

Monitoring Regional Economic Integration in Asia

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Key points

- Economic integration is already under way in Asia, albeit to a different extent in each subregion.
- Trade is the primary driver of integration, particularly in East Asia.
- Monitoring the progress of integration enables more adaptive policies that lead to greater macroeconomic benefits.
- Broad institutional support at the national and regional level is necessary for a systematic monitoring and evaluation mechanism.

Given the diversity of Asia and the capacity constraints of countries in the region to manage integration, building an integrated Asian market is not easy. It requires not only the ability to implement initiatives to support the markets, but also a high level commitment by countries to ensure that policies are supportive of integration. Because regional economic integration is a complex process, there is a need to understand how the process works so that policy makers are better informed of its outcomes and to guide them in formulating integration-related policies. Hence, monitoring regional economic integration becomes crucial.

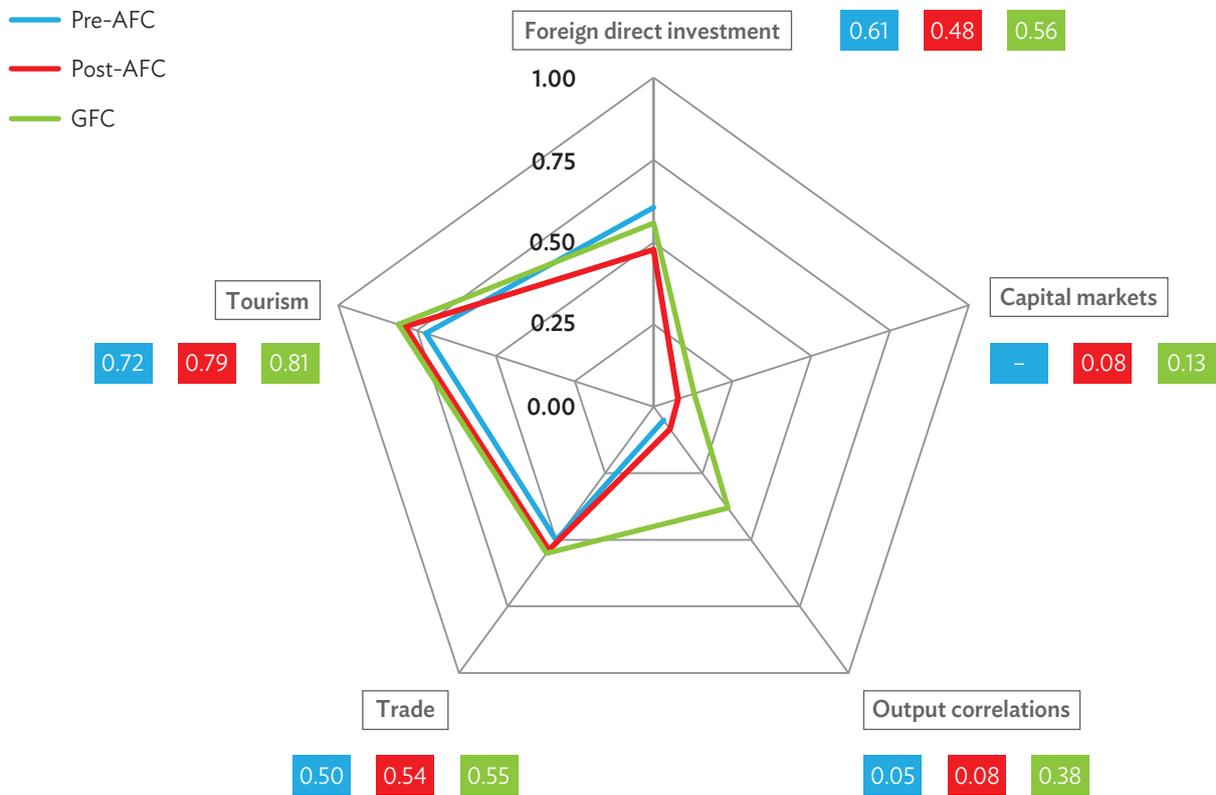
Asian economic integration has intensified over the years

Regional economic integration is a process in which two or more countries agree to eliminate economic barriers, with the end goal of enhancing productivity and achieving greater economic interdependence. It can take different forms, from the simplest preferential trade area to the most advanced monetary or fiscal union. In Asia, integration has intensified since the 1990s as countries recognized the need to harness domestic sources of growth, as is evident from the various indicators of integration such as trade flows, foreign direct investment, tourism, financial links, and output correlation (Figure 1). A number of factors contributed to this growth in regionalism, including the rapid expansion of Asian markets and existence of various mechanisms for cooperation. The most well-known model of integration in Asia is the Association of Southeast Asian Nations (ASEAN) Economic Community (AEC), which was formally established in 2015.

