasks such as law enforcement, cease-fire monitoring, and crisis management.

On 1 January 2003, the EU's first civilian crisis management operation under the ESDP was launched in Bosnia-Herzegovina (BiH). The European Union Police Mission (EUPM) took over from the United Nations' International Police Task Force (IPTF) to perform monitoring, mentoring, and inspection tasks. The aim was to contribute to the development of BiH police forces to the highest European and international standards and to support and consolidate the rule of law in BiH. Supported by around 400 support staff, international civilian experts and local support staff, the EUPM is composed of 531 police officers, 442 of whom come from the EU member states and 94 from third states. It has a mandate for three years and an annual budget of EUR 38 million.

At the opening ceremony of the EUPM in BiH, EUHR Javier Solana highlighted the significance of the EUPM as a representation of the "continuing development of the EU's external identity."²⁸

The EUPM is the first crisis management operation launched by the Union as part of the European Security and Defence Policy (ESDP). The fact that it takes place in Bosnia is the strongest statement yet of the EU's engagement in and partnership with the Balkans. The fact that the Union's first operation is a police mission – a civilian mission – demonstrates our commitment to a comprehensive crisis management approach that brings real added value. Above all, however, the participation of 18 Third States in the EUPM illustrates that the ESDP is an open project.

On 31 March 2003, the EU launched its first military operation under the ESDP in the former Yugoslav Republic of Macedonia (FYROM) to take over from NATO's Operation Allied Harmony. The Concordia mission, as the operation is called, is tasked with contributing to a stable and secure environment in FYROM that ensures the successful implementation by the government of the Ohrid Framework Agreement, signed in August 2001 by the representatives of the Macedonian Slavs and the Albanians. The Concordia was sent upon the request of the FYROM and based on the United Nations Security Council Resolution 1371. The Concordia makes use of NATO assets and capabilities for the conduct of its crisis management tasks in accordance with the EU-NATO permanent arrangements reached in December 2002. The operation, composed of 350 lightly armed military personnel, is therefore the first test case of the Berlin Plus arrangements.

In December 2003, the Concordia will be succeeded by a police operation which will be called Proxima. Proxima will be launched based on the invitation of the FYROM's Prime Minister Branko Crvenkovski to the EU.

The EU's second military operation, its first outside Europe, was the Artemis which was launched on 12 June 2003 in the Democratic Republic of Congo (DRC) and ended on 1 September 2003. The mission – composed of 1 800 military personnel, mostly French – was launched in response to a request made by the United Nations Secretary General Kofi Annan for EU intervention in Ituri, Congo. Its mandate as outlined in the UN Security Council Resolution was to “contribute to the stabilization of the security conditions and the improvement of the humanitarian situation”²⁹ in Ituri.

We have seen in the foregoing brief history of the European Union that the road to regional integration of Europe is both a gradual as well as a stop-and-go process where advance, stagnation and spillover occurred at different periods over different issue areas in response to both domestic and external factors and forces. As noted earlier, while the European experience is instructive for the Asia Pacific region, there is no doubt that the political, social and cultural environment plus the historical antecedents in Europe are not anywhere near those in the Asia Pacific region. Still, learning from the European “mistakes” and/or failures will definitely be important for the Asia Pacific region.

