

## ASEAN and East Asian Economic Integration

by

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and

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**Karl Jackson:** Well, to have me as a moderator is always a dangerous thing, because as my friends know, I tend not to moderate things. That is, I try to spice things up a little bit. Obviously, if we look back at the crisis of '97-'98, the crisis has passed in Southeast Asia. Not only has it passed, but each of the countries, each of the afflicted economies of Asia have gone back to relatively rapid growth, and even Japan has emerged from what seemed like an unending recession, that is the 15 year-long, so-called "golden recession."

### **A Crisis Resolved?**

But the questions, it seems to me, and we haven't had the chance to coordinate, but it seems to me the question is, have the underlying causes of the crisis of '97-'98 really been cured, totally and completely, within the afflicted countries? And if not, and most afflictions that go with governments don't ever get completely cured, if they haven't been completely cured, what's the next kind of crisis that we might conceivably be facing in Asian economies, and especially the relationship between Asian economies and this economy?

After all, the size of the U.S. current account deficit, approximately 7 percent of an enormous GDP, basically the United States is absorbing three quarters of the

world's surplus savings and using most of it for consumption. The question I have is, is this sustainable? In the long term, probably not, but of course the trick is to figure out when the short term becomes the long term and when conceivably we might be facing a significant adjustment. One of the obvious kinds of adjustments, one scenario is we all stand pat, nobody does anything. Asian currencies are, their valuation is still adjusted in order to keep the export-oriented growth going in China and all of Southeast Asia and South Asia. And the United States keeps absorbing all of those savings and providing the mega market for all of those goods and we all go along happily ever after.

But at some point, there's an alternative scenario, that is some sort of a crisis takes place and the staggering amounts of foreign money currently invested in T-bills in the United States, those investments begin to lose money because the dollar weakens very substantially. Then all of a sudden this massive horde of savings begins to move and we might have another major crisis of an economic kind in Asia.

Another, third alternative is, policymakers get smart and solve the problem ahead of time. I think that's the lowest probability outcome, actually. If we look back to the coming of the crisis in 1997 and 1998, I think a fair number of people figured out

that it was coming. All you had to do was go for a walk in Bangkok at night to figure out that it was coming, because you could see through buildings at night. That is, these skyscrapers were there, but there was no one in them. And behind every empty thirty story building was an empty bank, that is, a bank with massive non-performing loans. And if you look at the combination of a reluctance to adjust interest rates on the part of the exporting countries of Asia, you combine that with a willingness on the part of this mega-economy to continue sucking in the savings of the world, and then throw in the massive non-performing loan balances of the Chinese banking system, as well as other banking systems, I might add, in Southeast Asia that really haven't shed all of their NPLs, we could be looking at a significant crisis sometime in the next decade.

Now, with that as my sort of gloomy introduction, and I didn't clear any of this with my two colleagues to my right, and so if they don't respond to it that's fine. But I thought that I should at least throw something out here, put some raw meat, so to speak, on the table. Now I would like to turn the program over to them, and we'd like to begin with Dr. Worapot, who is going to discuss ASEAN-related things.

### **ASEAN's Role in Integration**

**Worapot Manupitpong:** Good afternoon. Thank you, Dr. Jackson. The topic that I was assigned to talk about today is ASEAN economic and financial integration. What we will be doing over the next eight to nine years will also address partially the issues that Dr. Jackson mentioned just now, even though yesterday we discussed more about the causes and the responses to financial crises at another conference at the Wilson Center.

So I'm not going to repeat that; rather I would like to focus on ASEAN economic and financial integration and what we plan to do in order to achieve our target.

This year, ASEAN is celebrating its 40<sup>th</sup> anniversary, and this year also marks an important milestone: the decision of the ASEAN leaders to accelerate the realization of the ASEAN community by the year 2015. This is five years earlier than originally planned.

Over the past forty years, ASEAN has made significant progress in its community building efforts, particularly in deepening and broadening economic integration. The ASEAN community that I mentioned just now comprises three pillars: security community, economic community and socio-cultural community. Of course, the focus of my presentation today is on one of the pillars, the ASEAN economic community. The vision for this community is to develop what we call a single market and production base, one that is competitive, equitably developed, and well integrated into the global economy.

### **Characteristics of the ASEAN Economic Community**

There are four characteristics of the ASEAN economic community. First, the single market and production base; second, competitive economic region; third, equitable economic development; and fourth, integration into the global economy. These four characteristics are illustrated in this ASEAN economic community house (Appendix 1, chart 1), and under each characteristic you see a list of its key elements. You can take it as how we define each of the characteristics of the ASEAN economic community. For example, if you look at the single market and production

base, the first column, you will see that they cover free flow of goods, free flow of services, free flow of investment, free flow of skilled labor, and a more free flow of capital. This can also be seen as the targets that we aim to achieve for this ASEAN economic community.