Asia's integration is basically market driven (influenced by policies), multispeed (different levels of integration) and multitracked (varies across sectors; ADB [2012]). To facilitate integration, policy frameworks have been established through various regional mechanisms and bodies (e.g., ASEAN and Asia-Pacific Economic Cooperation) and have resulted in varying integration results across sectors and subregions. Asia's trade openness is also above the global level, trade creating, and intense like in other markets (Figure 2). However, due to Asia's diversity, overall integration is still uneven. Across subregions, East Asia is the most integrated due to its extensive regional production networks.



Fig. 1 Indicators of Asian economic integration



-- = not available, AFC = 1997/98 Asian financial crisis, GFC = 2008–2011 global financial crisis.

Note: Figures are shares of intraregional flows in total trade, foreign direct investment, capital markets (debt and equity holdings), and tourism. Output correlations are based on 3-year rolling bilateral correlations of annual growth rates.

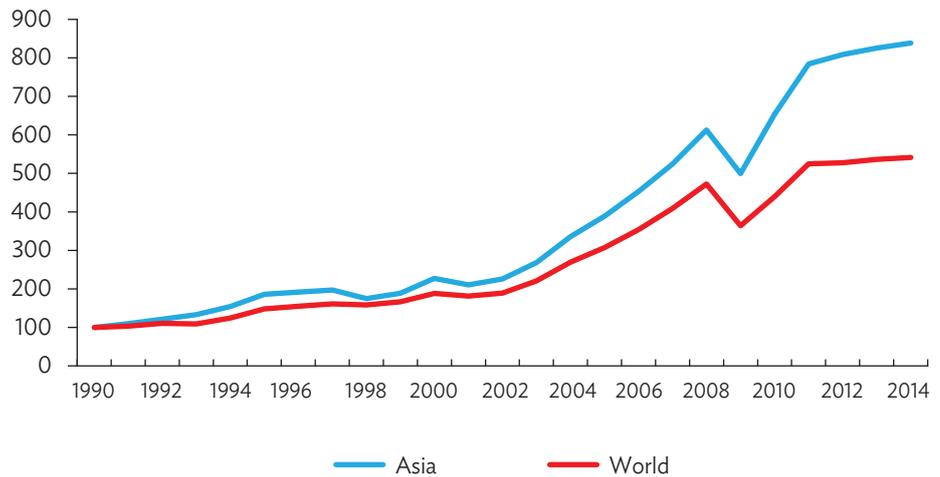
Source: ADB (2012).

One important characteristic of Asian integration is the rise of regional production networks and growing trade in intermediate goods. As production activities are fragmented into different tasks, the demand for primary and intermediate goods also rises—and Asian countries have been able to capitalize well on that, as exemplified best by the People’s Republic of China’s soaring trade in the region. By the end of 2014, intermediate exports accounted for 50% of total exports in Asia and also contributed most to export growth. Similarly, over the years, Asia has managed to build economic corridors that play a vital role in this market

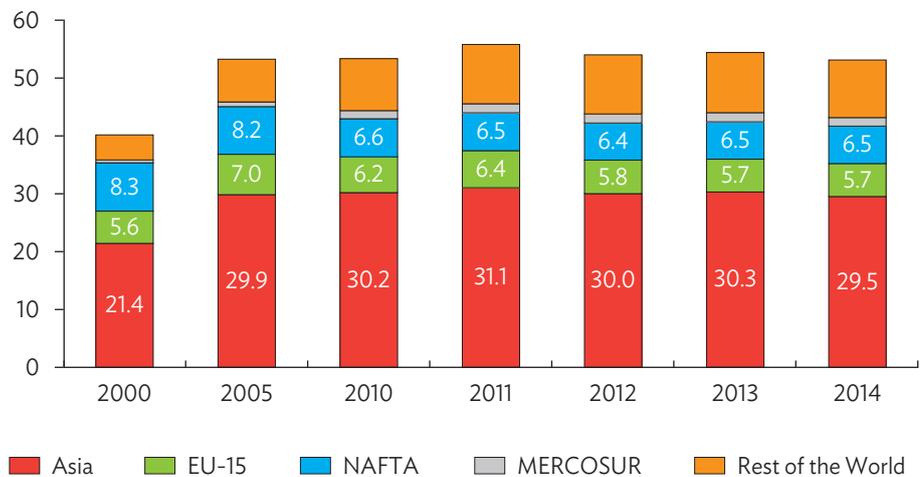
integration. Economic corridors (such as the Greater Mekong Subregion) not only connect the markets, but also facilitate the movement of goods, services, and people across borders. They also open new opportunities for industrialization as domestic firms take advantage of technical know-how from their trading partners to produce their own manufactured goods. Meanwhile, Asia’s deepening integration is also reflected in the growing number of regional trade agreements, the region’s increased ability to invest in global manufacturing industries, and increasing links with global capital and financial markets over the years.

