

### Research Focus

#### ***Australian perspectives on the road map towards East Asian economic integration***

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##### **The Australian economy and East Asia**

For 30 years, Australia has attempted to find a balance between its traditional ties with Europe, its vital links with the United States, and the emerging possibilities of a fast-growing Asia. Australia sees the advantage of its unique location in Asia and the Pacific. However since it is committed to supporting both the Asia-Pacific Economic Cooperation (APEC) process along with the East Asia Summit (EAS) process as mechanisms for promoting greater integration of regional economies, there is potentially a tension in its policy position.

East Asia is Australia's main regional trading partner. Australia's exports of natural resources and the Australian domestic market are vital to the continued economic growth of East Asia. Increasingly, Australia's economic interest lies not only in maintaining the resource, energy, and manufacturing trade opportunities in East Asia, but also in expanding its role in the financial sector and other service sectors, and in encouraging the opening up of those sectors in the region.

There are conflicting views on the recent proliferation of preferential trade agreements (PTAs) in East Asia. Some argue that because of increasingly complicated rules of origin, the trend is likely to distort and derail, rather than encourage broader and deeper economic integration. Others believe that the proliferation of PTAs is a natural way to

promote region-wide integration, which will be built on the clusters of bilateral PTAs. Whichever view one takes, the empirical evidence is clear that the wider the membership of these agreements, the larger the gains.

There are also different views emerging on which regional architecture will drive closer integration. Increasingly, the convention is to acknowledge the role of ASEAN as the driving force in East Asian regionalism. This position was reiterated in May by Japan's Prime Minister Fukuda in a significant policy speech on the region. That speech was in some measure an attempt to respond to the challenge laid down by the Secretary-General of ASEAN at the December 2007 launch of the new think-tank, the Economic Research Institute for ASEAN and East Asia or ERIA, when he asked for a Fukuda-II doctrine for Japan in the region. ASEAN itself has taken new initiatives directed at formalising its structures and these should add to its credibility in a regional role.

##### **Importance of financial integration**

From Australia's perspective, financial integration is as important and as necessary as trade arrangements. The lessons learned from the Asian financial crisis clearly underline the importance of financial cooperation in the region. With underdeveloped financial markets, countries in the region have fewer opportunities to fund investment and lack mechanisms to allocate capital more efficiently.

From the Australian perspective, strengthening the domestic financial markets is the first step toward regional financial integration. With a wealth of experience in financial reform and strong capital markets, Australia could play a more active role in the development of East

Asia's financial integration. Indeed, in 2006 the Howard Government said publicly that, 'if invited by ASEAN +3 members, Australia would be willing to make a financial and practical contribution to the Chiang Mai Initiative'. Australia has also taken an active part in developing the modalities underpinning the Asian Bond Market. The Rudd Government can be expected to strengthen Australia's regional focus.

##### **A roadmap and challenges to East Asian economic integration**

Current East Asian economic regionalism is underpinned by two seemingly contrasting trends: the increasing interest in 'financial integration' in the broad sense and the growing numbers of bilateral and sub-regional PTAs. The latter can be matched with the former only if preferential trade initiatives are structured to be the building blocks of economic integration. While PTAs in East Asia contain many similar provisions, they also contain many differences, and it is not clear that they can be used as the single foundation for stronger region-wide institutional cooperation. Several recent studies have questioned whether any of the existing PTAs in the region are truly consistent with and build on the WTO's General Agreement on Trade in Services (GATS).

The underlying goal of regional economic integration is to strengthen regional cooperation in East Asia and to help the economies in the region avoid a financial crisis and other similar catastrophes in the future. But this pre-supposes certain common understandings about the underlying features of market economies.

East Asian economies face challenges such as unfinished domestic reform, the need for

realistic and concrete strategies to move toward integration, lack of a regional authority to help control financial volatility, underdeveloped financial markets, and the existence of competing regional architectures. In addition, competition between China and Japan for leadership in the region, the role of the United States, and the region's diversity in many respects pose politico-economic challenges.

The likely solution is to opt for something akin to the earlier APEC notion of 'open regionalism', designing institutions and agreements that can flexibly be extended to incorporate additional members. Moreover, realistic and plausible views are needed in designing a framework for regional economic integration.

It is important to set attainable targets within realistic timetables so that, gradually, progress can be expected and observed. Due to the different nature and conditions within each nation, East Asian economic integration should be 'a hybrid regionalism', a regional arrangement that is beyond the influence of Japan, China, or any other single country. Australia can act as a valuable counterweight to encourage constructive engagement by all major countries, including the United States.

To accelerate trade liberalisation and integration, it is necessary to enhance free trade and factor mobility across the region; to

recognise that unilateral trade liberalisation is usually in the interests of each country; to minimise security risks of cross-border transactions; and to improve competitiveness through structural reforms in domestic markets.

To foster financial integration, it will be necessary to build a more concrete framework that may include, but is not limited to, provision of peer country assistance in financial reform; coaching and training to achieve consistent application of policies, legal and regulatory standards across the region; improvement of accounting standards and skills; clarification of tax rules; upgrading of corporate governance standards; greater transparency and peer surveillance of macro-economic policy-making; better understanding of how closer trade and financial integration imply macro-economic linkages that will need to be managed.

To ensure access to vital energy supplies, which are both economically indispensable as an engine of growth and for which Australia is a major supplier, cooperative approaches are necessary. Although potentially divisive and also strategically sensitive, energy issues have already been discussed in the EAS in which Australia participates.

To harmonise PTAs in the region, ASEAN as a whole and as individual countries, should set and maintain a common standard of practice

in trading arrangements. In addition, long-term impacts and benefits should be considered against short-term gain when deciding on the common standard of practice for the PTAs.

To further develop the studies of regional economic integration, the recently established Economic Research Institute for ASEAN and East Asia (ERIA), involving all the EAS members, could be used as a regional think tank to provide broad-based, empirical analysis on the trends, challenges, and opportunities of regional integration, and to suggest practical recommendations to policy makers. More rigorous analysis is needed of factors that impede regional integration as well as the factors that can potentially accelerate it. The research agenda for ERIA should include both the non-economic as well as economic aspects of the integration. Greater interaction between policymakers and researchers, and high quality, policy-relevant research, will be of critical importance. So research should also focus on planning and designing realistic mechanisms that inform future policies for the region.

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### **Events**

4 June, PNG Update, Canberra

11,18, 25 June, Climate and fisheries management in the Pacific Region, GDLN sessions

13 June, Taxation and public finance: income redistribution in Australia and beyond, workshop, Canberra

20 June, Structural reform, policy institutions: the regional and international agenda, roundtable, New York

14 July, China Update, Canberra

### **Crawford Seminars**

3 June, *The NZ emissions trading scheme - why is it so bad and can Australia's be any better?*, Richard Denniss, Crawford School.

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### **Publications**

#### ***Asia Pacific Economic Papers***

372, *Immunising future trade against protectionists: preventing the emergence of more sensitive sectors*, Andrew Elek

### **News from Asia Pacific Press**

Politics and State-Building in Solomon Islands, Sinclair Dinnen and Stewart Firth (eds)

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