For each element there will be two key sets of measures, one on liberalization and the other on facilitation. Now the liberalization measures usually deal with opening up the respective sectors, removing restrictions on market access and national treatments. While facilitation measures aim to promote greater efficiency through simplification and streamlining of procedures, as well as harmonization of practices and standards. These measures are expected to help ASEAN companies reduce their operating costs, to improve their economies of scale, and enhance their capacity to participate in regional production networks and supply chains.

Let me give a few examples of some of these measures. For trade in goods, liberalization measures involve elimination of tariffs and non-tariff barriers. For tariffs, ASEAN has reduced tariffs on most intra-regional goods to zero to five percent at present, and the target is to further reduce it to zero, meaning the elimination all tariffs for all intra-regional goods by the year 2015. For non-tariff barriers, these will be removed in two steps. First is to identify and classify existing measures into either non-tariff barriers or non-tariff measures. The non-tariff barriers will be phased out, starting from the year 2010 until 2015, so by 2015 all non-tariff barriers should also be removed. Non-tariff measures are those intended for prudential purposes and therefore will be excluded from this program.

In terms of facilitation of traded goods, this includes, as I mentioned earlier, streamlining of customs procedures, harmonization of technical regulations and standards, and simplification of rules of origin. These are being implemented through a number of initiatives. Most of them are listed here (Appx. 1, chart 2).

### **ASEAN Single Window**

I want to elaborate on one of them, which is the ASEAN single window. The ASEAN single window is one of the key initiatives that are aimed at streamlining and simplifying customs procedures, with the target of clearing all shipments through customs in thirty minutes. Of course we are not there yet, but the target is that by 2015, with everything in place, we would be able to clear customs in a very timely manner. To achieve this, each ASEAN country is setting up its national single window, which is a customs clearance system that enables a single submission of information and data, single and simultaneous processing of the data, and a single point of decision-making through close collaboration among the ministries and other parties involved in the clearance process. This will allow traders to submit all information to only one agency, so it will greatly simplify the process. As far as implementation goes, six countries, Brunei Darussalam, Indonesia, Malaysia, Philippines, Thailand, and Singapore, will put in place their national single windows by 2008, and the other four will follow suit by 2012.

### **Trade Facilitation**

Now back to facilitation. In order to address trade facilitation in a more comprehensive and coherent manner, an ASEAN trade facilitation work program has been prepared and adopted. This work program

will be implemented over the next eight years and covers areas such as customs procedures and techniques, trade procedures—and that includes rules of origin, import licensing procedure, technical standards and conformance, as well as capacity building.

For trade in services, liberalization has been undertaken under the ASEAN Framework Agreement on Trade in Services, or AFAS, since 1995. The AFAS aims to substantially remove barriers to intra-regional trade in services, originally by 2020 and now with the declaration by the ASEAN leaders earlier this year, the target is moved forward to 2015. So far, five rounds of negotiations were successfully concluded with packages of commitments in a wide range of services sectors, as shown on this slide (Appx. 1, chart 3). To facilitate movement of professional services in the region, mutual recognition agreements in engineering and nursing have been concluded, while negotiation is ongoing in a number of other services sectors.

### **Transport System**

In order to enhance the competitiveness of ASEAN as a region, we recognize the need for an efficient, secure, and integrated transport system, including efficient and effective logistical and service support. To date, ASEAN has been implementing several regional transport initiatives, which include the development of a trans-ASEAN transportation network. This includes the ASEAN highway network, the Singapore-Kunming rail link, as well as regional ports and airports. This also includes the development of integrated multi-modal transport systems that facilitate cross-border movement of goods, as well as movement of goods in transit. In addition,

ASEAN is also committed to implementing an open skies arrangement, as well as strengthening the integration of tourism and transportation services through joint programs and activities. I hope you can see the map (Appx. 1, chart 4). On the left side, you see the planned route for the ASEAN highway network, and on the right side is the Singapore-Kunming rail link project, or SKRL.

### **Financial Integration**

Now let me move to ASEAN financial integration. As part of the ASEAN economic community, we identified a single market and production base as our goal, including the free flow of services, and this includes financial services and also a more free flow of capital. Actually, a road map for financial and monetary integration of ASEAN was adopted by the ASEAN finance ministers and the ASEAN leaders in 2003. This road map aims to achieve a free flow of financial services through successive rounds of negotiation under what we call an enhanced positive list approach.