Fig. 2 Trade in Asia

Trade index (1990 = 100)



Asia's trade links: direction of trade (% of GDP)

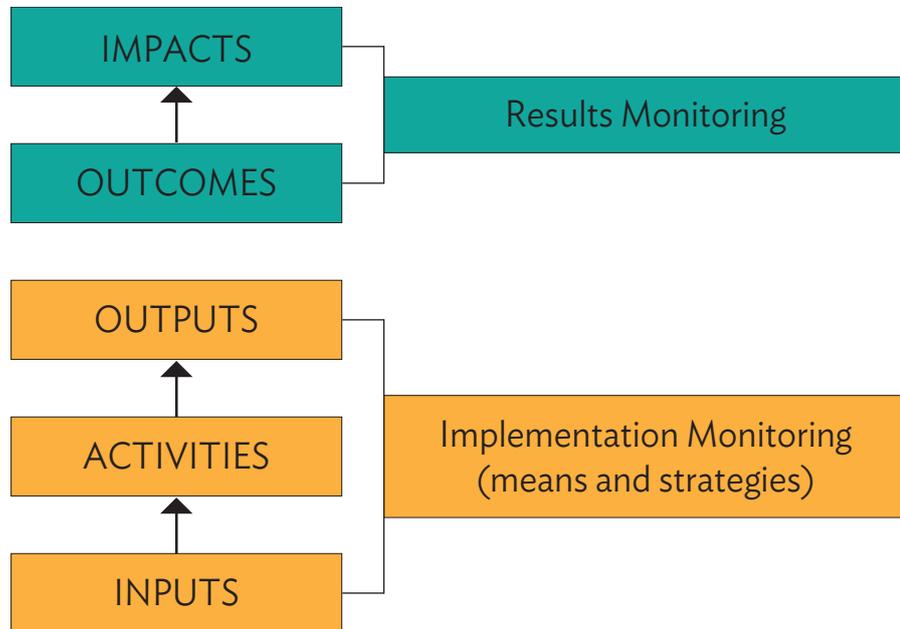


EU = European Union, GDP = gross domestic product, MERCOSUR = Common Market of the South, NAFTA = North American Free Trade Agreement.

Notes: Direction of trade refers to total trade (exports plus imports). EU-15 includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom. NAFTA includes Canada, Mexico, and the United States. MERCOSUR includes Argentina, Brazil, Paraguay, and Uruguay as founding members; Bolivia, Chile, Colombia, Ecuador, and Peru as associate members; and Venezuela, which signed a membership agreement in 2006.

Source: ADB (2012), updated by the authors.

Fig. 3 Key types of monitoring



Source: Morra-Imas and Rist (2009, p. 124).

Monitoring progress of integration is still limited

Despite the growing forces of regionalism in Asia, understanding the full impact of integration appears limited because of the lack of a systematic approach to measure its progress. This is unfortunate because integration has now become an important policy tool in many Asian countries. It is also perceived as generating significant macroeconomic benefits to the domestic economy through its links to trade, investment, and economic growth. However, the limited knowledge of integration outcomes fails to advance the real merits of integration. Thus, monitoring integration is needed not only to understand the integration process but also to influence the development outcomes of integration and to increase the capacity of policy makers to implement better integration policies to sustain the process (De Lombaerde et al. 2008).

Monitoring can be undertaken at two levels: compliance monitoring and outcome-based monitoring (Figure 3). In terms of compliance, one approach is to measure the implementation of various integration measures by tracking how countries comply with their commitments. The other approach is intended to benchmark outcomes and impacts of implementation, improve the quality of decision making, and make the integration process more sustainable by identifying problems (information gathering) and assessing changes required (information analysis).

Scorecard approach of monitoring integration

One example of compliance monitoring is the **scorecard approach** being developed in ASEAN to monitor the progress of the AEC. As designed, the AEC Scorecard involves measuring countries' compliance to agreed obligations and

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commitments under the various regional agreements, including the ratification, adoption, and transposition into domestic law of those agreements. It includes milestones and set targets to implement the various initiatives, ranging from tariff liberalization to competition policy all the way to realization of free trade agreements. Statistical indicators have also been developed to quantify integration targets.

For example, under the goal of creating a single market and production base in the AEC, countries have agreed on several measures and activities to facilitate the free flow of goods, services, investment, and skilled labor, as well as freer flow of capital. Measures that are being complied with are “scored” as implemented. They include targets set by governments to comply with tariff liberalization, investment impediments that need to be removed, progress of mutual recognition arrangements, and commitments made to liberalize financial and other services, among other measures.

