

# The risks of regional integration

What Asia can learn from European economic integration

IWAN J AZIS

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**As the EU experience shows, a single currency isn't necessarily key to unlocking the benefits of economic integration, writes Iwan Azis.**

Next month the UK goes to a referendum to decide whether it stays in the European Union or not. Whichever way the poll goes – and all signs suggest it will [go down to the wire](#) – it signals a serious crack in the wall of regional integration. It also highlights to other regions, including the Asia-Pacific, that economic integration comes with big risks as well as rewards.

The interest in economic integration is commensurate with widespread adoption of liberalisation policies embraced by many countries around the world during the 1980s. Of all cases of integration, the one in Europe is the most prominent. Driven by a lack of national self-confidence among western European nations after World War II, many were convinced that the benefits of integrating Europe would exceed the costs and the risks. [Some studies](#) even exaggerated the magnitude and extent of the benefits by conjecturing that intra-European trade would triple once a single currency is adopted.

In fact this could not be further from the truth. The share of intra-EU trade has been stagnant since 1990 at around 65 per cent. In contrast, with few regional arrangements and no single currency, the share of intra-Asian trade has increased from [40 per cent in 1990 to 54 per cent](#) last year.

Indeed, economies in Asia have been steadily integrating. But what distinguishes it from Europe is that the process in Asia is private sector and market-driven, and institution-lite. More importantly, it is driven by unilateral policy, not regional policy like in Europe.

Trade integration measured by cross-border flows of exports and imports began to increase after the 1997 Asian Financial Crisis. It intensified when the region got involved in global supply chains and production networks. Under these, electronic components produced in the Philippines are exported to Thailand where hard disks are made, and subsequently exported to China to be installed in computers to be exported by China to the US and the rest of the world. Such a classic example also applies to textile and apparel, electronics, automotive, and other sectors.

Some implications arise from these, however. Regionally, the whole process boosted Asian integration while at the same time making regional trade more efficient, and the economy grew robustly. Over the course of three decades, emerging Asia's share of world GDP surged from [10 per cent to 30 per cent](#), enabling the region to lift half a billion people out of poverty. During the 2008 Global Financial Crisis, about two-thirds of global growth come from the region.

Globally, however, imbalances emerged. By the mid-2000s, Asia's current account surplus reached almost half of global surpluses, while the current account deficits in the US alone reached an all-time high at 70 per cent of global deficits. Imbalances between saving and investment (excess savings in Asia and deficits in the US) also increased. Capital inflows from Asia that flocked into US government bonds despite their low returns “financed” part of the US deficits.

The subsequent collapse of *Lehman Brothers* marked the onset of the 2008 Global Financial Crisis. Tensions flared when Asia was accused of helping to bring this about by creating saving gluts, and the US was blamed for letting sub-prime loans grow with no oversight and doing nothing with its fiscal deficits.

Interestingly, [a jump in cross-border trade within Asia occurred again](#) precisely after the 2008 crisis, a repeat of what happened during the post 1997 crisis. It advances a suggestion that Asian integration has been crisis-driven. Falling demand of advanced economies surely contributes to it, but the fact that the value and volume of intra-Asian trade has also increased suggests something else. As trade also surged between Asia and other emerging markets in Africa, Europe and Latin America, an interest in “South-South trade” re-appeared.

Two remarks are in order. First, that rising trade integration coincides with the proliferation of free trade agreements (FTA) involving Asian countries does not imply causality. All surveys show that the utilisation of FTA facilities has been limited, suggesting that Asia's growing trade and integration is largely driven by unilateral liberalisation. Secondly, as the growth of world trade turned sluggish since last year, so did the growth of intra-Asian trade.

What about financial integration? Asia is less integrated in this sector. Asia's cross-border investment in equity markets is less than a quarter of the total, and only 11 per cent in the bond market. Although the trend is increasing, the region's financial sector has always been more integrated with economies outside Asia, particularly the advanced economies: US investors dominate in the equity market and Europeans in the bond market.

With growing regional integration also comes risks. It is in finance that these risks are particularly high. Asia learned the hard way from the financial contagion in 1997. At that time, a financial shock in Thailand spread rapidly to Indonesia, Malaysia, and even Korea. [My recent study](#) with some colleagues revealed that Asia also suffered contagion from the Lehman crisis in the US and the subsequent crisis in Europe. More importantly, the affected asset market in one Asian country generated spillovers not only on the same market but also on other asset classes in other Asian countries. The effect would have been more severe had the financial sector been more integrated.

As the UK prepares to decide whether to stay within the EU, the countries of the Asia-Pacific would do well to remember that they may only need to be friends to enjoy the benefits of integration, and that unilateral policy is more likely to lead to lasting success than formal structures.

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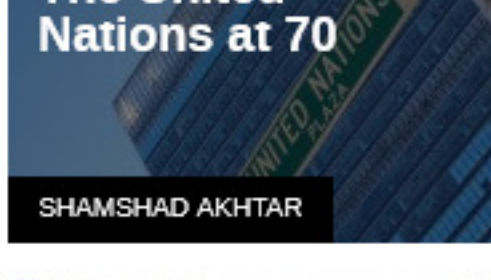
## About the Author



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