NOTES

1. Hanoi Plan of Action, available at <http://www.aseansec.org/8754.htm>.
2. Research Analyst of the Institute of Defence and Strategic Studies at the Nanyang Technological University in Singapore, remarks made during the ASEM Youth Dialogue on the New Security Challenges, Marriott Hotel, Cebu City, Philippines, 2-5 September 2003.
3. Comments by Dato' Mohamed Jawhar Hassan. *Terrorism in Souteast Asia: Perspectives from the Region: A CSCAP Roundtable Discussion*. Available at http://www.csis.org/pacfor/issues/v03n02_dmjh.htm6/30/03.
4. Southeast Asia has a large Muslim population. The largest Muslim nation in Southeast Asia and the world is Indonesia – 88% of its people or 203 568 721 are Muslim. In Malaysia 58% of the population is composed of Muslim ethnic Malays, while in the Philippines Muslims account for 6% of the country's total population.
5. "Pirate attacks have tripled in a decade, IMB report finds", 1 May 2003. Available from http://www.iccwbo.org/home/news_archives/2003/stories/piracy-quarter-1.asp.
6. "Concern grows as pirates attacks tankers", 31 October 2003. Available from http://www.iccwbo.org/ccs/news_archives/2003/piracy-Oct-2003.asp.
7. "ASEAN Countries Vow to Address Haze Problem", *Jakarta Post*, 11 March 2002.
8. 2001 ASEAN Declaration on Joint Action to Counter Terrorism, 5 November 2001, http://www.aseansec.org/newdata/2001_asean_declaration.htm.
9. ASEAN Regional Forum (ARF) Statement on Cooperative Counter-Terrorist Action on Border Security.
10. Department of Foreign Affairs. "RP, Singapore Firm Up Anti-terrorist Cooperation." Press Release No. 150-02, 20 August 2002.

11. Dana R. Dillon and Paolo Pasicolan. “Promoting Collective Response to Terrorism in Southeast Asia.” Available from www.heritage.org/library/execmemo/em825.html; Internet accessed on 19 September 2003.
12. “Singapore Not Ready to Sign East Asian Anti-terror Pact,” *Philippine Daily Inquirer*, 11 December 2002. Available online at http://www.inq7.net/brk/2002/dec/11/text/brkafp_8-1-p.htm.
13. Declaration on the Western European Union, Maastricht, 1992.
14. St-Malo Declaration, 4 December 1998.
15. Cologne European Council, *Presidency Conclusions*, 3-4 June 1999.
16. Helsinki European Council, *Presidency Conclusions*, 10-11 December 1999.
17. Gustav Lindstorm, *The Headline Goal*, Institute for Security Studies, available from www.iss-eu.org.
18. Burkard Schmitt, *European Capabilities Action Plan (ECAP)*, Institute for Security Studies, available from www.iss-eu.org.
19. Declaration on EU Military Capabilities, 19 May 2003.
20. Ibid.
21. Thessaloniki European Council, *Presidency Conclusions*, 19-20 June 2003.
22. Secretary Albright’s Remarks to the North Atlantic Council Ministerial Meeting, Brussels, 8 December 1998, quoted in Hunter, 2002, p. 23.
23. Jean-Yves Haine, *Berlin PLUS*, available from www.iss-eu.org.
24. 1999 Washington communiqué.
25. Helsinki European Council, *Presidency Conclusions*; Jean-Yves Haine, *ESDP: An Overview*, Institute for Security Studies, available from <http://www.iss-eu.org/esdp/01-jyh.pdf>.
26. “Study on Concrete Targets on Civilian Aspects of Crisis Management”, Annex 3 of the Presidency Report to the Feira European Council on *Strengthening the Common European Policy on Security and Defence*.

27. Ibid.
28. EUHR Solana's Remarks at the opening ceremony of the EUPM in Bosnia and Herzegovina, 15 January 2003.
29. Dov Lynch and Antonio Missiroli, ESDP Operations, Institute for Security Studies, available from www.iss-eu.org.

