

Economic integration and synchronization of business cycles in East Asia

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Abstract

This paper reviews trends in East Asian regionalism in the areas of trade and investment and money and finance. It finds that trade and, to a lesser extent, financial integration is increasing in the region. It also finds that business cycles are becoming more synchronized, enhancing the case for further macroeconomic integration. © 2007 Elsevier Inc. All rights reserved.

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1. Introduction

East Asia's experience with outward-oriented development policies during the last four decades is well known. This outward-oriented approach involved unilateral reforms and embraced multilateralism under the GATT/WTO framework and led to East Asia's economic dynamism and global integration, in tandem with regional integration in international trade and capital flows. Market-led regional integration flourished under the multilateral framework of trade—driven by increasing market access and the force of competition. It was only in the late 1990s after the Asian financial crisis when a paradigm shift occurred in East Asia's development strategy and it began to pursue formal (policy-led) regionalism more actively.² This development

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² In contrast, regionalism was popular in Latin America and Africa in the 1960s, driven by the desire to consolidate import-substitution policies in a regional context. These efforts were highly protectionist and ineffective (later referred to as “closed regionalism”).

can be attributed, as Kawai (2005) and others have mentioned, to various factors such as growing economic interdependence in the region, the slow progress in multilateralism, popularity of regionalism elsewhere, and various lessons learned from the 1997–1998 financial crisis.

This paper has two objectives: (i) to review the progress in regionalism in East Asia (defined as ASEAN+3³ unless specified otherwise); and (ii) to show that business cycles in the region are starting to become more synchronized. Needless to say, an East Asian economic community (on the trade front) and a single currency (on the monetary front) are long-term goals at best. However, transitional goals of integration in various areas are beneficial in their own right and will continue to drive East Asian integration forward.

The paper is organized as follows. Section 2 briefly reviews the trends in East Asian regionalism in the areas of trade and investment and money and finance. Section 3 presents various indicators of trade (similar to Kawai, 2005 and others) and financial integration. Section 4 explores whether increased trade integration has led to a greater synchronization of East Asian business cycles. And finally, Section 5 summarizes the paper and offers some conclusions.

2. Regionalism in East Asia

East Asian regionalism, which began in the late 1990s, has two features. First, in terms of scope it covers two macroeconomic areas—trade and investment, and money and finance. Second, in terms of geographical coverage, except for money and finance, it has been mainly bilateral and subregional. More recently, bridges are being built across the subregions and proposals have also been made for establishing an ASEAN+3 and East Asian Free Trade Area (FTA) which is also to include India.

2.1. Trade and investment

East Asia basically adopted multilateralism in designing its trade policy. In this sense, the ASEAN Free Trade Area (AFTA) initiated in 1992 was an exception. However, with the signing of the Japan–Singapore Economic Partnership Agreement in November 2002 and the Framework Agreement on ASEAN–China FTA, the region's approach seems to have changed. Presently, the region is experiencing a proliferation of FTAs. Within East Asia, eight FTAs have been signed and are presently under implementation, six are under negotiation and seven have been proposed.⁴ Similarly, between East Asia and South Asia, two FTAs are under implementation, eight under negotiation, and six have been proposed. Many of the FTAs in East Asia are FTA Plus in the sense that they go beyond just tariff reduction—into trade facilitation measures for customs duties, partial movement of labor, or the opening of government procurements, among others. The India–Singapore Comprehensive Economic Cooperation Agreement covers not only trade in goods but also services, investments, and cooperation in technology, education, air services, and human resources.

The growing number of FTAs in the region is in part a response to the uncertain progress of multilateral trade liberalization under the auspices of WTO. There is also a precautionary motive

³ ASEAN+3 includes the 10 members of the Association of Southeast Asian Nations (Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam), People's Republic of China, Japan, and Republic of Korea.

⁴ Taken from Asia Regional Integration Center website, <http://aric.adb.org>.

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