In addition to financial services liberalization, the road map also targets more developed and closely linked capital markets supported by greater capital mobility. These are expected to be achieved through capital market development and capital account liberalization programs.

The last pillar under the roadmap is currency cooperation. We do not aim for a currency union by 2020 but instead wish to facilitate and promote intra-regional trade and deepen regional economic integration, as well as to promote greater financial stability.

Since the adoption of the roadmap in 2003,

one round of negotiation on financial services liberalization was concluded in 2004 and another one will be concluded by the end of this year.

Now in terms of capital market development, efforts have been made to link up equity and bond markets among those that are in a more advanced stage of development, while new markets are being established or planned. One target of capital market development is to establish trading linkages among ASEAN exchanges by 2010. To achieve that, a survey is being conducted to identify impediments to cross-border portfolio investment while the ASEAN capital market authorities have been working on harmonizing practices and standards such as disclosure requirements, offering and distribution rules, accounting and auditing standards.

For bond markets, efforts are also being made to link them in three stages, and this includes information, trading, and settlement links. The agreement is for those countries that already have established bond markets to start sharing information on bond trading to help the others to move to a higher level. At present, Thailand and Singapore already have agreed to explore trading linkages between their two markets. In addition, the infrastructure for bond markets has also been strengthened through capacity building and this is being achieved through the ASEAN Plus Three “Asian Bond Markets Initiative.” This is the initiative under the ASEAN Plus Three cooperation framework that also includes China, Japan, and Korea. This capacity building includes facilitating the legislation process, developing markets, establishing a primary dealer system, and enhancing liquidity in the secondary markets. Of course, which ones are being implemented in which

country depends on the stage of development in the participating country. There have also been a few training programs to share experiences and promote best practices among the capital market authorities in the region.

This (Appx. 1, chart 5) shows where ASEAN is now, as far as economic integration is concerned, roughly. You can see the blue line showing the level of intra-ASEAN trade as a percentage of total trade, and the yellow line showing intra-ASEAN FDI as a share of total foreign direct investment. In absolute amount, both intra-regional trade and FDI have increased over the years. As a percentage of total trade, intra-regional trade has improved to around 25 percent in 2005, but intra-regional FDI has been less consistent. As you can see from this graph, intra-regional FDI fluctuated between 3 and 23 percent with the latest figure in 2005 at about 6 percent of total FDI. This illustrates that, as far as integration is concerned, financial integration is still lagging behind economic integration or trade integration.

Now this (Appx. 1, chart 6) shows intra-regional portfolio investment in developing East Asia. I don't have the data for ASEAN alone, but this developing East Asia includes some ASEAN countries as well as China. But even including China, you can see that intra-regional portfolio investment has been quite small, both in equities and bonds. It also shows that while equity and bond investment has significantly increased, particularly for equity, the level of intra-regional investment in equities and bonds has not improved, both in terms of recipients and investors.

If you look at the correlation in equity returns among the five ASEAN exchanges

(Appx. 1, chart 7), you can also see that the correlation of equity returns among the five ASEAN exchanges has been relatively low. But correlation has improved over the years among these markets, with one particular exception of those correlations with the Malaysian exchange. My speculation is that this may be partly due to the capital control measures that were put in place in response to the financial crisis in 1997 and 1998.

This is my last slide (Appx. 1, chart 8). This reviews the existing regulations on cross border capital flows, and you can see that ASEAN has quite a diverse regime across the credit, equity, and bond markets. Now the Y means no restriction, or that capital flows are allowed to flow in and out freely. N means you cannot do it. L means limited, there are some restrictions, while A means approval is required by the relevant authorities. These restrictions and measures, however, are expected to be gradually relaxed as progress is made to foster closer linkages of bond and equity markets in the region. But as far as capital account liberalization is concerned, ASEAN doesn't have any common program or time frame.

As for the current status, a blueprint of the ASEAN economic community is being drafted. It's being considered by all relevant ASEAN bodies and because of that, we cannot provide you with much information on the AEC blueprint, but by November this blueprint is expected to be considered and endorsed by the ASEAN leaders and after that it will be made public. This is to promote transparency in terms of ASEAN economic integration going forward. So let me stop there, and I'll be happy to answer any questions later. Thank you very much.

**Jackson:** Thank you. We will now hear from Professor Soedradjad Djiwandono.

**Soedradjad Djiwandono:** Thank you very much for the introduction. Ladies and gentlemen, I am very happy to be here, and thank you very much for the invitation by the Sasakawa Peace Foundation USA to let me share with you some of my views. Yesterday I spoke on the Indonesian crisis, and today I will be talking about East Asian economic integration and cooperation. The sequence is a little bit backwards.