BIBLIOGRAPHY

- Acharya, Amitav (2002), *Regionalism and Multilateralism: Essays On Cooperative Security In The Asia Pacific*, Times Academic Press, Singapore.
- ASEAN Secretariat (1995), *An Overview*, ASEAN Secretariat, Jakarta.
- Agoncillo, Teodoro A. (1990), *History of the Filipino People*, 8th edition, Garotech Publishing, Quezon City.
- Antolik, Michael (1992), “The Prospects for Orderly Change in ASEAN” in K.S. Sandhu *et al.* (eds.), *The ASEAN Reader*, Institute of Southeast Asian Studies, Singapore.
- Carlos, Clarita R. (1982), “China ASEAN Relations, 1967-1981”, *FSI Record*.
- Carlos, Clarita R. (1996), “The Philippines in ASEAN: An Assessment of 27 Years of Cooperation in Selected Issue Areas”, Foreign Service Institute, Manila.
- Carlos, Clarita R. (2002), “Combating Terrorism and Other Transnational Threats: The View from the Philippines”, National Defense University, 23rd Annual Pacific Symposium on Addressing Transnational Threats in the Asia Pacific Region, 20 February, Ft. McNair, Washington, DC.
- Clarke, Michael and Paul Cornish (2002), “The European Defence Project and the Prague Summit”, *International Affairs*, Vol. 78, No. 4.
- Dorman, Andrew M. and Adrian Treacher (1995), *European Security: An Introduction to Security Issues in Post-Cold War Europe*, Dartmouth Publishing Company Limited, England.
- Godson, Roy and Phil Williams (1998), “Strengthening Cooperation Against Transnational Crime,” *Survival: The IISS Quarterly*, Oxford University Press.

- Goldstein, Joshua S. (1994), *International Relations*, HarperCollins College Publishers, New York.
- Gonzales-Macaisa, Arlene (1999), “Philippines-Malaysia Relations,” *FSI Foreign Affairs Quarterly*, Vol. 1, No. 3, July-September.
- Goodspeed, Stephen S. (1967), *The Nature and Function of International Organization*, 2nd edition, Oxford University, New York.
- Howorth, Jolyon (2000), “European Integration and Defence: The Ultimate Challenge?”, Chaillot Paper 43, Institute for Security Studies of WEU, November.
- Hunter, Robert E. (2002), *The European Security and Defense Policy: NATO’s Companion – or Competitor?*, Rand, Santa Monica.
- International Commission on Intervention and State Sovereignty (2001), *The Responsibility to Protect*, International Development Research Centre, Ottawa.
- Jones, Matthew (2002), *Conflict and Confrontation in Southeast Asia 1961-1965: Britain, the United States, Indonesia and the Creation of Malaysia*, Cambridge University Press, Cambridge.
- Kraft, Herman (2000), “The Principle of Non-Intervention: Evolution and Challenges for the Asia Pacific Region” in David Dickens and Guy Wilson-Roberts (eds.), *Non-Intervention and State Sovereignty in the Asia Pacific*, Centre for Strategic Studies, Wellington.
- Liefer, Michael (1996), “The ASEAN Regional Forum,” Adelphi Paper 302, Oxford University Press, Oxford.
- Lyon, Peter (1992), “Post-War Regional Cooperation” in K.S. Sandhu *et al.* (eds.), *The ASEAN Reader*, Institute of Southeast Asian Studies, Singapore.
- McCloud, Donald G. (1995), *Southeast Asia: Tradition and Modernity in the Contemporary World*, Westview Press, Colorado.
- Mitrany, David (1966), *A Working Peace System*, Quadrangle Books, Chicago.

- Ramos, Narciso (1986), “ASA and The Philippines” in Pacifico A. Castro (ed.), *Narciso Ramos Secretary of Foreign Affairs (1966-1968): Selected Speeches*, Manila.
- Soesastro, Hadi (2001), “ASEAN in 2030: The Long View” in Simon S.C. Tay, Jesus P. Estanslao and Hadi Soesastro (eds.), *Reinventing ASEAN*, Institute of Southeast Asian Studies, Singapore.
- Solidum, Estrella D. (1991), *The Small State: Security and World Peace*, Kalikasan Press, Manila.
- Sperling, James and Emil Kirchner (1997), *Recasting the European Order: Security Architectures and Economic Cooperation*, Manchester University Press, Manchester.

ANNEX

Reflections on Asia Pacific Integration

by

Mike Moore

Former Director-general of the World Trade Organization

It is right and fitting that we should discuss, examine, audit, criticise and promote the issue of regional integration in Asia and the Pacific under the leadership of the Hawke Centre.

