



Unlocking the Potential for
East and North-East Asian
Regional Economic
Cooperation
and Integration

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United Nations publication
Sales No. E.16.II.F.3
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Printed in Incheon, Republic of Korea
ISBN: 978-92-1-120705-7
e-ISBN: 978-92-1-057735-9
ST/ESCAP/2770

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Please cite this publication as:

United Nations, Economic and Social Commission for Asia and the Pacific (ESCAP) (2017). Unlocking the potential for East and North-East Asian regional economic cooperation and integration.

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FOREWORD



The economies in the East and North-East Asian subregion have made remarkable economic progress during the past few decades. The subregion has become the powerhouse of the Asia-Pacific region and one of the most dynamic growth poles in the world, benefiting from outward looking policies that have resulted in rapid export growth, especially to the United States of America and Europe. However, in this era of growing uncertainty, with decelerating global trade, widening social disparities and increasing adverse impacts as a result of environmental mismanagement and ecological imbalances, there is an urgent need to rethink national development strategies.

Strengthening regional cooperation and integration offers great potential for the subregion to address these multiple challenges. At the regional level, ESCAP member States, through resolution 68/10 “Enhancing regional economic integration in Asia and the Pacific”, recognized the crucial importance of harnessing the potential of regional economic cooperation and integration in order to eliminate poverty and achieve inclusive and sustainable development. The Ministerial Conference on Regional Economic Cooperation and Integration in Asia and the Pacific, subsequently held in December 2013, resulted in the issuing of the Bangkok Declaration on Regional Economic Cooperation and Integration in Asia and the Pacific, which was later endorsed through ESCAP resolution 70/1. The Bangkok Declaration is a key outcome demonstrating the firm commitment of Asia-Pacific countries to work together on promoting regional cooperation and integration and further elaborating the four functional areas of work: (a) moving towards the formation of an integrated market; (b) developing seamless connectivity across the region in the areas of transport, energy and information and communications technology, among others; (c) enhancing financial cooperation for closing infrastructure gaps across countries in the region and exploring the possibility of providing liquidity support; and (d) increasing economic and technical cooperation to address shared vulnerabilities and risks.

In line with the four areas of work outlined in the Bangkok Declaration, the present report contains an examination of the current state of subregional cooperation and integration in East and North-East Asia, identification of potential areas for further strengthening subregional linkages and provision of recommendations on required policy actions. Ultimately, these policy actions will provide the groundwork for building bridges between East and North-East Asia and other subregions towards region-wide cooperation and integration.

Cementing subregional cooperation is an important strategy as progress on regional cooperation and integration has been uneven in the Asia-Pacific region. While South-East Asian economies have institutionalized their integration efforts through the Association of Southeast Asian Nations (ASEAN) and set forth a blueprint for realizing an “Economic Community”, East and North-East Asia has been lagging behind in terms of formal regional integration due to ongoing tension arising from historical, territorial and ideological disputes. In fact, as long as there is a military standoff between the Democratic People’s Republic of Korea and the Republic of Korea, the prospect of integration in the subregion is far from becoming a reality. Instead, the subregion should explore concrete ways of strengthening cooperation in key priority areas which are closely aligned with national development policies and where potential benefits of cooperation could be maximized so that eventually cooperation could lead to functional integration in these areas.

The Asian financial crisis of 1997/98 provided the first opportunity for deepening regional cooperation and integration in the region by dramatically demonstrating the impact of financial and economic crises and highlighting the need for a regional financial mechanism that could act as a lender of last resort for Asian economies. At that time, Japan, as the largest economy in the region, took the lead in proposing the establishment of an Asian monetary fund to serve the region in times of crisis. While the proposal failed in its original form, it created a strong momentum that became the basis for subsequent initiatives created under the ASEAN Plus Three process.

In the aftermath of the recent global financial crisis, the economic landscape has shifted to the East, and it is now imperative for the Asia-Pacific region, with East and North-East Asia taking the lead, to take bold action towards restoring dynamism in the region and beyond and to embrace a more sustainable growth path for all through strengthened regional cooperation and integration.

A handwritten signature in black ink, appearing to read 'Shamshad Akhtar', with a horizontal line underneath.

Shamshad Akhtar
Under-Secretary-General of the United Nations and
Executive Secretary, United Nations Economic and
Social Commission for Asia and the Pacific



EXECUTIVE SUMMARY

Regional cooperation and integration is a priority for countries in East and North-East Asia (ENEA) as they face increasingly complex cross-border challenges that cannot be solved by one country alone. The growing importance of trade integration, the enormous potential for energy and transport connectivity to usher in a new era of sustainable development, underscores the need for the subregion to work closely together on developing integrated markets and seamless connectivity. At the same time, cooperation on finance and the environment must also be strengthened to protect hard-earned development gains from shared vulnerabilities.

