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**Economic and Social Commission for Asia and the Pacific**

**Seventy-second session**

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Items 3 and 7 (a) of the provisional agenda \*\*

**Review of issues pertinent to the subsidiary structure of the Commission, including the work of the regional institutions**

**Policy issues for the Asia-Pacific region: key challenges to inclusive and sustainable economic and social development in Asia and the Pacific**

**Enhancing regional economic cooperation and integration in Asia and the Pacific**

**Note by the secretariat\*\*\***

*Summary*

The Economic and Social Commission for Asia and the Pacific endorsed the Bangkok Declaration on Regional Economic Cooperation and Integration in Asia and the Pacific through its resolution 70/1, entitled “Implementation of the Bangkok Declaration on Regional Economic Cooperation and Integration in Asia and the Pacific”. In the resolution, the Commission, inter alia, recognized the important progress achieved by regional groupings and organizations in integrating their subregions, and proposed an agenda aimed at deepening and broadening economic cooperation and integration in Asia and the Pacific and at moving towards the formation of an economic community of Asia and the Pacific as a long-term goal. The resolution included a proposal to establish four area-specific expert working groups: (a) moving towards the formation of an integrated market; (b) development of seamless connectivity in the region; (c) enhancing financial cooperation; and (d) increasing economic cooperation to address shared vulnerabilities and risks. The present document summarizes critical issues based on the outcomes of these expert working groups to further advance the implementation of the resolution.

The Commission may wish to consider the recommendations contained in this document and provide its comments and guidance to further facilitate the implementation of the Bangkok Declaration in preparation for the second Ministerial Conference on Regional Economic Cooperation and Integration in Asia and the Pacific.

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\*\* E/ESCAP/72/L.1.

\*\*\* The present document was submitted late owing to the need to incorporate recent inputs from the First High-level Follow-up Dialogue on Financing for Development in Asia and the Pacific (30-31 March 2016), and of the Asia-Pacific Forum on Sustainable Development 2016 (3-5 April 2016).

## **I. Introduction**

1. The Economic and Social Commission for Asia and the Pacific (ESCAP) has been a catalyst for regional cooperation in the Asia-Pacific region owing to its unparalleled ability to bring nations together. At the first Ministerial Conference on Regional Economic Cooperation and Integration in Asia and the Pacific in December 2013, member States adopted the Bangkok Declaration, which set the agenda for regional economic cooperation and integration.

2. The Commission endorsed the Bangkok Declaration through its resolution 70/1, and proposed an agenda aimed at deepening and broadening economic cooperation and integration in Asia and the Pacific and at moving towards the formation of an economic community of Asia and the Pacific as a long-term goal. The resolution included a proposal to establish four area-specific expert working groups: (a) moving towards the formation of an integrated market; (b) development of seamless connectivity in the region; (c) enhancing financial cooperation, especially to fund the region's large infrastructure deficit; and (d) increasing economic cooperation to address shared vulnerabilities and risks as well as challenges.

3. Consequently, the four area-specific working groups were established, consisting of government officials or experts nominated by the member States to participate in their personal capacities. With the support of the secretariat, the four working groups held two meetings in Bangkok in 2014 and 2015, and produced reports containing their assessments of the challenges, existing initiatives and gaps, and recommendations on the way forward. The final report on regional economic cooperation and integration incorporates findings of subregional and sector-specific analyses received from regional cooperation experts. The reports are aimed at informing the intergovernmental preparatory meeting(s) to be organized ahead of the second Ministerial Conference.

4. The present document highlights: (a) regional trends in regional cooperation and integration; (b) thematic issues and sectoral and subregional perspectives drawing on the findings and advice of experts; and (c) suggestions on policy and institutional priorities as the way forward for integrating Asia and the Pacific.

## **II. Trends in regional cooperation and integration**

5. Asia and the Pacific encompasses five subregions, stretching southwards from the rugged plains of Siberia in the Russian Federation to New Zealand and eastwards from Turkey to Polynesia. The diversity of cultures, geography, natural resources and production systems supporting some 4.2 billion people make subregional groupings and cross-border exchanges between proximal States a first step towards Pan-Asian integration. The proliferation and lack of common comprehensive institutional frameworks for economic cooperation, with the exception of the 10-member Association of Southeast Asian Nations (ASEAN), contribute to the slow pace of subregional economic integration. Lagging behind are the South Asian Association for Regional Cooperation (SAARC) and the Eurasian Economic Union, which is the sole regional customs union that exists, comprising five northern Eurasian states (Armenia, Belarus, Kazakhstan, Kyrgyzstan and the Russian Federation). For further details, see ESCAP regional economic cooperation and integration papers on the four subregions.

6. Regional economic cooperation and integration in Asia and the Pacific have evolved over the past several decades, with varying degrees of success. Since its inception, ESCAP has been proactive in pursuing the regional economic cooperation and integration agenda.<sup>1</sup> ASEAN was the first subregional association set up in 1967 to promote economic development, together with security and conflict mitigation as additional goals. These efforts were exclusive, open to members only and followed a consensus-building approach, adopting a non-legalistic and minimalist institutional design. The second phase of regional economic cooperation and integration that began in the mid-1980s stemmed from growing economic interdependence as countries in the region started to participate in global value chains. Market-driven, outward-looking structural reforms, including trade and investment liberalization following the accession to the World Trade Organization (WTO) in many countries, facilitated regional interdependence. Unlike the early stages of export-led growth directed outside the region, intraregional trade and production integration helped the region emerge as a global manufacturing hub. Following the Asian financial crisis of 1997-1998, the region started to pursue financial cooperation but it has mostly focused on pooling swap facilities to support regional liquidity in case of a new crisis.

7. In 2016, the region's multitrack, multi-sector efforts follow different processes at different speeds, employing various forums, promoting subregional cooperation in many sectors and utilizing both "bottom-up" and "top-down" approaches. This process is no longer dominated by Governments: markets, the private sector, multilateral organizations and civil society organizations are involved in bringing nations together.

8. The regional economic cooperation and integration process has progressed incrementally, in phases, and its fragmented approach has delivered partial successes but more is needed to move the region to a more advanced stage of regional cooperation and integration. For that purpose, the regional economic cooperation and integration design and implementation need to be aligned with the 2030 Agenda for Sustainable Development. With its focus on transboundary challenges, the Sustainable Development Goals both influence and need to be serviced by regional economic cooperation and integration. To reinforce the vision and goals of the 2030 Agenda, regional economic cooperation and integration have to incorporate the goals of eradicating poverty and reducing inequalities of income and access to ensure that deepening integration will promote shared prosperity through market integration, seamless connectivity, financial cooperation and stability, as well as dealing effectively with shared vulnerabilities and risks. In sync with the Sustainable Development Goals, regional economic cooperation and integration have to promote sustainable regional development and infrastructure that reduce poverty and inequalities.

9. Regional economic cooperation and integration should also drive the transformation of production processes across the region to support the 2030 Agenda and the Paris Agreement. Several Sustainable Development Goals are transboundary in nature and these are better served when nations work together in the spirit of regional cooperation. Thus, market integration needs to be supported by efficient and seamless-cum-sustainable connectivity, and by measures to build resilience against emerging vulnerabilities and risks.

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<sup>1</sup> In the 1950s, a number of regional cooperation efforts were driven by nationalism, decolonization processes, the idea of collective self-reliance and as a platform for development. These were largely political in nature and aspirational.

To broaden and deepen regional economic cooperation and integration, besides building political momentum, the ESCAP secretariat, pursuant to ESCAP resolution 70/1, will convene a second Ministerial Conference in 2017 to deliberate on regional analyses and initiatives and to seek guidance from member States on the way forward.

#### **A. The economy**

10. The region stands out for its high and sustained economic growth, which has gained momentum steadily since the 1950s and is linked to liberalization in trade and investment, technological advances and productivity enhancements, which together have supported the region's global integration with the developed economies. The region's share in the global economy reached 39 per cent of global gross domestic product (GDP) in 2014, compared with just 16 per cent in 1950. Advances in information technology and improvements in logistics led to the unbundling of most production processes and a large increase in trade of intermediate goods and services, which contributed to increasing the share of the region in global trade to 60 per cent. The integration of the region in global value chains also influenced foreign direct investment (FDI): 2014 saw significant FDI inflows to the economies in the region, reaching \$533 billion, while the FDI outflows from the region were also quite large, \$563 billion in the same year.

11. This economic dynamism helped the region lift hundreds of millions of people out of poverty – a pace of poverty reduction unparalleled in human history.<sup>2</sup> However, one of the most visible side effects of the region's rapid growth has been its heavy ecological footprint and significant environmental damage. The region is the world's largest source of greenhouse emissions (53 per cent) because of its heavy reliance on fossil fuels and rapidly growing energy demand. Rapid growth has also led to unprecedented levels of urbanization: 48 per cent of the population in the region lives in cities, many of which are congested and heavily polluted with significant health impacts.