It was Bob Hawke's leadership that saw the creation of Asia Pacific Economic Cooperation – APEC – in Canberra in the 1980s. I was at the first meeting, representing New Zealand. In those heady days, we called it the Hawke initiative. What was also significant then was that it was the first ministerial meeting where China, Hong Kong (a British colony at the time) and Taiwan sat down at the same table. Reaching such an outcome was difficult to navigate in order not to set precedents that could be used to signify any new status among the participants. We had three separate teams of Chinese language interpreters working with each group of participants.

More than a decade later, we need to audit progress. Hong Kong and Macau have been reunited with China. Both China and Chinese Taipei, the official name for Taiwan in WTO language, joined the World Trade Organization. I was proud to have played a modest role in their much-delayed membership when I was the World Trade Organization's Director-General. This long march to membership took 15 years – three times longer than the Second World War – and the final agreements ran into thousands of pages.

A sort of Asian caucus without Caucasians

How should we define our region? APEC provides an answer: the Pacific Basin.

For New Zealanders, the Pacific stops at the equator. For many North Americans, Asia is China, Korea, Japan; for Europeans, Asia is China and India. For some in ASEAN, it is themselves, together with countries and economies north, a little west and east, but not south.

In the eighties, I supported APEC not only as an end in itself, but also as a platform to push for further multilateralism. This meant a full conclusion to the Uruguay Round of trade talks, and the beginning of a wider round that would take on board far more serious issues for deeper negotiation. These issues had not been properly addressed in the Ministerial agreement to launch the Uruguay Round at Punta Del Este. That agreement was finally achieved at Doha, Qatar, when I was Director-General of the WTO.

I am not being critical of the Uruguay Round – any agreement is just yesterday's compromise, and it was the best we could do at the time. Better a small slice of cake than no cake at all. Agriculture had never before been on the negotiations agenda of the General Agreement on Tariffs and Trade (GATT)/WTO.

China's importance in the Asia Pacific

Let us examine the imperatives that are driving our region. No such discussion would be complete without talking about China. There are only two types of people – those who are thinking about China, and those who are not.

Chinese leaders told me that joining the WTO was the single most important decision that they had made in half a century. They saw the discipline, rules, rights and obligations of the WTO as an external peg to drive up and measure the reintroduction of a market economy. They would no longer be at the mercy of the whims of politicians and governments in the world's capitals who, at any time, could unilaterally stop their exports.

A rules-based system, such as that provided by the WTO, provides transparency and predictability, as well as a binding mechanism to resolve disputes when they arise. The rule of law is the definition of civilisation. In a world too often characterised by unilateralism and coercion, co-operation and

the rule of law presented by the rules of the WTO offer real hope. The rest of the world saw the accession of China in a positive light, too, realising that their rights, too, would be protected as China grew and became a great trading nation.

Much is written about China's stunning economic success. This year, China has become the world's fourth biggest exporter and is predicted to rise to third next year. But China is also a great importer, its imports surging a remarkable 40% in the past year. China has been the engine room of regional and global growth over the past few years.

Notwithstanding its recent economic success, however, China's position is also fragile and vulnerable: it has bad banks, state-owned enterprises in debt, and unfunded health, unemployment and pension schemes that exceed China's GDP in size. Furthermore, China is still only the size of California in economic terms.

Some politicians are dusting off their anti-Japan speeches of the 1970s and 80s, this time casting China as the enemy. This is unhelpful and distorts reality. The European Central Bank has blamed China for Europe's poor growth and high unemployment. China's inexpensive products and export drive have been blamed by the Japanese for Japanese deflation. The United States says that China has caused American job losses and forced American wages down. In my opinion, higher American tariffs against China would not save jobs in the United States, but they might just save some in Mexico.