You listened to Dr. Worapot about how it is being implemented by the ASEAN countries. And I'll try to explain to you the general issues and an assessment of what has been going on in East Asia, and the idea of economic and financial integration itself. So I will put it in a more general context and later on you hopefully can see that what you have been hearing from Dr. Worapot was actually part and parcel of the whole story that I will try to tell you.

I will give you some notes first on several things: integration and cooperation and observing what has been going on, the current status in East Asia of economic integration, and some of the agreements or consensus that are being achieved to enhance that kind of cooperation. We should try to remind ourselves, whenever we talk about integration and cooperation, that integration is, when you talk about de facto economic integration within a geographic region, when you talk about cooperation, it actually refers to some policy measures, how you cooperate or how one country cooperates with the others and make the integration happen.

Economic integration itself can be market-driven and privately led, or maybe policy induced. When several countries make

discretionary policies to promise to work together, to make the economy integrate, then you have cooperation. Integration can also come from businesses that have dealt with other countries.

### **Regionalization**

Now the other thing that I would always like us to remember, when you talk about regionalization, again, it's a market driven integration, arising from unilateral reform of individual economies within the region. And as we all know, most Asian countries actually were trying to implement the so-called Washington consensus. Everybody tried to liberalize and many of them actually did it individually without anybody trying to dictate or whatever. It came out of their consideration that it's better to liberalize, so they opened up their economies. And we have observed over time a different framework from what is usually called "closed regionalism," exemplified by the 1960s in Latin America.

But Asia's regionalism from the very beginning kept reminding us that this is so-called "open regionalism." Now in theory, we usually talk about the end result being an economic union, but it started from different kinds of things, whether it's from preferential trading arrangements or going to a free trade idea, to customs union, common market, and in the end usually the goal is to achieve some kind of economic union. When you have an economic union, countries have a common market and also agree to harmonize monetary and fiscal policies.

After looking at that, when we look at the current status of what's happening in Asia, economists usually look at the whole economy as two sectors, the financial and monetary, and the real sector. And the

financial and monetary sector is supposed to be there to support the operations of the real sector. Now, when you look more carefully, studies sometimes try to make a different kind of classification, but in the end you can reclassify things into those two categories. The ADB uses four pillars, I think Dr. Worapot was talking about two or three pillars. I have four pillars, hopefully it's not too confusing. But the ADB used to see integration and cooperation in these four areas, actually.

### **The Four Pillars of Regional Integration**

First, regional and sub-regional cooperation through cross border infrastructure. Just now, Dr. Worapot showed to you the map of the ASEAN highway system. Second is trade and investment, third is the financial part—money and finance, and fourth is cooperation on public goods. Actually it's not just public goods, but also public bads, because now it's more popular to talk about public bads than public goods when you cooperate with each other. For instance, as we see after 9/11, you talk about financial crime, about terrorism, about infectious disease, about the haze in Asia, those are instances in which these countries cooperate with each other. These four pillars have actually been evolving through this cooperation in ASEAN and also in Asia as a whole.

But my focus, of course, is mostly on economic integration itself, both the opportunities and challenges, in the real sector—in trade and investment, and in the monetary and financial sectors. When you talk about integration and cooperation, it will also include a sort of insurance against crisis, this is in particular what the Asian countries are discussing post-crisis, and also economic cooperation and integration, which aim at growth and development and

welfare, stability as well as risk management.

In his introductory remarks, Professor Jackson was talking about some of the issues that we are facing now, like the so-called global imbalances, and how Asian countries may later on try to deal with the unwinding of the global imbalances. What's happening in the financial sectors when it seems to be a possible repeat of the '97 crisis, as Professor Jackson mentioned, the high number of non-performing loans, whether it is sustainable or not. Maybe I will touch on that later on, in passing, when I try to explain what has been going on.