12. Since the global financial crisis of 2007-2009, overall growth fell from an average annual rate of 9.4 per cent in the period from 2005 to 2007 to 5.2 per cent in the period from 2012 to 2014.<sup>3</sup> Lower economic growth led to a drop in the region's demand for commodities, notably fuel. As a result, commodity prices fell, lowering inflationary pressures in import-dependent economies, and causing economic contraction in commodity-exporting countries. The resulting decline in domestic demand caused regional imports to drop by 14 per cent in 2015. Although the region's services trade growth improved to 6.1 per cent in 2014, it consistently remained below the 2012 level of 8.2 per cent (ESCAP, *Asia-Pacific Trade and Investment Report 2015*).<sup>4</sup>

#### **B. Measuring regional economic cooperation and integration**

13. Regional economic cooperation and integration is a process that facilitates shared prosperity through the free flow of goods, services and

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<sup>2</sup> In 1990, 52 per cent of Asians were living in poverty and by 2012, this share had declined to 15 per cent compared with the global average of 17 per cent.

<sup>3</sup> Overall growth deceleration is due to a slowdown in international trade, lower demand from China while it is rebalancing its economy, and weakening total factor productivity growth.

<sup>4</sup> United Nations publication, Sales No. E.15.II.F.15.

people, and through policy coordination and institutional arrangements<sup>5</sup> between two or more countries so as to meet the long-term goal of sustainable development in the region. Regional economic cooperation and integration are multidimensional and include integrated markets for goods, services, capital and labour; infrastructure connectivity; financial cooperation; and economic and technical cooperation to address shared vulnerabilities and risks. This section focuses on overall levels of trends in regional economic cooperation and integration using a set of quantitative indicators.

14. Three composite measures of economic integration, trade and investment, monetary and financial, and cross-border mobility of people (table 1), reveal that the overall level of the region's integration seems to be much higher than in Africa, closer to that of the Americas, but lower than that of Europe.<sup>6</sup> Within the region, however, there are wide variations in the degree of economic integration across its major subregions; East Asia is the most integrated; though lower than both Western Europe and North America. In terms of overall economic integration, South-East Asia ranks second, followed by the Pacific and Oceania,<sup>7</sup> South and Central Asia. Separate papers have been issued in tandem to this report to offer further insights into the subregional dynamics of regional economic cooperation and integration.

15. In terms of trade and investment, East Asia's subregional integration is higher than that of North America, although lower than that of Western Europe; meanwhile South-East Asia falls behind East Asia but is much higher than other subregions. Within the region, East and South-East Asia have roughly the same levels of monetary and financial integration, while other subregions hardly have any. Within the region, integration in terms of cross-border people mobility is the lowest in the Pacific (excluding Australia and New Zealand) but higher in East Asia – only marginally lower than in Western Europe - followed by South-East Asia, Pacific and Oceania, South Asia and Central Asia.

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<sup>5</sup> The term “institutional arrangements” is used in a broad sense, covering norms, rules, values, formal and informal processes.

<sup>6</sup> A full definition and methodology for estimation of these indices are provided in Dominik Naeher, “An empirical estimation of Asia's untapped regional integration potential using data envelopment analysis”, ADB Economics Working Paper Series, No. 445 (Mandaluyong City, Asian Development Bank, 2015). Available from [www.adb.org/sites/default/files/publication/172903/ewp-445.pdf](http://www.adb.org/sites/default/files/publication/172903/ewp-445.pdf).

<sup>7</sup> Excluding Australia and New Zealand, the Pacific subregion has much lower economic integration than in the other subregions.

Table 1  
Regional integration across major regions in the world

<i>Regions</i>	<i>Composite regional integration index</i>	<i>Trade and investment</i>	<i>Monetary and financial</i>	<i>Cross-border mobility</i>
Asia-Pacific <sup>a</sup>	0.28	0.26	0.15	0.42
Europe	0.41	0.46	0.35	0.43
Americas	0.31	0.32	0.13	0.48
Africa	0.17	0.07	0.01	0.42
Subregional groups				
Western Europe	0.89	1.00	1.00	0.68
North America	0.62	0.65	0.31	0.90
South America	0.27	0.28	0.06	0.46
Western Africa	0.25	0.12	0.01	0.60
East Asia	0.50	0.68	0.22	0.62
South-East Asia	0.38	0.42	0.21	0.50
South Asia	0.11	0.08	0.01	0.24
Central Asia	0.11	0.09	0.01	0.23
Pacific <sup>b</sup>	0.02	0.04	0.01	0.02
Pacific and Oceania <sup>c</sup>	0.23	0.12	0.09	0.47

*Source:* Dominic Naeher, “An Empirical Estimation of Asia’s Untapped Regional Integration Potential Using Data Envelopment Analysis”, ADB Economics Working Paper Series, No. 445 (2015) ([www.adb.org/sites/default/files/publication/172903/ewp-445.pdf](http://www.adb.org/sites/default/files/publication/172903/ewp-445.pdf)), adapted in Madhur, “Drivers and Draggers of Regional Economic Cooperation and Integration in Asia and the Pacific” (ESCAP, Bangkok, 2016).

<sup>a</sup> These values are given for Asia only in Naeher (2015).

<sup>b</sup> Only developing Pacific. Data for the Pacific not included in Naeher (2015).

<sup>c</sup> Including Australia and New Zealand.

16. Geography influences how cross-border connectivity has evolved in the region (table 2). Countries located near seaports and with developed shipping lines are relatively more integrated. Better air connectivity supplements sea links, especially for the movement of time-sensitive, low-weight and high-value merchandise, and air connectivity plays a much bigger role in the movement of people – for tourism, business and migration.

Table 2  
**Geography and connectivity<sup>a</sup>**

<i>Subregion</i>	<i>Liner shipping connectivity index (2004-2015)</i>	<i>Air connectivity index (2007) (percentage)</i>
East Asia	108.4	2.9
South-East Asia	42.4	3.1
South Asia	29.9	2.8
Central Asia	-	3.2
Pacific	-	4.6
Pacific and Oceania	8.1	2.0

*Source:* Madhur, “Drivers and Draggers of Regional Economic Cooperation and Integration in Asia and the Pacific” (ESCAP, Bangkok, 2016).

*Note:* Some regional economies are excluded from these indices because of the non-availability of data.

<sup>a</sup> Weighted by country populations to arrive at group indices.

17. Conversely, adverse geography has challenged both regional and global integration in Central Asia and the Pacific. It needs to be noted, however, that geography is only an enabling and not a determining factor for regional economic cooperation and integration. South Asia has favourable geography, yet its performance in regional integration (and global integration) is one of the lowest within the region. China’s favourable geography did not automatically lead to its better integration with its neighbours and the rest of the world until the country began opening up its economy in 1979.

18. The subregions have benefited differently from the national policies with respect to their global and regional economic integration. This is captured well by a range of subregional indices (table 3). The World Economic Forum’s enabling trade index, the World Bank’s services trade restrictions index and the World Bank’s logistics performance index together reflect the subregion’s “at-the-border” policy openness. Meanwhile, the World Bank’s Doing Business (distance to frontier) indicator reflects “behind-the-border” openness. While geography helped East Asia to grow fast and integrate economically, South-East Asia, which has a less favourable geography and sea connectivity than East Asia, benefited from positive spillovers from East Asia. Equally importantly, over time, successive South-East Asian countries have also taken appropriate policy measures – opening up to international trade, investment, capital and to people more generally.<sup>8</sup>

<sup>8</sup> The “ASEAN 5” began their economic liberalization policies when Japan was looking to relocate its industries. They pursued this opening-up programme, although with significant differences across countries, thus gaining from the next two waves of industrial relocation and economic opening-up – the new industrial economies initially and China subsequently.

Table 3  
National policies and regional economic cooperation and integration<sup>a</sup>

<i>Subregions</i>	<i>Enabling trade index 2014</i>	<i>Logistics performance index (2014)</i>	<i>Service trade restrictions index (overall)</i>	<i>Doing Business indicator (2015)</i>
East Asia	4.4	3.6	35.0	64.6
South-East Asia	4.1	3.1	48.1	61.8
South Asia	3.6	3.0	58.7	53.6
Central Asia	3.9	2.5	19.4	59.6
Pacific	-	-	-	56.4
Pacific and Oceania	4.9	3.8	18.7	74.5

*Source:* Madhur, “Drivers and Draggers of Regional Economic Cooperation and Integration in Asia and the Pacific” (ESCAP, Bangkok, 2016).

*Note:* Some regional economies are excluded from these indices because of the non-availability of data.

<sup>a</sup> Weighted by country populations to arrive at groups indices.

19. South Asia’s failure to pursue outward-oriented policies held back the subregion in achieving either significant subregional or global economic integration. Central Asia and the Pacific countries are in general handicapped by their less favourable geography despite their relatively more open external economic policies. Encouragingly, however, Central Asia is now moving somewhat faster on regional economic integration.

### C. Drivers of regional economic cooperation and integration

20. The traditional list of drivers of integration includes factors such as contiguous borders, historical roots and ties, which need to generate stability and security between two or more States. The European Union and ASEAN, for example, were created with similar goals: fostering stability and security in the post-war era, gaining a stronger collective voice and supporting economic growth. While the traditional drivers of integration remain important, they are supplemented by multidisciplinary and multidimensional motivations and approaches to integrate regions. In reality, every region is unique in terms of its interest; as such, different factors have influenced the nature, scope and process of integration. ASEAN has been described as an “institution-light” informal organization with a network type of governance, in contrast to the European Union, with its formal supranational institutions at the core. In recent years, a range of factors and developments provided new impetus to regional economic cooperation and integration.