Europe's inflexible labour markets and high government spending are not China's fault. Economists say that China could be held responsible for no more than 0.1-0.2% of Japan's deflation. American job losses in manufacturing are more to do with increases in American productivity than with Chinese competition, according to American reports. The Chicago Federal Reserve has published a study that shows that China's fixed exchange rate has had little impact on jobs in the United States. The conspiracy theories about China do not add up.

On the other side of the ledger, growing Chinese imports are also the growing exports of many other countries. Cheap and efficient Chinese export products raise productivity in the countries importing them and ease those countries' inflationary pressures. The West spends and Asia funds that spending through its saving. Next, China and ASEAN may well be blamed for the current account deficits of some countries.

Everyone was impressed with China putting a man into space. That is not hard, it is getting him back alive that is hard. I was more impressed to read that China is to be involved in a European joint venture to establish a rival global satellite navigation system to that of the United States. Fascinating, too, are the United States' overtures to China over America's Mars and space missions.

Napoleon said of China: China is a sleeping giant; let her sleep. Well, China now is well and truly awake to the opportunities of global trade – buying, spending, exporting, and engaging with the rest of the world. A French friend in Shanghai told me that there is a delegation of French businesspeople in that city every week.

For those who fear China, I ask this question: if it were best for China to stay poor, then would it have been better had Germany remained in ruins after the Second World War, Japan in rubble, and Holland still flooded?

Deng Xiaoping, the leader who instigated the economic reforms in China, told the Communist Party faithful that reform will produce inequality between the rich and the poor, but if we are to be equal, we will be equally poor. As a result of the reforms started by Deng Xiaoping, 200 million Chinese have been lifted out of poverty – and this is only the beginning.

Consider these facts. China is now the world's largest beneficiary of foreign direct investment (FDI), overtaking the United States for the first time in a few hundred years. China is now the world's largest producer of aluminium. China is now the world's second-largest consumer of electricity. China is now the world's largest importer of iron ore and steel. China now has a larger trade surplus with the United States than Japan does. Korea now exports more to China than it does to the United States. China now has the world's largest number of students studying overseas. China now has more mobile phones than any country other than the United States. China produced one million more cars in 2003 than it did the year before, and will be the world's biggest importer of food within eight years. These remarkable facts and figures add up to an incredible story of achievement.

On the day I wrote this speech in Geneva, there were two stories about China on the front page of the *Financial Times*. The first told how General Motors' Chinese operations helped the company meet its profit targets, despite falling revenues in the United States, South Africa and Europe. The second explained how China had overtaken Japan as the world's second-largest importer of crude oil.

In that same day's paper, I read of Premier Hu Jintao's tour to oil-exporting nations, including Egypt, Algeria and Gabon, and of concerns about the Chinese economy overheating with 9.9% growth in the final quarter of the last year. Elsewhere in the paper, there was a story about inflation in China, and an editorial extolling the fact that China's growth in per capita purchasing power contributed nearly one-third of the world's 3.2% economic growth last year – a greater contribution than the United States', and well ahead of Japan's and Europe's. China, it was reported, has now broken the USD 1 000 per person income barrier.

That day's *Financial Times* also argued that the fact that Wal-Mart can sell a Chinese-made DVD player for USD 29 is not just a testament to productivity and cheap labour cost, but also the product of overinvestment. Many economists have raised the dangers of overinvestment in China. But they have also noted that the government has acted appropriately to slow credit growth in the last year, after the vulnerability of state banks – already burdened with bad debts – had been reduced.

China has also quickly pulled itself out of deflation thanks to rising food prices, themselves a boon to productive peasants and an effective transfer of wealth from the city to the countryside.

Of course, China remains subject to the laws of economics and the lessons of history, just as – after the Asian economic crisis – the young tiger economies of Asia quickly became kittens. But nationalism (as well as national pride derived from economic success) has now replaced communism as the motivating force in China. This is a truly momentous change.

China is not going to change the world – it already has. China will replace Japan as the regional power, and all roads will now lead to Beijing, or, more correctly, Shanghai.