### **Trade and Investment Status**

When you look at the current situation, on the status of trade and investment itself and the whole intra-regional trade share, we can see from this table (Appx. 2, chart 1) that, actually when you talk about East Asia, that is, the fifteen countries, the ten in ASEAN plus five, you can see over there that in terms of intra-regional trade, the share has been increasing from 1980 to 2004, from 35 percent to 55 percent. If you subtract Japan, it is a little bit less, but still very substantial. And if you talk about some of the institutions that we are trying to follow, the so-called ASEAN Plus Three, it's a little bit less again, from 30 percent to 39 when you compare 1980 and 2004. When you look at just the ASEAN ten, the increase was from 18 percent of total trade to 24 percent, not really that much for twenty years of development. But if I come back again to the East Asia fifteen, that 35, 43 and 55, in comparison to other kinds of trade arrangements, like NAFTA, NAFTA is actually lower than the East Asia fifteen, from 34 percent to 46 percent. While the EU, when you look at the EU fifteen countries, is from 61 to 62, it almost didn't

change in the last 24 years. It went up in 1990, but it went down again. But when you look at the present EU, the 25 countries, then actually the trend is still going up. Now that is reflecting what happens in the real sector through trade.

### **Financial Status**

Let's look at part of the financial sector (Appx. 2, chart 2). When you look at the stock market, the inward and outward foreign direct investment, you can also see the development of this whole economy, from Japan, Korea, PRC, Singapore, Malaysia, Indonesia, and Cambodia. You see over there that Japanese investment abroad kept increasing, and actually the inflow of investment has also been increasing. Korea is the same picture on a smaller magnitude. But for other developing countries, traditionally we say that developing countries are usually the recipient of foreign direct investment, but now actually you can really see from the statistics that developing countries are also, bit by bit, investing abroad. While Singapore is not a developing country, the FDI going into Singapore went from 53 percent of GDP to 80 percent to 150 percent in 2004. But the investment outflow has also been increasing, from 0.8 percent of GDP to 6 and 11 percent. Even Indonesia, as a developing country, and also a country that has a lot of problems, we can see that it's not just FDI coming into Indonesia, but also going out now. Even Cambodia is showing the same thing.

This is just a repeat of what I said, that when you look at the relative position, East Asia's trade actually is still bigger than NAFTA but smaller than the EU. We can also see from the table that I just showed you that the degree of East Asian economic integration through trade is very high, and

this has not been at the expense of extra-regional trade, meaning that total trade is increasing, both for intra as well as extra.

In general, FDI into Asia's economies has been on the rise, and outward FDI has also been increasing. So we can say that trade and investment, both market driven and policy stimulated, have contributed substantially to East Asia's economic integration.

### **Patterns of Investment and Trade**

When you observe this development, it seems that the pattern of investment has been that it was started by multinational corporations that are actually making investments in manufacturing for export to other countries. And in the end, also creating more openness in the whole economy of Asia through so-called "production networks" whereby some parts are produced in one country, another part is produced in a different country, and to make the final product you have to trade. So that is part of why trade relations are increasing, using production networks and supply chains.

So it started with the Asian newly industrializing economies, followed by the rest of ASEAN as well as lately by China. Thus the process of economic integration proceeds with market driven, private-led FDI and trade, preceded by, what I've been saying before, unilateral liberalization, because of the Washington consensus from the 1980s. But since 1990, policies supportive of regional cooperation have been supported by corporations, AFTA/CEPT for example. By the way, I happened to be the signatory of this AFTA/CEPT in 1992.

After the Asian crisis, though, the unilateral

liberalization that started in the '80s, which is non-discriminatory, has been replaced by the proliferation of FTAs, which are discriminatory. But nonetheless, East Asia's share of global GDP has increased from 17 percent in 1980 to 29 percent in 2005 due to investment as well as trade.

After looking at all these development statistics at the present time, when you look at the FDI and trade regime in Asia, the picture is something like this. According to Dr. Raseen Sally, in ASEAN, Singapore is the country that has really free trade, most of the tariffs are almost zero. Old ASEAN, meaning the ASEAN six, have relatively liberal trade policies with liberal FDI regimes, with the average tariff less than 10 percent and low non-tariff barriers, with of course some pockets of protection in agriculture and in services. Most of the agreements in ASEAN always have some exclusion lists. Some of the exclusions are a little bit ridiculous, but that's the reality. I'm sorry to have to use that word. Maybe some people will get mad at me because I said it's ridiculous.

The PRC of course has swung from extreme protectionism in the past to rather liberal at present. Surprisingly, well, not really surprisingly, Japan and South Korea now are a little bit reluctant to further liberalize their trade and FDI. Or maybe it's fatigue in their liberalization. Taiwan did liberalize substantially in the run up to WTO accession.

Actually it was interesting, yesterday in our discussion about all these arrangements, Professor Grable from the University of Denver reminded developing countries that now with the proliferation of trade and investment agreements, bilateral in many cases, developed countries use this kind of avenue to push programs for liberalizing

the financial or other sectors. After the Washington Consensus became very unpopular, that is the new avenue for them. And if it's done bilaterally, almost like a reciprocal agreement, you're almost forced to relinquish some control because you need to make gains in some other areas.