21. **Agglomeration and economies of scale and scope.** Until the onset of the 1997 Asian financial crisis, Asian economic integration was market-driven, fueled by the sequential growth of major regional economies and the participation in global production processes, attracting FDI and creating an intricate web of intra-firm production networks. By the end of 2015, the region’s economies were parties to as many as 155 (59 per cent) of the global total of 262 preferential trade agreements that were currently in force. These agreements give the private sector reciprocal and legally binding market access, reducing risks of trade and investments. Enlarging markets facilitate greater specialization and benefit through economies of scale and scope.



22. **Rebalancing Asia.** The global financial crisis has seen a “new normal” situation of sluggish growth in major developed economies characterized as “secular stagnation”. This means that developing economies of the region have to explore new sources of economic growth. ASEAN, the third largest economy in the region, has declared its commitment to form a community. Together with China, Japan and the Republic of Korea, ASEAN countries are transforming themselves from producers engaged in global value chains to final consumers. As such, they are adopting rebalancing strategies to create new opportunities by further opening their domestic markets. Additional sources of aggregate demand can come from boosting investments in regional infrastructure using the region’s savings.

Table 4  
**Mega-regional initiatives**

<i>Parameters</i>	<i>TPP</i>	<i>RCEP</i>	<i>FTAAP</i>	<i>ESCAP RECI</i>
Participant economies	12	16	21	58
Share of global GDP (%)	59	29	58	46
Share of world population (%)	11	49	40	60
Share of world imports (%)	31	28	47	37
Share of world exports (%)	24	30	45	39

*Note:* Based on 2013 data.

*Abbreviations:* ESCAP RECI, ESCAP regional cooperation and integration; FTAAP, Free Trade Area of the Asia-Pacific; RCEP, Regional Comprehensive Economic Partnership; TPP, Trans-Pacific Partnership.

23. **Mega-regional initiatives and regional economic cooperation and integration.** The Asia-Pacific economies are engaged in several important mega-initiatives (table 4), such as the Regional Comprehensive Economic Partnership and the Trans-Pacific Partnership, and Central Asian countries are currently involved in building the Eurasian Economic Union. Table 4 compares the relative size of the two concrete mega-initiatives (the Trans-Pacific Partnership has already been signed and the Regional Comprehensive Economic Partnership is under negotiation), and another two which are either under study (Free Trade Area of the Asia-Pacific) or consideration (regional economic cooperation and integration). Given that the legal text of the Trans-Pacific Partnership is now in the public domain and the Regional Comprehensive Economic Partnership has gone through 16 rounds of negotiations, there is sufficient information available to comment on the depth of commitments of those two deals. The Trans-Pacific Partnership is hailed as a twenty-first century agreement, including not only comprehensive (negative list) liberalization of trade in goods and services, but also new approaches to liberalization under investment and competition and WTO-plus commitments in areas such as intellectual property rights and government procurement. With these features, the Trans-Pacific Partnership is setting a new benchmark for the regional free trade agreements and it is yet to be seen how close the Regional Comprehensive Economic Partnership will come. Often simple recognition of standards in the areas of agricultural trade or education degrees would allow for more cross-border transactions in the region, benefiting, in particular, the poor and laying the foundation for a future platform of deep reciprocal and binding liberalization commitments.

24. **Political dynamics.** The region's changing political dynamics is likely to open newer regional economic cooperation and integration frontiers. On the one hand, the fact that countries such as Myanmar, which is a potential land bridge for ASEAN and South Asia, are benefiting from newer political structures, and the lifting of the sanctions placed upon the Islamic Republic of Iran, which is strategically located with its large energy resources and which is key to West Asia connectivity and beyond, open up completely new and exciting opportunities for the region. On the other hand, the President of China's visionary connectivity agenda (One Belt, One Road to revive old Silk routes) is taking multipolarity to the next stage and the backing by its own financial resources that are deployed in newer vehicles, such as the Silk Road Fund, Asian Infrastructure Investment Bank and the partnership with the New Development Bank, has far-reaching implications for regional economic cooperation and integration, offering competitive financing structures and fast-tracking infrastructure development. It has the potential to better integrate Central Asian countries and South Asia and further strengthen intra-subregional integration. Reinforcing these initiatives, China's G-20 presidency in 2016 has vowed to lay the foundation for a world economy that is innovative, invigorated, interconnected and inclusive.

25. **Sustainable Development Goals.** Implementation of the 2030 Agenda for Sustainable Development will require a fundamental rethink to set regional economic cooperation and integration on the sustainability path through sustainable cross-border connectivity. High and sustained economic growth over the past several decades, while significantly contributing to poverty reduction, has also led to a rapid rise in energy consumption within the region, now accounting for almost 50 per cent of global energy consumption. In spite of large investments in domestic production capacity, the region will remain dependent on energy imports. Regional economic cooperation and integration may be a means of enhancing regional energy security for an expanded role of renewables, lowering use of fossil fuels, and power and natural gas market integration will be necessary for the region to meet the targets of the Sustainable Development Goals. Besides energy, five other goals<sup>9</sup> have large transboundary impacts and benefit from collective regional action through regional economic cooperation and integration.

26. **Externalities and regional public goods.** Regional connectivity is a public good and just like all public goods, markets do not provide the optimum level of connectivity and other services or risk mitigation. Regional economic cooperation and integration, if appropriately structured, can play an important role in promoting risk-coping strategies to deal with shared vulnerabilities such as disasters or climate change – both being transboundary in nature. ESCAP has a major role to play in ensuring regional economic cooperation and integration are best placed in facilitating regional public goods and tools to internalize externalities.

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<sup>9</sup> Sustainable Development Goal 6 (water): ensure availability and sustainable management of water and sanitation for all; Goal 8 (economy): promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all; Goal 13 (climate): take urgent action to combat climate change and its impacts; Goal 14 (marine ecosystems): conserve and sustainably use the oceans, seas and marine resources for sustainable development; and Goal 15 (ecosystems): protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss.

27. **Diversity premium.** The region is amongst the most diverse regions of the world in terms of geography, size of the economy, population and community, economic conditions, poverty and social situations, resource endowments and environmental conditions, with different forms of governments and political systems and overall quality of human well-being. Overall gains from integration rise when there is diversity. The region has large and growing internal markets: by 2030, the region will be home to 66 per cent of the global middle class, compared with 28 per cent in 2016.<sup>10</sup> The region could also benefit from the liberalization of labour markets, while surplus and deficit countries in the region would benefit from the free movement of people. The region's large deficit of infrastructure, both in national economies and in terms of cross-border connectivity and investing in infrastructure, could also be a major source of regional demand. Given the high savings rate of the region, greater cooperation and integration of financial sources could be a major driver to accelerate economic growth.

28. **Political will and local ownership.** Political will is an important driver of regional economic cooperation and integration: in fact, most of the successful integration examples had leaders who drove an integration process. Regional economic cooperation and integration create redistribution impacts and this can be handled better with strong political leadership. It is not enough to have acceptance at the leadership level; success in regional economic cooperation and integration requires local ownership that is widespread, in different groups of stakeholders of the society and is internalized in the national development agenda.

29. The region is still in the process of being connected and as is evident from the global experience, it takes a long time, if not decades for countries to be integrated as a block. In the meantime, the leadership of the region has identified four areas, market integration, seamless connectivity, regional financial cooperation and a framework for shared risks and vulnerability, as a medium-term priority for the region to manage and profit from interdependence. These issues are considered important for the national economies, but also for the region to meet the 2030 Agenda for Sustainable Development. The next stage will be to review these priority areas, taking stock of where the region is and what are the emerging challenges.

### III. Thematic issues: a perspective from the subregions

#### A. Market integration

30. The region is the largest trading region in the world, accounting for almost 40 per cent of global exports and imports (2014). Intraregional trade shares for goods, an indication of trade integration, have consistently risen since 1990, peaking in 2010 at approximately 52 per cent. The level of intraregional trade varies in different subregions. Moving against the global trend, the growth of the commercial services trade in the region improved from 4 per cent in 2013 to 5.1 per cent in 2014 for exports, and from 5.7 per cent to 6.1 per cent for imports, though it remains below the peak level of 2012 at 8.2 per cent and is below potential. The region remains a net

<sup>10</sup> It is estimated that in 2015, for the first time in 300 years, the number of Asian middle class consumers equalled those in Europe and North America put together. See Homi Kharas and Geoffrey Gertz, "The New Global Middle Class: A Cross-Over from West to East" (Wolfenson Center for Development, Brookings Institution, 2010).

importer of commercial services, accounting for 28 per cent of world exports and 32.6 per cent of world imports (table 5).

Table 5  
Market integration across the Asia and the Pacific region 2014

Subregions	Intraregional Trade		Trade in services		Foreign direct investment		Intermediate goods		Trade facilitation
	Percentage of total		Annual growth percentage		In billions of United States dollars		Percentage of total		Percentage
	EXP	IMP	EXP	IMP	Inflow	Outflow	EXP	IMP	
ENEAS	54.9	53.0	9.1	11.0	245	259	17.0	21.0	69.6
NCA	27.1	39.5	(6.0)	(3.1)	41	62	19.0	17.0	41.5
SA & SWA	25.3	39.8	5.4	13.0	53	17	26.0	34.0	41.3
SEA	68.2	62.3	(0.2)	(0.2)	133	80	18.0	25.0	56.1
Pacific	77.7	60.3	0.4	(9.1)	57	-	19.0	15.0	25.2
Region	54.0	50.0	5.1	6.1	533	563	18.0	22.0	46.5

Note: Trade facilitation is as a percentage of the WTO Agreement on Trade Facilitation.