India – the Asia Pacific's second emerging economic giant

The economic roar of the Chinese dragon has deafened many people to another emerging economic giant. The story of India's economic transformation is almost as remarkable as China's. In fact, over the past five years, India's record has been even more spectacular.

In the West, India's surging economy is often cast in a negative light, focusing on the loss of IT and call centre jobs to India. India's growth, the story

goes, relies on its ability to provide low-cost, back-office functions to corporations seeking to cut costs. While there may be some truth to that, this characterisation of India as a low-rent, low-wage economy that offers no more than cheap phone banks is grossly unfair, and demonstrably untrue. The truth is far more interesting, and with far more serious implications for India as well as for the rest of the world.

While India undeniably offers the advantages of a low-cost business environment, its true strength is that it is fast becoming one of the smartest economies in the world. Far from the image of sweatshops and call centres, the true drivers of India's economic growth are research and development (R&D), information technology (IT) engineering, the pharmaceutical industry, automotive engineering and high-end manufacturing.

Consider these facts. There are 150 000 IT engineers employed in Bangalore, 30 000 more than in Silicon Valley. India is one of only three countries to have built a supercomputer (the others are Japan and the United States). India's pharmaceutical industry is growing at 8-10% annually, and is now the fourth largest in the world. One hundred major multinational companies have established R&D centres in India in the past five years. They include Intel and Texas Instruments, whose Indian researchers develop microprocessors and multimedia chips. General Electric employs 1 800 engineers (in Bangalore alone) engaged in R&D for each of its 13 divisions. India's automotive components industry was projected to grow by over 200% in 2003, and is projected to be worth USD 15 billion in five years. Exports of electronics components manufactured in India have grown by 200% in just three years.

The picture for 2004 and beyond is no less rosy, with many expecting India to quickly establish itself as a global leader in industrial engineering, bio- and nanotechnology and analytics. And, yes, the business-process outsourcing industry continues to employ an additional 500 people every day.

The Internet and the communications revolution have abolished time and distance. In the 1980s, blue-collar jobs shifted dramatically to developing countries, creating rust belts in Western economies and forcing painful restructuring. Now, white-collar jobs from medical diagnostics to legal research – in fact, any work that is not shop-front – can be moved internationally. There is no difference between calling upstairs and calling a continent away. American researchers talk of 3 million jobs moving offshore in less than a decade.

India, with its rich family commitment to education, the use of the English language and a business environment rooted in English law, is, and will be, a winner. India's universities produce 260 000 engineers and 5 000 PhDs a year. The "brain drain" that used to see thousands of educated Indians go to Europe and the United States is becoming a "brain gain". Many are returning home with their skills and a financial nest egg with which to start up in business.

India's success is still restricted to small pockets of stunning excellence. Bureaucracy, corruption and populist, nationalistic politicians still cause problems and choke growth and creativity. Troubles and tensions with neighbours are costly and capable of spinning out of control. But there are glimmers of hope. Slowly, air and road transport is opening between India and Pakistan. Talks are continuing about the gas pipeline through Pakistan to feed India's growing industrial appetite. India and China have exchanged military visits and shared naval exercises. Tensions are being lowered. Give India ten years of 5-8% growth, and we will have another superpower at the table.

I had always hoped that China's success would spur her neighbours into reform. Russians look uncomfortable when you explain China's success. A strong, confident and growing India and Russia, alongside China, are welcome and healthy outcomes.

Regionalism must not displace multilateralism

Asia's economic integration is accelerating. The World Bank has noted that East Asian intra-regional trade, excluding Japan, has grown at double the rate of world trade. East Asia's share of global exports has doubled over the past 25 years, but trade within the region has risen sixfold. This growth has been driven by multinationals spreading their supply chains across Asia as they take advantage of the distinct comparative advantages in the region's economies.