### **Monetary Sector**

Now, on the monetary sector. Monetary and financial cooperation and integration have been attracting large regions and are involving larger numbers of countries or economies. I'm just stating this as a fact. Maybe it's due to the fact that it's become part of the agenda at many fora after the crisis, as we can see from the presentation by Dr. Worapot. In fact, the major motivation behind monetary and financial cooperation and integration has been the building of a financial architecture to ensure against the reappearance of crises or to cope with them if they arise.

But recently, the issue of global imbalances and how to address the adverse effect of their unwinding has also been added to these things. Part of it was explained by Dr. Worapot, but I just want to show you the motivations of how and why these countries are willing to do that.

First, externally, because of the success of the EU, but internally, actually, the devastation of the financial crisis in 1997 was significant. There have been many theories about why it happened, but there is broad agreement that it was caused by a weak financial sector. Another area was unsustainable external exposure by corporations. In contrast to the Latin American crisis, which generally came from government borrowing, in Asia it's because of corporate borrowing, the external exposure plus the weakness of the

banking sector. This led to some of efforts to cooperate in this area.

It has already been mentioned by Dr. Worapot that the institutional framework that seems to be the most effective in terms of the financial sector is the ASEAN Plus Three finance ministers' meeting and the EMEAP. The name is a little bit strange: Executives' Meeting of East Asia-Pacific Central Banks. This is a forum where high officials in various central banks meet and was actually the idea of the minister of finance of Japan. In the beginning it was just higher officials, but since 1997, that was the first time that it was attended by governors of the central banks, and I happened to be in that first governors' meeting in Tokyo. We can identify these two fora as the most instrumental in terms of cooperation in finance.

### **Areas of Cooperation and Integration**

The areas where cooperation and integration can take place include resource pooling. Right now, because reserves have been mounting—there are more than two trillion dollars held in reserve by central banks in Asia—resource pooling is one thing that could be done. Surveillance, I think it was explained by Dr. Worapot. Capital market development, also exchange rate cooperation. These are all the areas that could be used. Exchange rate cooperation is not there yet, I think. On resource pooling, I think we have been looking into all these areas since the unborn Asian monetary fund and the birth of the Chiang Mai initiative. Partly because most Asian countries after the crisis had a bad experience with the IMF, the idea is to have more credibility on how to deal with a short-term problem and followed by something that is a little bit longer-term and

on a bilateral swap, and make the swap multilateral.

On capital markets, I was following this carefully before the crisis, and generally the complaint in the region was that Asian countries, all of them have high savings rates, accumulating a lot of savings, but yet, Asian companies, whenever they try to get financing, they go to London and to New York. That's always the case. Why do we have to do that? Why can't Asia also have a financial intermediary that's good enough to do that? These ideas are sort of trying to solve that issue.

On exchange rate cooperation, there are several ideas. None of them are being negotiated or realized by ASEAN, and the debate among academics is actually more prominent than among officials. Among the academics there's a lot of debate about whether we have a bipolar system or what. But when you look at the prevailing exchange rate regime, it is like what I said about the trade and investment regime. Among the exchange rate regimes that are prevailing right now, we can see that many are a pegged or fixed system: Hong Kong has a currency board; in Malaysia, Prime Minister Mahathir went to this system in September of 1998; and China before July 2005. After July, China tried to be a little bit flexible. Well, the flexibility of China is not really that flexible, at least seen from Washington. The U.S. has kept trying to ask China to make it a little bit more flexible but has not been very successful. With a freer system we have Thailand, South Korea, Indonesia, and with some flexibility we have Singapore, the PRC after July 2005, and Malaysia. So part of the problem is that it is still difficult for them to really be united because the exchange regimes are so varied from one country to another. If you want to have a

monetary union, you have to deal with that.

With trade and investment, much has been going on. In the capital market, maybe something is going on there, partly because of the success of the Chiang Mai initiative.

Facing all these kinds of problems, the most important thing, it seems to me, is to manage and to develop the current arrangement and framework that is already in place. We have many avenues already in operation, and should give them a chance before venturing into a new ones. That's the idea of my colleague Dr. Iwan Azis of Cornell. I like what he said in one of his presentations last year, that policies must be predicated not on the ideal world, but on the world as it is. Sometimes we are thinking so ideally that we design something that is not implementable. This requires considerations on the status of the institutions, limitations constraining the working of any arrangement, whether sequencing is needed, et cetera. We can discuss it in the questions and answers. The present arrangement has been progressing nicely, and we are used to a multi-track approach. It is best to be pragmatic and eclectic. After all, ASEAN countries are known to be very pragmatic, maybe that is the best way. That is the way I see the future facing ASEAN countries. Thank you very much.

