



DYNAMIC EAST ASIA: PROGRESS AND PROSPECTS FOR ECONOMIC GROWTH AND REGIONAL INTEGRATION

CENTER ON JAPANESE ECONOMY AND BUSINESS

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Ever since the 1997 Asian financial crisis, the nations of East Asia have found a renewed political focus: regional economic cooperation. It has been close to ten years since the financial catastrophe, and it has brought tremendous change, not just for certain countries, but for the region as a whole. The distrust of foreign capital, although still prevalent, has diminished. Certain markets were opened up through vigorous restructuring, consolidation, and then through expansion. As elsewhere in the world, growth in the information technology (IT) sector helped boost many economies, while the emergence of China as the region's economic engine has, and will stay, at the forefront of everyone's mind for years to come.

Although economic growth in East Asia has recently been robust, it shows signs of slowing down due to cyclical issues, higher oil prices, and other factors. There are still many issues East Asia needs to tackle, including the elimination of deep political mistrust toward one another, the ongoing need for an even more stable financial market, and a continuation of government and institutional assistance when a crisis similar to the one in 1997 happens again. How should the region proceed hereon? What kind of roadmap should East Asia follow in order to strengthen its financial and monetary cooperation and integration?

To answer some of these questions, on September 12, 2005, the Center on Japanese Economy and Business invited Mr. Haruhiko Kuroda, President of the Asian Development Bank to Columbia Business School, to outline some of his thoughts and suggestions on regional economic cooperation. This program was co-sponsored by the APEC Study Center of Columbia University.



HARUHIKO KURODA
President
Asian Development Bank

I. INTRODUCTION

As a former professor, I fondly recall my teaching years because I enjoyed the really objective, independent, and free discussions one can have at that setting. At international meetings, each national representative or international organization has its own interests and views that are inherited from their long history. But at a university, you can really have free and dynamic discussions. So, today, although I'm a representative of the Asian Development Bank (ADB), I would like to speak rather freely and would very much welcome any questions and comments on my views and my presentation.

I'll speak on two things today, two things that are, of course, interrelated. One is the recent economic assessment or recent economic outlook of East Asia, including, most importantly, China and Japan. The other is the economic integration in the region and the steps required to make further progress in this area.

II. EAST ASIAN ECONOMIC OUTLOOK

Let me start with a broad economic overview. Last

year, East Asia posted its highest gross domestic product (GDP) growth rate since the 1997 Asian financial crisis. Buoyed by strong growth in the United States, improved growth in Japan and the European Union, and the recovery in the information technology (IT) sector, the region registered an average growth of 7.6 percent, which is extremely high. I mention the IT sector because it's a sector that is now really important. This is true not only for Japan, but also for countries like the Philippines, Malaysia, Singapore, and even Thailand, where the IT sector is very closely tied to their respective economies than in the rest of East Asia. That said, this year the IT expansion can be seen as less buoyant, and major industrial economies are in the mist of a general slowdown. The global IT market has softened somewhat compared to 2004, while oil prices have skyrocketed by 75 percent since January.

In the current environment, we expect East Asian GDP growth to be somewhat slower in 2005. But the rate of growth will still be robust, at about 6.9 percent. That is the broad regional picture, but within it, there is considerable variation among various countries. China will continue to be the fastest growing economy, with growth of 9.2 percent, followed by Vietnam, Laos, Indonesia, and Malaysia. If we exclude China from the forecast, East Asia's average GDP growth this year is around 4.3 percent.

Looking ahead, we expect an average growth rate for the region of about 7 percent in

2006. China shows few signs of slowing, and expectations are that it will grow by almost 8 percent in each of the next two years. Excluding China, the average GDP growth for the region next year is forecasted to pick up to about 5 percent.

It is well worth noting that these forecasts are subject to a number of major regional and global risks. They would be, among others, the global payments imbalance, the ongoing possibility of a hard landing for China, a possible significant increase in long-term interest rates, the ever-present potential for a major health pandemic such as the Avian flu, and, of course, persistently high and volatile oil prices.