When we talk of regionalism (or of China and India) we should remind ourselves of what multilateralism and the WTO have done to underpin this success story. In the 1990s, tariffs on office and telecoms equipment were abolished when the WTO's IT agreement came into force. Asia took advantage of this agreement.

We pursue regionalism for good reasons, but my fear is that, when regionalism and bilateralism substitute for multilateralism, there will be problems of trade diversion. I am not convinced that difficult trade issues, such

as agriculture, anti-dumping, investment, the movement of people, trade facilitation or disputes systems, can be effectively handled outside a multilateral framework.

A web of bilateral and regional trade agreements is being spun across Asia. This is binding Asian economies together. ASEAN leaders last year agreed in Bali to build an ASEAN economic community by 2020, a single market and product base with a free flow of goods, services, investments, capital and skilled labour. Thailand has forged Free Trade Agreements (FTAs) with China and India. Singapore has an FTA with China and is negotiating with India and Korea. Japan is also working on FTAs with Indonesia, Malaysia, the Philippines and Thailand. In addition, as a group, ASEAN will have FTAs with China by 2010, India by 2011 and Japan by 2012. And it will soon embark on an FTA study with Korea. There have also been FTA discussions among the Northeast Asian economies of China, Japan and Korea.

In George Orwell's famous futuristic novel *1984*, the world was divided into three competing blocs – Oceania, Eurasia and Eastasia. The blocs were locked in a military struggle between political ideologies and for territory. Happily, Orwell's vision of the future did not come to pass – the Cold War ended peacefully.

It would be ironic if we were subsequently to act in accordance with Orwell's vision in the field of trade. This is not as far-fetched as it might seem. The United States is negotiating a Free Trade Area of the Americas “from Alaska to Cape Horn”. The European Union (EU) will soon take in ten new members. Asia is evolving towards an East Asian Community and, one day, an Asian Economic Community. If these three regions were to turn inwards, and each were to pursue an isolationist, beggar-my-neighbour strategy, everyone would be the loser.

Our Asian friends should remember that much of Asia's prosperity has been based on access to the big markets of the United States and the European Union. Without those markets, the economic miracle of Japan and rise of the Asian dragons and tigers would not have taken place. Today, while a large proportion of Asian exports go to China, a large proportion of those exports eventually end up in the United States and Europe as components in Chinese products. In addition, Asia relies heavily on foreign direct investment. Almost 60% of global foreign direct investment to developing countries in 2002 went to Asia. So while intra-regional Asian trade and investment will grow, the United States and the European Union remain vital economic partners for Asia.

By and large, I have painted a positive picture. But what is wrong with the picture? Where are New Zealand and Australia, and where are APEC's resolutions and the promises of its leaders? What is the status of the Doha Development Round? It is my melancholy duty to report to you that APEC's leaders meet and make commitments for the Pacific Basin and the Doha Development Round, and then, too often, their ministers and ambassadors do not follow their lead.

For example, APEC did excellent research into the benefits of trade facilitation that showed that the Asia Pacific had more to gain from trade facilitation than cuts in tariffs. The chemicals industry, for example, used APEC's trade facilitation agenda to bring about enormous potential cost-saving. In 2002, APEC trade ministers agreed to a recommendation of APEC's Chemical Dialogue – one of three public/private sector forums in APEC – that they would implement the Globally Harmonised System (GHS) of Chemical Classification and Labelling and Hazard Communication by 2006. What this means in real terms is bringing hundreds of differing national requirements for the labelling down to a handful, thereby facilitating trade in these chemicals. One company estimated that the implementation of GHS would result in cost savings of 10-12% of the unit costs of its products – a huge saving.

How then did some APEC Ministers allow trade facilitation to become one of the subjects that helped collapse the Cancun WTO Ministerial meeting? I am a multilateralist and a proud Pacific Islander. I know that it is oxygen going out of Geneva and the WTO that puts wind in the sails of the alternatives. Regionalism that is open can be a springboard for multilateralism.