Abbreviations: ENEAS, East and North Asia; EXP, exports; IMP, imports; NCA, North and Central Asia; SA & SWA, South Asia and South-West Asia; SEA, South-East Asia.

31. The region remains a major destination for FDI, receiving 43 per cent of global inflows (\$533 billion) in 2014. While this amount represented an absolute decline of 1.5 per cent from the preceding year, the region continued to outperform the global average. The region is also continuing to gain prominence as a major outward investor. In 2014, outflows from developing Asian economies reached \$450 billion (which, including developed countries, totalled \$563 billion), a 20 per cent increase compared with the 15 per cent decline in outflows from regional developed economies. Recently, the share of mergers and acquisitions in intraregional FDI has increased, reflecting a shift away from greenfield investments.

32. Until the 1990s, preferential trade agreements were largely absent as trade policy instruments in the region; between 2000 and 2015, the number of enforced agreements increased from 54 to 156 (Asia-Pacific Trade and Investment Agreements Database, 2016). Approximately half of all trade agreements put in force by the region are free trade goods agreements, while close to 39 per cent of agreements are comprehensive in nature, covering goods, services and other areas. Most of these comprehensive partnership agreements can be described as WTO-plus as they include commitments to investment, competition policies and government procurement.

Table 6  
Trade costs<sup>a</sup>

Region	ASEAN-4	East Asia-3	NCA	Pacific Islands	SAARC-4	AUS-NZL	EU-3
ASEAN-4	76						
East Asia-3	75	51					
NCA	351	177	121				
Pacific Islands	175	174	368	133			
SAARC-4	128	125	282	317	114		
AUS-NZL	101	89	338	73	142	54	
EU-3	108	85	152	211	114	109	43
USA	85	63	180	163	109	100	67

*Abbreviations:* ASEAN-4, Indonesia, Malaysia, the Philippines and Thailand; AUS-NZL, Australia and New Zealand; East Asia-3: China, Japan and the Republic of Korea; EU-3, Germany, France and the United Kingdom; North and Central Asia-4, Georgia, Kazakhstan, Kyrgyzstan and the Russian Federation; Pacific islands, Fiji and Papua New Guinea; SAARC-4, Bangladesh, India, Pakistan and Sri Lanka.

<sup>a</sup> Trade costs shown are tariff equivalents calculated as trade weighted average trade costs of countries in each subregion with the three largest developed economies (Germany, Japan and the United States of America).

33. Recent global events<sup>11</sup> have brought trade facilitation and paperless trade into sharp focus because high trade costs act as non-tariff barriers and dampen trade (table 6). The ESCAP global survey of trade facilitation and paperless trade<sup>12</sup> shows that, except for East and North Asia and South-East Asia, other subregions lag behind in implementing trade facilitation agreements. Trade costs vary between 51 to 351 per cent in tariff equivalent terms. ESCAP research indicates that region-wide implementation of cross-border paperless trade in Asia and the Pacific could lead to export gains of \$257 billion annually. Even partial implementation of cross-border paperless trade measures could lead to an export increase of \$36 billion annually, and the time required to export could decrease by as much as 44 per cent and cost by up to 31 per cent.

34. The region appears to be less inclined to reduce its reliance on preferential liberalization in the foreseeable future. However, the region is realizing that business as usual, with regard to trade agreements, may no longer be the best course. With slow global trade growth and limited success in multilateral negotiations, the region has to be open to new and broader scope agreements. These include, but are not limited to: (a) success in reaching agreement under the Trans-Pacific Partnership; (b) ongoing promising efforts in negotiations on the Regional Comprehensive Economic Partnership; (c) new momentum gained following the establishment of the ASEAN Economic Community at the end of 2015; and (d) the region-wide

<sup>11</sup> Successful conclusions of the World Trade Organization (WTO) Trade Facilitation Agreement negotiations (December 2013), the fifth Global Review on Aid for Trade for reducing trade costs and the adoption of the Addis Ababa Action Agenda of the Third International Conference on Financing for Development (both in July 2015).

<sup>12</sup> The survey was designed and led by ESCAP and implemented by all five regional commissions.

renewed momentum on newer trade facilitation approaches, that members of ESCAP have entrusted the secretariat to develop. There is also need for South Asia to be opportune and strike a regional trade agreement as this subregion's intraregional trade is barely one third of its potential (close to \$172 billion according to ESCAP), and is locked in services and investment restrictions; this would spark the restructuring of industrial and regional value chains. Amid a decline in demand for traditional market powers, less developed economies could also benefit from greater exports to neighboring emerging economies.

35. Labour market integration in the region is lagging behind other forms of integration, although there have been some advances in recent years. The Treaty on the Eurasian Economic Union, which came into effect on 1 January 2015, binds several countries origin and destination of the North and Central Asian subregion, including Armenia, Kazakhstan, Kyrgyzstan and the Russian Federation, into a single labour market. This involves rationalizing and regularizing long-standing labour migration flows between these countries, notably through giving migrant workers' rights of access to employment and social protection systems. Meanwhile, the ASEAN Economic Community has enabled greater mobility of highly-skilled labour through mutual recognition agreements in specific professions. However, this affects only a limited share of ASEAN migration, most of which occurs at the lower end of the skill spectrum. Labour migration between the ASEAN member States remains largely irregular and thus limited in its potential to benefit the development of countries of origin and destination, as well as the migrants themselves.

## **B. Seamless connectivity**

36. Throughout history, globalization and development successes have been contingent on progress in infrastructure connectivity as it is a means of enhancing the effectiveness of regional production networks and trade efficiency. At the same time, trade efficiency enhancements through the removal of trade and other transport and supply chain barriers have a positive impact on growth.

37. Physical networks are the starting point, but without the development of an efficient infrastructure services sector, (for the distribution of goods) or transport companies (for people), marketing, logistics, finance or the insurance impact of connectivity are limited. Productivity of infrastructure networks and their efficiency in "cross-border connectivity" depend on the policy and regulatory environment (including legal, health or safety rules, governance aspects and strong and capable institutions).

38. Several quantitative studies, using different models, have confirmed the significance of regional infrastructure for overall welfare gains in Asia. For instance, annual investment of approximately \$800 billion in transport, communication and energy infrastructure from 2010 to 2020 across developing Asia would result in welfare gains of \$1,616 billion (in 2008 prices) in 2020, or 10 per cent of the projected GDP.<sup>13</sup> Integration scenarios assess that connecting South Asia with South-East Asia<sup>14</sup> would generate

<sup>13</sup> Fan Zhai, "The ASEAN Economic Community: A General Equilibrium Analysis" (2010). Available from <http://onlinelibrary.wiley.com/doi/10.1111/j.1467-8381.2012.02079.x/abstract>.

<sup>14</sup> Asian Development Bank and Asian Development Bank Institute, *Connecting South Asia and Southeast Asia* (Tokyo, Asian Development Bank, 2015).

greater overall welfare gains subject to the removal of non-tariff barriers and other trade cost reductions.

39. Seamless regional infrastructure connectivity with effective removal of barriers would be critical to revive growth and trade and its efficiency in terms of cost and time efficiency, stimulate overall demand, and would enhance productivity growth.

## 1. Transport connectivity

40. Transport connectivity is vital for realizing inclusive and sustainable growth. Efficient regional transportation networks enlarge market size and help national economies to grow further through higher trade and production. ESCAP has formalized the backbone of a regional network of transport infrastructure through development of the Asian Highway Network, covering 143,000 km and passing through 32 countries; the Trans-Asian Railway Network, covering 117,500 km of railway lines and serving 27 member States;<sup>15</sup> and an Intergovernmental Agreement on Dry Ports. The enhancement of a multi-modal network would help to achieve the goal of sustainable transport connectivity.

41. ESCAP has facilitated three Intergovernmental Agreements: on the Asian Highway Network, the Trans-Asian Railway Network, and Dry Ports; these are treaties to facilitate regional economic cooperation and integration. In parallel, it has supported infrastructure network planning, regional common frameworks on transport facilitation and developed standardized models to assist the region to move towards harmonization of technical and operational regulations. However, the overall outcome has been very complex with more than 100 bilateral and 30 subregional agreements for international land (road) transport. Furthermore, some countries in the region are often the contracting parties to different legal regimes covering geographically overlapping territories facing different and sometimes inconsistent rules related to international transport operations.

42. Commission resolutions 68/4 and 71/7 cover the Regional Strategic Framework for the Facilitation of International Road Transport and the Regional Cooperation Framework for the Facilitation of International Railway Transport, respectively. Four transport facilitation models to address non-physical barriers support member States, namely, the Secure Cross-Border Transport Model; the Efficient Cross-Border Transport Models; the Model on Integrated Controls at the Border Crossing; and Time/Cost-Distance Methodology. Two model agreements for harmonizing the legal environment for cross-border transport by road are now under preparation. ESCAP has extended its work to supporting capacities of countries with special needs to promote public-private partnerships.