I won't go into detail on all these points. However, I should point out that as a large net importer of oil, Asia is quite vulnerable to rising oil prices. So far, the impact on growth in most East Asian countries has been rather limited. But further increases could significantly reduce East Asian growth, particularly in Thailand, the Philippines, Korea, and, to a lesser extent, China.

High oil prices also create additional fiscal burdens on those countries that subsidize or directly control the retail price of oil products. We are seeing signs of this in a number of countries, including Indonesia, Malaysia, Thailand, and Vietnam. These countries are now taking significant steps to lessen their reliance on subsidy bills, recognizing that the long-term costs of subsidizing oil products outweigh the short-term benefits. Thailand has recently completely removed subsidies, but other

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countries are taking a more gradual approach.

Indonesia and the Philippines have also announced a number of administrative controls, such as limiting working hours to reduce fuel consumption. These measures may provide a degree of temporary relief, but since it appears that higher oil prices may be here to stay for some time, or even for some years, the need for a more permanent solution is now urgent. Tax policies to encourage more sustainable energy use, the creation of an efficient and competitive energy sector, along with comprehensive transportation policies, and a build-up of strategic reserves are necessary to manage this major challenge, not just for each country, but also for Asia as a whole.

With a number of significant risks in the forecast, countries in East Asia will need to shore up their fiscal positions and tighten their monetary policies to sustain high growth. Successful implementation of structural reforms also remains a priority. Stronger financial systems will help countries achieve currency and financial stability and enable the management of private capital flows on a sound basis. Financial and corporate sector restructuring is also needed to improve local investment conditions for overall economic efficiency and competitiveness.

III. REGIONAL MONETARY AND FINANCIAL COOPERATION

Let's now talk about current regional monetary and financial cooperation in East

Asia. As countries deal with these challenges on a national level, they are also working together for a greater regional economic integration. This is another way to build up a strong resilience to a crisis and spread the benefits of growth to more people in more countries.

Up until the 1997 financial crisis, regional economic integration in East Asia was primarily the result of market forces and private-sector investment. Government-led economic cooperation initiatives were few and limited to cross-border infrastructure, trade, and investments. The Greater Mekong Subregional Cooperation Program was one such initiative. With ADB support, this program brought the countries of Cambodia, China, Laos, Myanmar, Thailand, and Vietnam together to enhance economic relations. Another example is the Association of South East Asian Nations (ASEAN) Free Trade Area, which aims to reduce tariffs and promote prosperity among ASEAN countries.

The 1997 crisis forced countries in the region to recognize their growing economic interdependence. This recognition, along with slow progress in multilateralism, the popularity of regionalism elsewhere, and weakness in the international financial architecture, led governments to extend existing regional cooperative efforts to include policy dialogue, money, and finance.

ASEAN+3 (China, Japan, Korea) has played a lead role in this effort. The members of ASEAN+3 have worked to strengthen the region's resili-

ency through several measures, which include a regional economic review and policy dialogue processes that work as a regional surveillance mechanism, the Chiang Mai Initiative, which provides liquidity support during times of crisis, and several regional initiatives to develop bond markets. Recently, the ASEAN+3 finance ministers agreed to double the size of existing bilateral swaps under the Chiang Mai Initiative. They also agreed to significantly increase the amount of swaps that can be disbursed without International Monetary Fund (IMF)-supported programs. In addition, they adopted a collective decision-making system for activating financial resources when needed. This is a step toward multilateralization.

I believe that monetary and financial cooperation in East Asia has now reached a critical stage. It is important that progress continues in order to secure the gains the region has made. It is also worth noting that intraregional trade in East Asia has grown from less than 35 percent of total trade in 1980 to 54 percent in 2003. This is a lower proportion than the EU, but higher than North American Free Trade Agreement's (NAFTA) 46 percent. With trade integration of this magnitude, the region could reap significant benefits from enhanced regional cooperation in money and finance.

IV. NEXT STEPS

How should the region proceed hereon? What kind of roadmap should East Asia follow in order to

strengthen its financial and monetary cooperation and integration?

At this stage, there isn't a standard roadmap or strategy, but let me offer a few suggestions by drawing on the research of both the ADB and the ASEAN+3 Research Group. Let me add that these suggestions are not, by any means, consensus ideas among ASEAN+3 members.