What is at stake in the Doha Development Round

The UN Millennium Development Goals, set by over 100 world leaders in health, education and poverty reduction, would cost just USD 58 billion annually. That is only one-third of the estimated windfall that developing countries would gain from a successful Doha Development Round. Abolishing all trade barriers could boost global income by USD 2.8 trillion and lift 320 million people out of poverty in 12 years. Two-thirds of the benefits of cuts to tariffs would go to developing countries. Unacceptable injustices exist in the global trading system, but we now have an agenda for development from Doha that can and must help remedy these problems.

OECD subsidies for agriculture cost over USD 1 billion a day. Abolishing these subsidies would return three to five times more than all the overseas

development assistance put together. Kofi Annan wants USD 10 billion to fight AIDS – that’s just 12 days of OECD agricultural subsidies. Fishing subsidies cost about USD 20 billion annually and put local fishing families out of work in the developing countries. Rich countries must commit to change this within the Doha negotiations. Rich countries’ subsidies for fisheries pollute the water; their subsidies in agriculture pollute the ground; and their subsidies in energy pollute the air.

It is important to examine product areas where poor countries’ competitive advantage is negated by subsidies in rich countries – such as coffee, cocoa, sugar and cotton. Consumers in Europe pay 50% more for sugar than they need to. Subsidised production in countries such as the United States and Japan come at the expense of jobs and wealth in poor countries. This protectionism costs the American consumer USD 2 billion annually for sugar alone.

Coffee is even more disgraceful. Ten years ago, the world coffee market was worth USD 30 billion and growers received USD 10 billion. Today, it is worth USD 60 billion and growers receive less than USD 6 billion. To give you an idea who is hurt by this, one need only note that coffee represents over 60% of Ethiopia’s and Uganda’s total exports.

What happens is this: the rich countries’ tariffs on raw beans escalate every time value and jobs are added in the poor countries, such as roasting and packaging the beans. The tariffs go up so that jobs are created in Europe and the United States, but not in the poor producing countries.

Some of the poorest cotton-producing countries are forced to compete against a United States subsidy worth USD 3.4 billion annually. World prices have fallen by 66% since 1995, so America is set to raise the tariff – for a total of 25 000 American farmers with an average household income of USD 800 000.

Let me share one example from a book I read recently. Mongolians and Norwegians both paid the United States about USD 23 million in tariffs last year. But the total value of Mongolia’s exports to America was USD 143 million; Norway’s was USD 5.2 billion. In effect, Mongolia paid 16 cents in every dollar’s worth of sweaters and suits that it sold to Americans, while the Norwegians paid half a cent for every dollar’s worth of gourmet smoked salmon, jet engine parts and North Sea crude that it sold to them.

Of course, countries need not wait until the conclusion of the Doha Development Round to commence reforms or liberalise trade. For instance, trade facilitation, according to APEC and United Nation Commission on Trade and Development (UNCTAD) studies, will generate huge returns. Market access opportunities do not help if trucks are held up at borders for days due to bureaucratic delays. Domestic red tape and bad governance – wherever it occurs, in developed or developing countries or economies in transition – is costly and corrosive.

Of course, the issue is not just trade. Much must be done on the ground in poor countries to build their infrastructure. The roads, ports, customs systems, legal systems to support property rights, an honest public service, accountable politicians, and an active civil society all contribute to development.

I'm still positive. Our region should not wait for the new Round to conclude – that would be irresponsible. But we must put as much effort and commitment into fulfilling our APEC goals and promises as we put into regional substitutes. We all have a profound self-interest in cutting a WTO deal. Bluntly, in the end, I think it will be easier. In trade, as in life, shortcuts take longer, because you can get lost and lose your bearings and your principles. The result is to postpone the fulfilment of the promise that our collective future holds.

OECD PUBLICATIONS, 2, rue André-Pascal, 75775 PARIS CEDEX 16
PRINTED IN FRANCE
(03 2005 02 1 P) ISBN 92-64-00916-7 – No. 54017 2005