43. Given their unfavourable geography, the leaders of the North and Central Asian countries have prioritized the modernization of infrastructure for transport, power generation and communication. A large program of infrastructure connectivity will open up a major transit route from East Asia to Europe. Historically, infrastructure connectivity of North and Central Asian countries has been to the Russian Federation. More recently, east-west

<sup>15</sup> The ESCAP secretariat, in close collaboration with member countries, carried out a number of corridor studies aimed at identifying the routes of the two networks based on the criteria that the selected routes had to be: (a) capital-to-capital links; (b) connections to main industrial and agricultural centers; (c) connections to major sea and river ports; and (d) connections to major container terminals and depots.

transport corridors have been developed: Chinese investments in high-speed and ultra-high speed railway infrastructure in North and Central Asian are evolving as the connectivity game changer. North and Central Asian countries are building a system of networked corridors linking the region, and also linking the region to Europe, thus moving away from the old model of one or two regional corridors. The revival of the Chinese Silk Road Economic Belt and its land and sea transport corridors linking China to the Middle East, Africa and Europe through the landlocked North and Central Asian countries offers prospects to establish trade partnerships and networks along main trade corridors.

44. The potential for connectivity is likely to grow as the implementation of the rail, air, road, sea and oil and gas pipelines funded by the \$40 billion Chinese Silk Road Fund and the Asian Infrastructure Investment Bank materializes. Furthermore, the strategic location of the South Asian subregion within the Eurasian continent coupled with the historical trade patterns along the Silk Road or the Grand Trunk Road between Chittagong, Bangladesh, and Kabul are proof that immense possibilities for interregional connectivity exist. These grand plans will change the connectivity landscape, but for seamless connectivity, work needs to be launched to move from unimodal to multimodal connectivity and harmonize different road standards. Currently most hard borders require transloading, and there remain missing links, which create the problem of last-mile connectivity.

## **2. Energy connectivity**

45. Sustainable Development Goal 7 underscores the need for access to affordable, reliable, sustainable and clean/modern energy for all by 2030. Despite enormous economic success, the region is home to the majority of the world's energy poor, who do not have access to electricity and who use traditional fuels for cooking and heating, with consequent impacts on environmental, health, and gender inequality.

46. The region now accounts for almost half of global energy consumption, and in spite of large investments in domestic production capacity in the last two decades, the region, which was a net exporter of energy until 1990, has now become a net importer. Compared to 1980, the region's share has nearly doubled from 23 per cent to more than 42 per cent of global energy imports in 2012. The region is particularly vulnerable in terms of oil import over-dependency on a single geopolitical region, with shipping and other bottlenecks further exposing the region to a range risks.

47. Though the region has adequate energy resources to meet its large and growing demand, most conventional energy resources are highly concentrated in five countries that account for more than 85 per cent of total regional energy resources, which are beyond their future demand requirements. With a large part of the region suffering from an energy deficit that is likely to grow as population and industrial requirements rise, harnessing trade between surplus and deficit countries calls for urgent action on regional energy connectivity. Trade and investments in regional energy networks, however, remain low, barring a few recent cross-border investment deals, with other opportunities remaining untapped.

48. Strengthening access to energy through enhanced resource sharing and linkages is critical to raising standards of living, the delivery of health and other services, and productivity of the economy as well as to augmenting transportation and communication networks. The International Energy Agency estimates cumulative global requirements for energy infrastructure



development to be \$68 trillion until 2040, of which 40 per cent will be required for the region.

49. Overall regional energy trade remains below potential, even though the largest producers and consumers of energy coexist in the region. Subregions have initiated energy sharing, though these programs remain ad hoc and contingent on voluntary, unanimous, and continuous decisions of members. Energy-sharing opportunities are being promoted by international financing institutions and bilateral aid organizations, however, projects involve long negotiations to structure appropriate and mutually acceptable transactions among parties, given the lack of common frameworks.

50. Furthering the energy integration process in the region depends on the eventual integration of a regional power grid and power market. Energy networks are capital intensive and, with large sunk costs, they present major challenges in financing and maintenance, especially when these are subject to different legal and regulatory regimes. Often, when energy markets are dominated by state ownership, investments from private sources are difficult to come by because of the lack of credit worthiness of state enterprises and opaque governance structures. In view of these issues, subregional energy-sharing deals (for example, the Central Asia South Asia Electricity Transmission and Trade Project 1000 and the Turkmenistan–Afghanistan–Pakistan–India Pipeline and other cross-border projects) involve large transaction costs.

50. Without appropriate institutional arrangements, the region is not able to exploit economics of scale and it takes a long time for any project idea to move from the drawing board, with bureaucratic processes in obtaining multiple and different procedural requirements and approvals, to actual implementation, as there are no established standard procedures to bring project ideas to implementation nor any systematic institutional arrangements to support such project development. To support energy cooperation in the region, the new ESCAP Committee on Energy will, inter alia, provide a platform for policy- and experience-sharing exchanges. Early identification of the opportunities for energy development efforts calls for action such as the standardization of the regulatory environment, operation and design standards, energy pricing and ultimately development planning. To effectively garner long-term benefits from an integrated and efficient energy system, measures need to be adopted to reduce development costs and improve sustainability performance.

### **3. Information and communications technology connectivity**

51. The potential of ICT to catalyse development is well recognized; beyond enabling better communications ICT has an edge in efficiently delivering economic and social services, the sustainable use of resources, and has the potential to reduce costs of cross-border transnational communications and transactions. With advancement in ICT, market access beyond borders is no longer the exclusive domain of multinational corporations. Small businesses can create markets and reach a huge base of potential customers beyond borders, spur innovation and productivity with ICT. Value chains are not only shifting from manufacturing to ICT-based services segments but facilitating new global hubs based on ICT.

52. Successful rollout of mobile telephony with a penetration rate of 88.8 mobile phone subscriptions per 100 inhabitants on average for the region has been due to rapid technological progress, localization resulting in affordable devices and services, and in most cases, a reasonably favourable

regulatory environment. However, the full potential of ICT for development is still limited by the availability and affordability, in particular, of broadband Internet. According to the International Telecommunication Union, Asia and the Pacific is the region with one of the world's widest gaps in broadband connectedness and where broadband penetration is among the world's lowest.<sup>16</sup> One of the key underlying components is the availability of international bandwidth to deliver affordable and reliable broadband Internet. The physical infrastructure of the Internet, mainly submarine and terrestrial fibre optic networks, as well as efficient traffic management, plays an important role in determining the supply and price of international bandwidth in the region.

53. The ESCAP-led Asia-Pacific Information Superhighway initiative aims to increase the availability and affordability of broadband internet across the region by strengthening the underlying Internet infrastructure. The initiative aims to (a) upgrade the regional physical broadband infrastructure and add new fibre optic cables to create a seamless regional broadband network, (b) improve Internet traffic management to reduce inefficiencies in the way data is routed within and between countries of the region, (c) strengthen infrastructure resilience and (d) expand broadband Internet to deliver broadband access in underserved areas.

54. This is a strategic regional initiative which will not only provide critical infrastructure and the foundation for communication purposes but also help launch various socioeconomic services and applications to accelerate the achievement of the Sustainable Development Goals. Additionally, it is an initiative at the heart of the World Summit on the Information Society, with its primary objectives of providing inclusive access and narrowing the digital divide in Asia and the Pacific.

### **C. Financial cooperation**

55. The financial landscape of the region varies a lot – on one hand the region has some large thriving regional financial centres that are well integrated globally, and on the other hand smaller markets are not only more isolated but suffer from weak financial intermediation. Financial exclusion is quite substantial across Asia.

56. The region has had a series of disruptive financial crises. Among these, the Asian financial crisis of 1997-1998 not only resulted in steep depreciation in currency values but caused phenomenal economic and financial disruption and brought to the forefront the weaknesses of the financial systems' regulatory and supervisory framework in the crisis-affected countries (Indonesia, Malaysia, the Republic of Korea and Thailand) and inherent dangers of contagion given the growing globalization.

57. The key lessons of the Asian financial crisis were the importance of, inter alia, the crisis prevention and mitigation framework, well-diversified financial systems with supportive bond markets, modernization and enforcement of regulatory systems, good capitalization of the financial institutions and resolution mechanisms, and the corporate governance of firms and financial institutions. Given the diversity in size and strength of Asian financial markets, national financial market development has to precede regional financial market integration.

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<sup>16</sup> *Economic and Social Survey of Asia and the Pacific 2014*, (United Nations publication, Sales No. E.14.II.F.4).

58. Subsequent to the 1997 financial crisis, a number of larger markets overhauled their financial regulatory regimes, encouraged bank consolidation and restructuring, and set up bank resolution regimes. Furthermore, the region strengthened macroeconomic and financial surveillance, developed the local currency denominated bond market, built up regional reserves, and developed the Manila Framework in 1997 to foster Asian regional cooperation to promote financial stability. More specifically ASEAN+3 (China, Japan and the Republic of Korea) laid the foundation for a subregional architecture in 2000. To some extent, the region has managed to limit the spillover effects of the recent global financial and economic crisis due to the stronger regulatory regime and its enforcement, and also regional financial safety nets and deposit insurance mechanisms helped.

59. The 2013 Bangkok Declaration on Regional Economic Cooperation and Integration in Asia and the Pacific underscored three priorities for regional financial cooperation: (a) financial stability, (b) strengthening and linking national markets, and (c) resource mobilization, especially for funding large infrastructure gaps and the 2030 Agenda for Sustainable Development. The Third International Conference on Financing for Development approved the long-term Addis Ababa Action Agenda, which underscores the need for vigilance on systemic issues while harnessing all sources of financing for development. In addition, cooperation on domestic and international tax matters is also considered a relatively new yet important area for cooperation.