The present report contains an exploration of the issues of market integration (trade, foreign direct investment and movement of people); seamless connectivity (transport and energy); financial cooperation; and shared vulnerabilities (environment and disaster risk) under the framework of the Bangkok Declaration on Regional Economic Cooperation and Integration in Asia and the Pacific, with the aim of proposing a set of recommendations for East and North-East Asia that would help the subregion reap greater benefits from cooperation and become a building block for cooperation and integration at the regional level.

In the ESCAP region, the subregion of ENEA covers China (including Hong Kong, China; and Macao, China), the Democratic People's Republic of Korea, Japan, Mongolia, the Republic of Korea and the Russian Federation. At the outset, the countries and areas concerned are more dissimilar than similar in terms of stages of development, economic structure and size, political systems and culture. The ENEA subregion is home to the most advanced and globally linked economies together with less developed and isolated economies. Owing to these differences and long-standing historical and geopolitical tensions, institutionalized regionalization has not made much progress, and regional economic cooperation and integration is a challenging concept to apply for all ENEA countries. Yet, there are increasing interactions, both officially and at the grass-roots level, reflecting the growing importance and interdependence within this group of countries. Also, despite the various limitations in fully engaging the Democratic People's Republic of Korea, there have been positive developments in recent years, including a growing number of both small and large-scale projects to enhance trade, transport and tourism infrastructure in that country.

From an economic standpoint, regional integration is more likely to be successful when countries have complementarities in factor endowments that can be shared for mutual benefit. East and North-East Asia is such a subregion. With the capital- and technology-rich economies of Japan and the Republic of Korea, China's labour-rich economy and Mongolia and the Russian Federation's abundance of natural resources, the economic diversity in the subregion offers a particularly strong platform for mutually beneficial cooperation and integration. The fact that regionalism has been underdeveloped in the ENEA subregion compared with other parts of the world means that the subregion still has many opportunities to take advantage of the multiple complementarities among its diverse economies (ESCAP, 2012).

Furthermore, greater cooperation and integration could offer solutions to not only the old problems of poverty and political instability facing the subregion but also new challenges, such as environmental degradation, urbanization and congestion.

Drivers of economic cooperation and integration in East and North-East Asia: harnessing economic complementarities and exploiting new opportunities

Strengthening regional cooperation and integration within the ENEA subregion could produce enormous benefits. For instance, the potential for energy trade in the subregion has long been recognized in view of the coexistence of some of the largest consumers and producers of energy. Even more promising is the potential for renewable energy connections using solar energy generated in the Gobi Desert. There are ongoing discussions to develop

a super grid in the ENEA subregion, which would furnish clean energy to China, Japan, Mongolia, the Republic of Korea and the Russian Federation. There are also different but complementary motivations for each country. China requires cooperation from subregional countries to operationalize its Belt and Road Initiative. The Democratic People's Republic of Korea is seeking to bring in more investment for infrastructure development. For Japan and the Republic of Korea, the achievement of enhanced stability through regular interactions and dialogue with the Democratic People's Republic of Korea and improving connectivity to new growth poles in the region are important priorities. For Mongolia, enhancing connectivity with its subregional neighbours is essential for increasing trade and investment. Finally, for the Russian Federation developing the underdeveloped far eastern districts requires greater engagement with other ENEA economies.

Challenges and prospects of subregional cooperation and integration

Among ENEA economies, the Democratic People's Republic of Korea has very few economic linkages to the outside world. Also, the transitioning of China, Mongolia and the Russian Federation to an open market system at a comparatively later stage than Japan and the Republic of Korea has made regionalization in the ENEA subregion a greater challenge than in other parts of the world. Despite these challenges, economic pragmatism has led to various forms of technical cooperation to support market-driven regionalization in the ENEA subregion. For each of the functional areas of cooperation and integration discussed in the following sections, a pattern of regionalization without regional institutions emerges. While this form of bottom-up regionalization has served the purposes of the ENEA subregion in the past, there are clear areas where stronger government-led action would catalyse greater flows of goods and people.

Moving towards market integration

Trade

With most ENEA economies adopting export-led development strategies, the subregion's share in global trade and intrasubregional trade has increased significantly in the past two decades, making the ENEA subregion the second largest trading bloc after the European Union. Despite recent slowdown in trade growth, the potential for ENEA subregional trade remains great, particularly with the continuing push for bilateral and multilateral free trade agreements. While the subregion has achieved significant progress in lowering trade costs through tariff reduction and trade facilitation, there is still substantial room for improvement, particularly in enhancing connectivity through cross-border paperless trading.

Foreign direct investment

The ENEA subregion is fast emerging as one of the most dynamic growth engines of the global economy. Foreign direct investment (FDI) and multinational enterprises have been the drivers of these phenomena, and they are contributing to subregional integration in various forms. However, intrasubregional FDI remains relatively low with the gap between intra- and interregional inflows of FDI growing in recent years. Greater economic integration is

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