**Jackson:** Thank you very much. We'd like to open this up to questions for our two speakers or for anything that's on your mind concerning this extremely rich offering of information on the changing regional economic and financial architecture of Asia.

### **Cooperation between Regional Organizations**

**Questioner:** Thank you for a wonderful

presentation. I've been following ASEAN online for a few years and I was just wondering to what extent, and it just might be too much, how much interface you have with some of the other regional organizations in South Asia, because I think that that's an important part of expanding. ASEAN has done tremendous work, and I think some of the other regional frameworks could use some of your talents.

**Worapot:** There has been some, but not much. Particularly with SAARC, the South Asian Association for Regional Cooperation. As far as cooperation between one secretariat and another, we have started discussing how we can share experiences in terms of coordinating regional cooperation. Not much activity has taken place yet, but I would expect that that will change as we move along in our integration.

### **Inequality**

**Questioner:** I want to ask you about inequality. There is tremendous inequality in the ASEAN region, inequality between countries and obviously economic inequality within countries. What does economic integration offer to deal with that issue? Certainly in the European Union, that was a big argument for integration, it was going to deal with the vast differences between European countries, and it also offered hope for people in Europe who were less well off. In the first presentation you mentioned equity, but it went by quickly. I think it said small and medium enterprises under that category. I was wondering if there were other more substantial efforts to deal with the inequality question and I'd be interested in hearing from any of the speakers on this issue.

**Worapot:** Yes, you saw one of the four

characteristics of the AEC, which is equitable economic development, and there are two key elements in there. One is SME development, and the other is IAI, but you may not know what it is. It stands for Initiative for ASEAN Integration. So basically we are trying to narrow the development gaps between the less developed members of ASEAN and the more advanced members. This is being achieved through this initiative, the IAI, by providing technical assistance to the CLMV countries, Cambodia, Laos, Myanmar, and Vietnam, in order for them to be able to catch up with the rest of the ASEAN members. We're talking about helping them to adjust to ASEAN integration and implement the various ASEAN agreements. Actually, one element in the ASEAN economic community is capacity building, and that is mainly aimed at the CLMV countries. As we see the further development of regional production networks and supply chains, attention will also be paid to the CLMV countries to see where they can participate. We focus on the comparative advantages they have and how we can enhance their capacities to participate in this development of regional production networks and supply chains.

**Djiwandono:** I guess if I may, it was already mentioned by Dr. Worapot, that is the terms between new members and the old, of course the mechanism is to allow the new members, who are less developed, more time to reduce tariffs, et cetera. There's always that kind of stipulation in our agreements.

The other part, even though it's not really directed at reducing inequality, but when there's some cooperation to address public bads that can be beneficial. The worst victims are those who are marginalized or who are poor. When you talk about the

tsunami, when you talk about a pandemic like SARS, when you talk about health, the worst victims are the poor. Addressing that kind of issue can have a positive impact on reducing part of the problem of inequality.

### **Labor and Outsourcing**

**Questioner:** I'd like to build on the question that was asked before and push it a little further in terms of labor rights. There has been criticism in the international press of some of the lack of adherence to ILO standards in some of the countries. That's one. And then there's the whole issue of competition in a lot of areas among the countries themselves, and businesses in some of the developed part of the region moving from one country to another as they're looking for cheaper sites for manufacturing and various production facilities.

So I wonder how these economic, political, social problems play out in this arena. And again, there is increasing animosity almost, in certain sectors of the United States towards some of the developments in terms of outsourcing of American firms' production or multinational corporations that originally were U.S.-based in some of the countries in your region. How does that play out in your inter-regional forums?

**Djiwandono:** These things are being talked about and debated, but how to deal with it seems to be very difficult, that is, to create region-wide standards. Bilateral agreements are getting more and more popular, partly because of that. When some countries cannot really deal with some of the demands through the regional mechanisms, then they will deal with it bilaterally.

So I completely agree with your concern.

Actually, we don't have a single policy on many of these issues. And now individual countries are struggling with that, and some countries who are already more advanced than the others can respond to the demands of international standards—like on workers from the ILO—or from other countries on a bilateral basis.

So when you look at all the initiatives, the whole picture is becoming very muddy. Academics talk about spaghetti balls, maybe it's even worse than spaghetti balls, because there are a lot of problems that intermingle or overlap, even in the idea of non-intervention. How do you deal with Cambodia? How do you deal with Myanmar? Trying to approach them using one leader after another hasn't helped.