## 1. Financial stability

60. **Economic surveillance and monitoring.** The ASEAN Surveillance Process, a mechanism for peer review, launched in October 1998, has now matured. There is a dedicated unit at the ASEAN secretariat and national surveillance units in selected countries, and subregional surveillance is now being conducted through the Economic Review and Policy Dialogue – a forum of the ASEAN+3 finance ministers and central bank governors – and in April 2011 the ASEAN+3 Macroeconomic Research Office was established in Singapore to strengthen the Dialogue process.

61. **Short-term liquidity support.** In 1977, the monetary authorities of the five largest ASEAN economies created an ASEAN Swap Arrangement with an initial value of \$100 million, which was expanded to \$2 billion, to provide liquidity support for members experiencing balance of payments difficulties. The Chiang Mai Initiative offered a network of bilateral swap agreements among the +3 countries – China, Japan and the Republic of Korea – and between one of these +3 countries and a select ASEAN member. This has been supplemented by the ASEAN Swap Arrangement. The Chiang Mai Initiative Multilateralization, launched in March 2010, pooled all these networks of bilateral swap agreements into a single reserve pooling arrangement of \$240 billion, governed by a single contractual agreement. In 2012 the Reserve Bank of India announced a \$2 billion Framework on Currency Swap Arrangements for SAARC members. The Anti-Crisis Fund of the Eurasian Economic Community is now close to \$8.5 billion and offers financial credits and investment loans. China, Japan and other countries have established bilateral swap agreements with a total value of \$320 billion. Out of this, \$230 billion is held under China-led bilateral swap agreements with more than 30 countries since 2009 to support trade and investment and promoting the international use of the renminbi.

## 2. Financial markets development cooperation

62. ASEAN, ASEAN+3 and the Executives' Meeting of East Asia and Pacific Central Banks Group are the principal mechanisms of financial market development cooperation. As a part of its ASEAN Economic Community project, a Roadmap for Monetary and Financial Integration of ASEAN has been institutionalized, but, because of the differing size of financial markets and their state of development, ASEAN has pursued a flexible approach, known as "ASEAN minus X" to accommodate the limitations of less developed markets. Under this road map, The ASEAN Framework Agreement on Services aims to progressively liberalize financial services (banking, insurance, securities and others) and gradually remove restrictions on ASEAN banks, insurance companies or investment companies in providing financial services in other member States. The ASEAN Banking Integration Framework aims to harmonize domestic regulation, set criteria for qualified ASEAN banks, and develop ASEAN financial infrastructure and capacities of less developed ASEAN members.

63. Within the capital markets cooperative framework, the role of The ASEAN Capital Markets Forum, established by the securities market regulators in 2004, which initially focused on harmonization of rules and regulations, has been extended to standardize the capital market disclosure standards for cross-border offerings of securities.

64. The South Asian Federation of Exchanges, established in 2000, aims to work towards common standards of listing, trading, clearing, settlement and investors' protection, and encourage cross-border listings and securities trading. In North and Central Asia, Kazakhstan and the Russian Federation are leading the capital markets integration efforts being undertaken under the Eurasian Economic Commission. The Kyrgyz Stock Exchange has a trading system developed by the Kazakhstan Stock Exchange. In the Pacific islands, looking to becoming a subregional exchange, in 2010, an electronic trading platform was launched.

## 3. Resource mobilization and infrastructure financing

65. Investing in sustainable and resilient infrastructure is a prerequisite for achieving many of Sustainable Development Goals; however, the availability of funding for infrastructure varies across the region. Although most countries in East and North-East Asia have been exceptionally successful in resource mobilization for infrastructure development and have significantly increased their infrastructure stock, the majority of the countries in the region still face enormous infrastructure deficits. While a number of new multilateral and country-based specialized infrastructure financing institutions have been set up<sup>17</sup> in addition to traditional existing institutions, the lack of access to sufficient long-term financing continues to be a major challenge.

66. Public sources of finance have traditionally played the most important – and in many countries the only – role in financing infrastructure. These sources will continue to be essential, but given the existing deficit and increasing rate of urbanization that the region is expected to see in the next

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<sup>17</sup> Such as the New Development Bank, the Asian Infrastructure Bank, the ASEAN Infrastructure Fund, the Silk Road Fund, the Eurasian Development Bank, the SAARC Development Fund, the Pacific Region Infrastructure Facility, the One Belt, One Road Initiative, and a recent \$110 billion scheme by Japan to support high-quality infrastructure projects.

few decades, unless private investments are mobilized, it would be difficult to fund all the necessary infrastructure. However, the role of the private sector in financing infrastructure varies considerably across the region, being more advanced in countries that have more developed financial markets. A major challenge to the availability of infrastructure financing by capital markets is the availability of risk capital and long term-finance. Except for some countries in East and North-East Asia, the majority of countries in the region still face enormous financing bottlenecks. This is partly the result of the lack of an enabling infrastructure sector and macroeconomic policy environment, as well as insufficient capacities to develop project feasibility studies and a pipeline of public-private projects.

#### 4. Disaster risk and associated vulnerabilities

67. The Asia-Pacific region is the most disaster-prone region in the world. In the last decade, the region reported 1,624 disasters, 400,000 deaths, 1.4 billion people affected, and more than half a trillion dollars' worth of economic damages.<sup>18</sup> The damage has also been increasing as a proportion of GDP, from 0.16 per cent in the 1970s to 0.37 per cent in the decade 2004-2013. The economic losses are higher if lost income, increased costs of production and other financial losses to businesses as a result of damages to assets activity are taken into account.

68. The most frequent disasters are floods and storms, while earthquakes and tsunamis are the deadliest. Over the period, the region has had 8 of the 10 largest disasters in terms of fatalities, and 4 of the 10 largest in terms of economic damage. Incidence and frequency of transboundary disasters is high in the region as it hosts the world's two most seismically active fault lines which cross many national frontiers. The region has three major ocean basins where a cyclone developing in one basin can affect multiple countries simultaneously. Countries in the region also share rivers and river basins with floods regularly spreading across national boundaries.

69. Disasters reverse economic and social gains and are a serious threat to the attainment of the Sustainable Development Goals.<sup>19</sup> Disaster risks are likely to be exacerbated should the region proceed on an unsustainable growth path; in any case rising population pressures and urbanization take their toll on existing environmental buffers. Climate change may increase the frequency and intensity of extreme weather events.

70. In recognition of these challenges, a broad array of initiatives are underway to develop regional capacities and systems for early warning and to strengthen disaster resilience, disaster-related database development and information-sharing. Despite the availability of innovative technology applications and know-how, still there are significant gaps for monitoring and early warning of hazards such as transboundary river basin floods, glacial lake outburst floods and landslides. Slow onset disasters such as drought and El Niño, which are also transboundary, add another layer of challenge as they often go unnoticed until too late.

<sup>18</sup> EM-DAT: The CRED/OFDA International Disaster database. (Accessed on 4 March 2016).

<sup>19</sup> A case in point is the Nepal earthquake in 2015, which seriously set back the country's aspiration to graduate from the least developed country category.

## 5. Shared climate change vulnerabilities

71. Another major shared risk facing the region is climate change, which has transboundary and multisectoral impacts and hence has a strong link to regional economic cooperation and integration. Global commitment to address climate change is underpinned by the Paris Agreement, which aims to limit global warming below 2 degrees Celsius, and by Sustainable Development Goal 13, which requires countries to take urgent action on climate change and its impacts. Reaching the 2 degrees Celsius target requires global emissions to decline by 40-70 per cent below 2010 levels by mid-century. The region accounts for some 53 per cent of global greenhouse gas emissions, the largest share in the world, and hence the region must play a leading role in emissions reductions and move to a low-carbon development model, if global emissions are to stabilize.

72. With the acceleration of climate change consequences and the concomitant increase in the frequency and severity of natural disasters, Pacific island countries face development challenges that are large and difficult to tackle alone. Natural disasters, particularly tropical cyclones, cause major disruptions and put enormous pressure on Governments for reconstruction and its financing. Identifying ways to manage risks and create opportunities to share or transfer disaster contingencies are essential

73. Addressing shared vulnerabilities is a regional public good and ESCAP is well placed to facilitate cooperation among member States. Within the context of increasing impacts of cross-border disasters, ESCAP member States recognize that building resilience to disasters through regional cooperation is a key priority for achieving sustainable development in the region and have called upon the secretariat to deepen and extend regional cooperation mechanisms for cross-border disasters.

## IV. Integrating Asia and the Pacific: a forward-looking agenda

74. The secretariat has been requested to facilitate regional economic cooperation and integration, specifically in the four priority areas: market integration, connectivity, financial cooperation, and risks and vulnerability. As the global experience indicates, the process of integrating regions, especially a region as diverse and large as Asia and the Pacific, is expected to be a long-term endeavour. It would therefore be crucial to select areas where it is possible to achieve early successes so as to build on the current momentum. This part of the report outlines a number of areas where the region and ESCAP together can initiate actions towards a more integrated Asia and the Pacific.