However, one difficulty with the scorecard approach is that it does not capture implementation problems on the ground. It is focused on compliance and activity. As a compliance tool, it only tracks the implementation of commitments by countries, not the problems associated with them, such as delays in the ratification of signed agreements, inability to align regional initiatives with domestic laws and regulations, and lack of political will to implement commitments. Because of these problems, the ability of the scorecard to keep track of the implementation is also limited.

Output- or impact-based monitoring

Another approach is output-based monitoring, which measures the outcomes (integration results covering the core elements of the AEC) rather than the process (implementation) of integration. This is made possible by developing a set of indicators that are being monitored to capture progress toward the integration targets. ASEAN has been developing the ASEAN Community Progress Monitoring System (ACPMS) since 2002 to assess the progress of the ASEAN Community including the AEC. Under the ACPMS Framework, most of the indicators are considered outcome indicators (e.g., variation in terms of prices and per capita income) rather than process indicators (e.g., number of AEC agreements ratified), and they are selected based on the overarching goals of the AEC. For example, in measuring progress toward the creation of a single market, the ACPMS Framework uses indicators such as growth in intra-ASEAN trade, tariff reduction, growth in intra-ASEAN foreign direct investment, income convergence, and the like.

One advantage of this approach is that it reflects actual results arising from compliance of various measures. Corrective measures that affect the implementation results can be identified. Outcome indicators provide both quantitative and qualitative dimensions of changes resulting from implementation. They are meant mainly to track the trends of a specific measure or initiative, but not to evaluate its impact. For example, in assessing how the AEC can contribute to

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higher economic welfare, the framework uses indicators that present only the trends in income convergence over time, not the outcomes of the AEC measures designed to increase income.

However, one key challenge in using this approach is how to identify the right indicators to capture the integration outcomes. Data requirements are much higher than policy indicators, hence data availability is crucial. For example, services trade integration, which is an integral part of Asian integration, is not being adequately examined because of lack of data on services trade as well as of data on regulatory barriers that affect the free flow of services. Yet another issue is the reliability of indicators. Given the existence of multiple policy initiatives that can affect the integration outcomes, it is important that a concise and well-targeted indicator for each measure is selected to ensure a correct interpretation and monitoring of results.

Toward a structured approach to monitoring regional economic integration

As Asian economic integration becomes more important and continues to gain momentum in the coming years, it is critical that countries are able to effectively manage their integration agenda. One proposal is to **develop a systematic monitoring and evaluation mechanism** for integration in order

to advance the relevance of regional economic integration and achieve better implementation (Zelenka 2015).

While it involves both elements of compliance and output-based monitoring, this mechanism will measure outputs, impacts, results, and compliance in a more systematic manner. For example, monitoring data and indicators to establish trends and benchmarks for analysis will be regularly collected, analyzed, and discussed. Once the relevant data and indicators are analyzed, results will be compiled and presented using monitoring reports, which in turn will be made publicly available as part of the process of delivering information to the general public, policy makers, and market participants about the merits of market integration.

This mechanism should also be designed by putting in place appropriate **instruments and structures for monitoring**. A system of integration indicators needs to be developed and this should be backed up by statistical capacity to collect new data, particularly in critical integration areas (for example, cross-border services trade flows) and update existing data and information. It is also important that the indicators are linked with other elements of information technology and management information systems.

To be effective, this **monitoring mechanism has to be institutionalized** both at the regional and country levels. A regional monitoring system to keep

track of compliance with integration targets, outcomes, and milestones needs to be designed. At the same time, it has to be supported by a network of national monitoring systems across various countries within a regional grouping.

For example, in applying this model to the AEC, the ASEAN Integration Monitoring Office (AIMO) at the ASEAN Secretariat can be tapped to implement the monitoring exercise, by being the repository of information and data, reports, and statistical databases, as well as a leading authority to assess regional economic integration. AIMO will still be responsible for implementing the scorecard and output-based monitoring of the AEC, but its regional monitoring system should be linked directly to the national monitoring system in each country. This is important to immediately address implementation bottlenecks on the ground and effect corrective measures.

To ensure that the monitoring system is going to work in practice, effective **institutional support** is needed. This involves capacity-building support to both the region and countries implementing the system. Adequate budget and staffing for AIMO are prerequisites, while effective training programs to design and conduct monitoring are crucial for countries to enable their policy makers to follow through on their commitments. Other institutional support includes the strengthening of a regional settlement mechanism to enforce commitments, better coordination among national agencies in charge of integration, strong involvement of the private sector in the integration process, and greater policy and macroeconomic coordination.

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