So I can only concur that these are very thorny issues, and even individually inside each country they are still not being resolved. So having a common policy is a very remote prospect for ASEAN countries.

### **Investment and Transparency**

**Questioner:** My first question is, with regard to the data in the first presentation, you had mentioned, I think, an equity total number that was pretty significant. I was wondering whether that was strictly portfolio equity or did that include private equity and corporate investments into other corporate entities.

And then, for the panel, my question is with regards to the U.S.'s Sarbanes-Oxley. Has that forced, in your views, directors to think much more about transparency in their operations in ASEAN countries and some of their ASEAN businesses?

**Worapot:** Which statistics are you referring to?

**Questioner:** I think the number totaled around 120 billion.

**Worapot:** In terms of portfolio investment?

**Questioner:** Right, I was curious if that included private equity and corporate investment, or whether that was strictly sort of mutual fund-type investments.

**Worapot:** I think that follows the definition of portfolio investment that includes both equities and bonds. But that \$122 billion includes China, so you can expect a majority of it going to China and of course the rest would probably go to the ASEAN Four countries. But the point I was trying to make there is that, despite a large amount of portfolio investment inflows into the region, the intra-regional investment was quite small.

**Jackson:** Would anyone like to say anything about Sarbanes-Oxley style transparency and ASEAN? I think that would be called the wave of the future, perhaps, but the wave is still a long way from the shore. I can probably elaborate a little bit for you. The tradition in Southeast Asia is that every private corporation has three sets of books, right? One set of books for when the tax collector comes around, and a second set for when he says, "Okay where are the real books?", and then the third set is the real books, right? Well, Sarbanes-Oxley says you are only supposed to have one set of books, as well as some other things. The question is, how rapidly are the Southeast Asian private corporations and regulators beginning to move in that direction? My own view is that they have moved somewhat since 1997-1998. It's a new world in comparison to that, but it's a long, long road we have to travel.

**Worapot:** I think that as far as listed companies are concerned, there has been movement towards converging to the international standard, particularly where accounting and auditing standards are concerned. So that would enhance transparency. Of course, this problem is not limited to ASEAN, but by bringing companies into the stock exchanges you are subjecting them to a list of rules that will enhance transparency in those companies. In some ASEAN countries we have two exchanges, one for large companies and the other for small and medium enterprises, and hopefully that will also lead to greater transparency among those companies as well.

**Djiwandono:** I cannot speak about other countries, but I can say something about Indonesia. Not the corporations, but I know something about the banking sector. I guess the banking sector in Indonesia, if I compare it to the time when I was at Bank Indonesia ten years ago, right now it is much better. Partly due to the fact that the experience of the crisis had a big impact on bank owners. At that time, I kept saying in my explanations as to why our policy was not really working well, I said that I'm a macroeconomist and maybe part of my mistake, so to speak, was that I relied too much on the macro side. If you're a macroeconomist, a monetary economist, you design banking policy and your assumption is banks are run by bankers. After the crisis, I saw that some of the banks were run by crooks. Pardon my language, but this is the clearest way to say it. But now after this whole thing, like the new rule on reporting suspicious transactions, for example, compliance seems to be very good. Maybe better than some other countries. Some other countries have a good law, but when you look at the

number of reports, they are not really that many. In those terms, Indonesia seems to be getting better. I'm not very sure on that issue about corporations in general, sorry.

### **Taiwan**

**Questioner:** I'm from Taiwan originally, so I want to see if you have any opinion about how or what kind of scenario we would have to have to get Taiwan included in these trade negotiations in the future? Thank you.

**Djiwandono:** On the second part, in the financial sector, some of the fora include Taiwan. I can even attest to you that my last days as governor were actually hosting a governors meeting. Actually I had already been fired, but publicly it was not announced yet, so I was still hosting the governors meeting. The assistant governors meeting included Taiwan.

The governor was a good friend of mine. He was attending the meeting, and he died in a plane crash returning to Taiwan. In my book, I mention that being a central bank governor during that crisis was very risky. I was fired, my colleague died in an accident, another one was an associate of Anwar Ibrahim and resigned because Anwar was sacked by Mahathir, the head of the Bank of Thailand was sacked, et cetera. Anyway, I just wanted to say Taiwan is included in some of the financial fora, which sometimes the PRC doesn't really like, but they are still included, I think.

**Jackson:** I'd like to thank Dr. Worapot and Professor Djiwandono for providing us with these excellent presentations. Thank you all very much for coming.