75. Trade and investment integration with both global and regional markets has been central to the region's growing prosperity so far. Since the global financial crisis, the region has had to explore new sources of sustained growth that can be harnessed through furthering and deepening regional economic cooperation and integration and reinforcing them through the implementation of sustainable development goals. The following provide impetus to regional economic cooperation and integration:

- First, new political and leadership momentum is generated to steer the 2030 Agenda and implement the Sustainable Development Goals, which will address the region's challenges of uneven

growth with persistent poverty, environmental degradation and inequality.

- Second, a number of key new subregional agreements and integration deals, in transport, energy, and ICT lend greater confidence in attaining seamless connectivity and trade facilitation.
- Third, optimization of capital of the multilateral development banks, the recent establishment of China's Silk Road Fund, and the Asian Infrastructure Investment Bank and the New Development Bank will be supportive of regional infrastructure development.
- Fourth, recent regional initiatives, such as China's One Belt, One Road, the Republic of Korea's Eurasia Initiative, discussion on South Asia-Central Asia and South Asia-South-East Asia transport development, energy highways and the information superhighway, all aim to advance connectivity throughout the region and beyond.
- On the trade front, megaregional initiatives such as the Trans-Pacific Partnership Agreement, the Regional Comprehensive Economic Partnership or the Eurasian Economic Union have the potential to move the region to a cohesive framework to reduce fragmentation and diversion costs these blocs might impose on excluded countries and to turn these blocs into the drivers for trade and investment revival.

#### A. Establishing an integrated market

76. **Curtailing protectionism.** Non-tariff and behind-the-border regulatory measures contribute to a large part of the overall trade costs, ranging from 50 per cent to 350 per cent, depending on the subregion.<sup>20</sup> Most of the bilateral and regional trade agreements signed by the members of the region are not effective in managing these forms of protectionism. To effectively deal with these constraints, ESCAP can assist countries to prioritize the areas for cooperation. For example, sectoral agreements such as services trade, e-commerce or digital trade may serve as effective instruments for broader region-wide cooperation. At the same time, work streamlining and potentially harmonizing, where appropriate, non-tariff measures would support trade and investment liberalization for developing countries and countries with special needs.

77. **Promoting trade facilitation and cross-border paperless trade.** The Commission's work on trade facilitation and paperless trade was endorsed by the second meeting of the Interim Intergovernmental Steering Group on Cross-border Paperless Trade Facilitation in March 2016. This regional agreement, the first of its kind, proposes approaches and measures to advance trade facilitation to enhance international trade efficiency and transparency, while improving regulatory compliance. A next step would be to consider establishing a regional cooperation dialogue platform to develop cooperative solutions for trade and investment promotion and to enhance stakeholder capacities and expertise. Fostering agreement on the least

<sup>20</sup> In terms of tariff equivalents, based on the ESCAP World Bank: International Trade Costs database.

developed countries-wide duty free quota free rules of origin and lifting the absorptive capacity of the least developed countries for trade, technology and investment through the regional Aid for Trade initiative are a few ways of seeking cooperative solutions. This will not only promote regional economic cooperation and integration but will serve to enhance compliance with Sustainable Development Goal 17 – the means of implementation of the 2030 Agenda which calls for providing technical assistance and review and monitoring, including data collection and analysis.

## **B. Seamless connectivity**

78. Improving market integration calls for intersectoral coordination and action to build holistic and integrated physical networks which offer efficient, competitive and sustainable infrastructure services. Integral to connectivity is a predictable and harmonized legal, policy and regulatory environment. The region needs to move from bottom-up to top-down approaches, and from a project-to-project-basis approach to a more holistic planning and implementation process. This would involve reflecting on a region-wide development of multiple initiatives, multimodal corridors, transmission networks, gas pipelines and telecommunication networks and identifying and sequencing crucial linkages. The secretariat is promoting joint work between transport, energy and ICT to synergize regional connectivity from cross-sector benefits. There will be emphasis on, inter alia:

- Multimodal connectivity to reduce transit distances or mode shifting.
- Investing in climate-smart infrastructure choices for countries to realize their emission targets.
- Promoting power grid connectivity to facilitate sharing renewable electricity and gas across borders.
- Expanding broadband access through the information superhighway.

79. To promote shared understanding of the goals of future regional infrastructure development, its process and modalities of implementation, member States may consider convening a multi-stakeholder platform such as an Asia-Pacific infrastructure forum to deliberate on options to implement integrated and cross-border infrastructure projects. This forum would offer a platform for sharing experiences and knowledge of best practices and coordination mechanisms for regional infrastructure development across sectors, Governments, the private sector and development finance institutions. The forum could examine different financing and facilitation options and mechanisms and offer advice on how to address cross-border technical and regulatory barriers and promote transparent competitive processes for project and innovative financing mechanisms, including public-private partnerships.

## **C. Energy connectivity**

80. Regional energy connectivity will help implementation of Sustainable Development Goal 7, which calls for improved access and the move to cleaner sources of energy to meet the region's future energy demands. The establishment of the new ESCAP Committee on Energy offers an opportunity to institutionalize an intergovernmental platform, which can consider measures to foster an enabling environment to promote regional energy connectivity. Discussion could revolve around need to:



- Deal with barriers to energy trade through the removal of legal, regulatory and technical hurdles and seek upfront political authorization. Despite the many benefits of energy resource-sharing, a number of countries have explicit and implicit restrictions on exports and imports of energy goods and services whose removal is critical upfront.
- Promote sufficient levels of technical and regulatory standardization for deepening interconnectivity through the eventual development of an integrated power grid.
- Promote competitive energy market structures through rationalization of the state's role, together with measures to improve the investment climate to attract new investments, improve efficiency and adopt new technologies.
- Develop a regional mechanism to facilitate transboundary power trade through the streamlining of contracts, increasing the availability of financing, reducing risk, and accelerating project development through the building of mutual trust among parties and norm setting. A broad regional agreement and strong institutional arrangements are critical to monitor and ensure the achievement of benefits, while creating neutral institutions to regulate project implementation and benefits will also be essential.
- Build on the existing political support to promote regional energy connectivity. There is a need to formalize and consolidate declarations and intentions from the subregional levels in the shape of Asia-Pacific Energy Charter. This will help to nurture the long-term commitment of member Governments and provide increased comfort and confidence to the private sector and institutional investors.

#### **D. Transport connectivity**

81. **Strengthen and expand existing networks.** The Asian Highway, Trans-Asian Railway and dry port networks aim to connect national and subregional transport infrastructure. The Regional Strategic Framework for the Facilitation of International Road Transport and the Regional Cooperation Framework for the Facilitation of International Railway Transport help operationalize these networks. Further enhancement of these frameworks should aim to:

- Formalize regional intermodal/multimodal transport corridors through development of dry port and maritime linkages to foster seamless inter-regional connectivity; this needs to be backed by legal instruments that aim to harmonize standards, regulations and procedures to connect all subregions as well as landlocked developing countries and small island developing States.
- Reinforce integrated and intermodal transport through the development of regional frameworks and infrastructure for logistics systems, including strengthening of dry ports.
- Harmonize standards and regulations to promote road safety, logistics information systems and intelligent expressway transport systems.

- Develop regional standards and models for harmonizing cross-border/transit transport processes, including at border crossings; develop intermodal rules and regulations, technical standards and documents.
- Integrate different modes of transport in a manner that facilitates emission and pollution reduction – a measure that will significantly contribute to sustainable development.
- Enhance regional and interregional institutional architecture by promoting a Eurasia transport cooperation council backed by ESCAP to promote Eurasian corridor agreements and standards.

## **E. ICT connectivity**

82. The Asia-Pacific Information Superhighway initiative, focusing on ICT development within and across national borders, will benefit from using the Commission's platform for a region-wide public-private dialogue. This would help resolve outstanding issues on ICT cross-border connectivity and its traffic and network management, while extending its mandate to promote e-resilience, and digital inclusion to further the initiative. A regional cooperation framework can help:

- Create platforms for subregional organizations, such as ASEAN, SAARC and the South Pacific Council, to support their subregional ICT connectivity initiatives and policies and institutional capacity development and facilitate the exchange of good practices and lessons learned in expanding ICT connectivity, Internet and traffic management, e-resilience and inclusive access.
- Promote the principle of open access to encourage fair competition and innovation.
- Prepare pre-feasibility studies for transnational infrastructure, draft public-private partnership frameworks that reflect the requirements of bankable projects, recommend transparent processes for projects and assist member Governments in dialogue with private sponsors.
- Identify public-private partnerships and other financing modalities for the implementation of Asia-Pacific information superhighway master plan under preparation.

## **F. Financial cooperation**

83. Financial integration within the region lags behind trade integration. Asia's intraregional cross-border portfolio and bank flows are in the range of 20-30 per cent relative to intraregional trade – which is more than half of the region's total trade. Studies confirm that intraregional financial integration is constrained in Asia by the varying size, depth and maturity of financial systems, barriers to foreign bank penetration, the degree of openness of capital accounts and differences in regulatory quality and capacities, for example.

84. In this context, regional financial integration could receive a boost through:

- Internationalizing the renminbi, which is likely to gain momentum.
- Enhancing confidence in cross-border markets through effective investor protection, contract enforcement and the establishment of, inter alia, transparent rule of law and bankruptcy regimes.
- Easing capital account restrictions and reducing barriers to entry of financial institutions into Asian markets.
- Fostering stronger macrofinancial prudential policy frameworks to manage cross-border, sector, currency and tenor mismatches and counterparty risks.

85. With a large segment of the Asia financial markets more integrated with global financial markets, the region has the potential to mobilize long-term funding from international capital markets and institutional investors, subject to the country and project risks of regional infrastructure being managed well.

86. Among subregional blocs, to create a single market, the ASEAN Economic Community Blueprint has resolved to push for financial integration through regulatory and policy coordination. Steering the process, the ASEAN Minister of Finance and central bank governors in 2015 resolved to pursue further the ASEAN financial integration, and this process will benefit from the vibrant Singapore and Malaysian markets. Other regional blocs lag behind in the development of financial cooperation. The Association of Financial Supervisors of Pacific Countries, created in 2002, meets regularly to discuss supervisory- and surveillance-related developments with the International Monetary Fund's Pacific Financial Technical Assistance Centre serving as its secretariat. The Eurasian Economic Community launched the Anti-Crisis Fund in 2009, which is responsible for surveillance mechanisms, including regular data reporting and ongoing policy dialogues.

87. There is need to not only harness financial integration at the banking level, but the fragmented and shallow Asian financial markets could benefit from deepening of the capital markets through common regulatory frameworks, listing rules and corporate governance standards. This should provide an impetus to cross listing and possible mergers or different forms of alliances among stock exchanges. Stronger alliance and consolidation of smaller capital markets would not only foster financial integration but lift and harmonize the regulatory architecture of weaker capital markets in Asia. Markets would benefit from the removal of restrictions to foreign flows and the alignment of securities market rules and regulations and their enforcement practices to those of the International Organization of Securities Commissions. Deepening capital markets is critical for financing the Sustainable Development Goals, in particular the large infrastructure and climate financing requirements, but also to ensure the liquidity of the system is being competitively channelled to enhance financial inclusion.

88. **Financial stability.** Financial stability is critical for well-functioning markets. Within the region, the most mature macrofinancial surveillance mechanisms, namely the ASEAN+3 Macroeconomic Research Office and the Chiang Mai Initiative Multilateralization, would benefit from more capacity enhancements and flexibility for drawdown of the funding to cater to the ASEAN subregion. Except in the ASEAN subregion, there is a virtual absence of a regional financial oversight framework to conduct macrofinancial surveillance, including regional compliance with the

international prudential regulatory and oversight frameworks. Though the Bank for International Settlements and the Financial Stability Board do perform such oversight for larger and emerging markets and financial institutions of Asia, the midsize and smaller markets are without effective surveillance because they do not pose a systemic risk to the global financial system. The need for surveillance of Asia is critical given that the region could face new and emerging risks from the normalization of advanced countries' monetary policies and accompanying regulatory tightening of cross-border flows as larger economies adopt the more stringent Financial Stability Board regulatory architecture. Similarly, there is need to deliberate on a region-wide arrangement for liquidity support should the region's vulnerabilities compound. A combination of the development of early warning and strengthening of the region's financial institutions capital base and risk buffers aligned with emerging regulatory guidelines should be assigned high priority.

89. Financial stability will be reinforced by a region-wide push to diversify its financial system and credit portfolios which henceforth need to cater to the emerging financing requirements of sustainable development. The Asia-Pacific Forum on Sustainable Development has served well now for three years to offer a solid platform for engagement and the exchange of experience and to examine options for how to promote sustainable financing in the region. Following these deliberations, the region, with the Commission's support, is now positioned to launch the Asia-Pacific Tax Forum which will be instrumental in augmenting tax revenues, while pushing for reforms and greater cooperation on international tax regime. Stable public finances will not only help to raise public sector finances for infrastructure but will allow leveraging of private funds. At the same time, the efforts of the Asia-Pacific Forum on Sustainable Development to deepen domestic capital markets by expanding its investor and issuer base to offer long-term financing, enhancing financial disclosure with the objective of assessing carbon emissions and ensuring climate-friendly ventures are promoted and strengthening regional alliances on financial inclusion.

## **G. Disaster risk resilience**

90. Each hazard has particular characteristics and requires suitably adapted early warning systems supported by the right data and specific technical and coordination mechanisms. Given the transboundary nature of disasters, cross-border cooperation in common and best practices, information-sharing and community involvement, inter alia, is critical.

91. **Risk prevention and mitigation.** This would safeguard people and economic activity from the transboundary nature of disasters. Addressing complications created by natural disasters lends itself to regional cooperation and solutions. In view of this, the Commission's intergovernmental platform has deliberated on the need for facilitating strategic partnerships and promoting the pooling of resources and sharing of expertise, innovative technology applications and resources for multi-hazard early warning systems in the region through South-South cooperation and regional cooperation.

92. **Monitoring and early warning for transboundary disasters.** While progress is underway in strengthening early warning systems for tsunamis and tropical cyclones, significant gaps still exist for other cross-border hazards, despite scientific advances and their availability, especially in terms of space technology applications. Regional cooperation, supported by ESCAP, can assist countries in the region by extending information on basin floods, glacial lake outburst floods, flash floods and landslides.

93. **Science-policy interface to address slow-onset disasters.** Significant gaps exist in understanding the sectoral impacts of slow-onset disasters like drought and El Niño, making evidence-based policymaking a challenge. ESCAP, through its work in space applications and multi-hazard early warning systems, can develop methodologies and guidelines for scenario-based impact outlooks on, inter alia, food and social dimensions for slow-onset disasters, and build the capacity of those countries with high risk and low capacity to address these disasters effectively.

## H. Regional cooperation on climate change

94. Climate change recognizes no boundaries and the region is facing air pollution, temperature and sea level rises, storm surges and environmental degradation. Sustainable Development Goal 13 calls for urgent action to combat climate change and its impacts; climate actions are reinforced by the demands of sector-specific Goals, including Goal 7 which, besides calling for access and sustainable energy for all, calls for the doubling of renewable energy and energy efficiency. In the same vein, Goal 9 calls for resilient infrastructure development, which, inter alia, calls for promoting sustainable transport systems to curb emissions. So, in evolving regional economic cooperation and integration, it is important to recognize the significance of the development of climate-friendly regional infrastructure. This will reinforce the Goals which call for sustainable transport development.

95. In the climate pledges submitted prior to the Paris Agreement, most developing countries identified both unconditional climate targets and higher targets contingent on international support. While climate finance is needed, there are many opportunities to drive climate action through regional cooperation. The Paris Agreement also requests countries to strengthen international and regional climate change cooperation. Few bilateral and subregional climate change cooperation initiatives are underway; however, regional climate cooperation is still at a formative stage, with its full potential yet to be realized. There is significant scope for the region's large emitters to undertake collaborative emissions reduction partnerships through technology, finance and policy approaches, targeting areas such as low carbon cities, enhancing carbon sinks and clean energy.<sup>21</sup>

96. These partnerships may generate positive spillovers, particularly for the developing countries, such as improving access to low-cost technologies, increased knowledge, policy experience and other public goods. For large and small emitters alike, identifying common challenges interlinked with climate change such as urbanization, air pollution, energy, and water and food security offers opportunities for collective action.

97. Developing countries and particularly countries with special needs have knowledge, capacity, technology and financing gaps which hinder the development of comprehensive solutions. ESCAP is already offering countries e-learning platforms for green growth and working on the development of low-carbon growth models. The Commission's existing intergovernmental platform and Environment and Development Division can promote partnerships, spanning a range of developmental areas to play an important role in enabling regional climate cooperation. ESCAP can facilitate

<sup>21</sup> Global Commission on the Economy and Climate, *Seizing the Global Opportunity: Partnerships for Better Growth and a Better Climate – the 2015 New Climate Economy Report* (Washington, DC, New Climate Economy, 2015). Available from <http://2015.newclimateeconomy.report/>.

South-South and regional climate cooperation in areas such as science, technology and innovation, climate finance and sustainable energy through knowledge-sharing, focusing on the needs of developing countries and countries with special needs. For climate adaptation, regional approaches to developing agricultural resilience, developing joint early warning systems and adopting innovative insurance products for climate-related natural disasters can yield high gains, particularly for countries with special needs. ESCAP is already active in many of these areas.

## **V. Issues for consideration by the Commission**

98. The ESCAP agenda for regional economic cooperation and integration is built on the premise that investments in regional connectivity through physical infrastructure and trade facilitation will lead to lasting development gains if they are accompanied by the architecture to expand opportunities for private sector actors as well. As trade will become a crucial component of growth, creating an environment conducive to value-added regional value chains will be a main pathway towards inclusive and sustainable growth. The region needs to strengthen financial cooperation, both to enlarge the scope of the macrofinancial surveillance to mitigate the emerging risks and to achieve financial diversification. Meeting the financing requirements of the Sustainable Development Goals calls for continued financial stability but also deepening of financial markets. Although the pathway to integration will not be easy, as it requires political commitment to, inter alia, remove entrenched barriers such as bottlenecks in solving territorial claims and disputes around enclaves and to launch collective endeavours to seamless connectivity, ESCAP offers a vital platform where Governments can work together to harmonize policy and regulations and receive the technical guidance needed to build the industrial capacity to meet the growing demands of trade partners and compete on an intraregional scale.

99. The Commission may wish to consider the analysis and recommendations contained in this document and provide its comments and guidance to further facilitate the implementation of the Bangkok Declaration in preparation for the second Ministerial Conference on Regional Economic Cooperation and Integration in Asia and the Pacific. Member States may also wish to share their experience and views on the issues and challenges raised.