First, the regional arrangement for liquidity support should be strengthened. Despite the recent expansion of the Chiang Mai Initiative, the total size of support that can be made available to a country in a financial crisis is relatively small. The total right now is about 40 billion dollars, and there's an agreement to double that amount to 80 billion dollars. A financial crisis a country could face might be very large. That means that even the 80 billion dollar amount might be too little, especially when you remember what happened in countries like Indonesia. This can be increased by earmarking a percentage of foreign exchange reserves owned by member countries for a centralized regional reserve pool. This could then be quickly disbursed to avoid a potential financial crisis like the one we saw in Indonesia.

Second, the ASEAN+3 Economic Review and Policy Dialogue needs to be strengthened to avoid regional financial crisis and ensure financial safety. At this stage, although ASEAN+3's Economy Review and Policy Dialogue exists, it is still weak. I think these Asian countries may be more willing to engage in sound policy dia-

logue in a regional setting where they have greater control, rather than in a global format where they have less control.

A regional setting may also be advantageous since there will be substantial common issues among the economies in the region, especially as interdependence within the region grows. Stronger regional surveillance can complement and contribute to the economic surveillance done on the global level. It will also increase the likelihood of detecting vulnerabilities in a timely manner.

Regional surveillance also requires the commitment by member countries to discuss policies of other members frankly. And as in any cooperative effort, they must also surrender some or even a small degree of sovereignty over policies for the good of the region. Strengthening the current arrangement would perhaps call for the establishment of an independent entity, such as a regional policy dialogue body.

During a recent meeting organized by the IMF in Singapore, Asian ministers mentioned the necessity of strengthening regional surveillance. It is very interesting that countries from East Asia, particularly from ASEAN, are now insisting on a stronger regional surveillance system that would assist their own, and the overall Asian, economy. Another important issue is exchange rate cooperation in the region. Under increased interdependence, even the smallest change in exchange rates could significantly disrupt trade and financial flows. So far, there hasn't been

a clear regional initiative in this area, but there are some encouraging signs. For example, on July 21 of this year, China and Malaysia joined Singapore in adopting a managed floating exchange rate regime with reference to a basket of currencies. Other countries may also eventually consider adopting the basket currency regime in order to promote greater exchange rate stability, since this would be beneficial to intraregional trade.

One of the most fundamental causes of the 1997 financial crisis was overreliance on the banking sector as a source of financing, coupled with debt maturity and currency mismatches. In order to address this issue and to mobilize the region's vast pool of savings for investment in the region, ASEAN+3 implemented the Asian Bond Markets Initiative. As part of the initiative, ADB established Asian Bonds Online, which contains a lot of information on all markets in the region.

In 2004, ADB debuted local currency bonds in India and Malaysia to further assist with bond market development. These transactions represent the first bond issue by a foreign entity in the respective markets. In May of this year, we issued local currency bonds in Thai baht, and we plan to expand this program to other countries such as China, as well. This will not only enhance liquidity, but also help ensure increased investment in Asia and the Pacific.

Finally, the region should continue to promote intraregional trade. Cooperation in

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trade, as well as in money and finance are two sides of the same coin. As of last year, there were more than 30 free trade agreements (FTAs) under negotiation. These agreements can extend beyond tariff reductions to include property rights and labor mobility issues. One example is the recently signed India-Singapore comprehensive economic cooperation agreement, which covers trade in goods, services, investments, technology, education, air services, and human resources.

While bilateral and regional agreements are largely beneficial, they should be building blocks—not stumbling blocks—to global trade integration. Many people say that if you have inconsistent bilateral agreements, they will pose too many challenges to overall global trade. FTAs vary in scope, so their proliferation poses challenges, as well as opportunities. ADB has initiated a study of FTAs in Asia that will recommend ways to harmonize with these agreements and with the World Trade Organization's (WTO) guidelines on global trade. Although institutions like the ADB are basically development banks and aid countries with long-term financial assistance, and we are not in the business of negotiating trade issues, I must say that trade and finance are intertwined. Trade issues should also be seriously studied and discussed within institutions like the ADB.

Although many East Asian nations are currently at a different level of economic development, the previously mentioned multitrack, or multispeed,

approach would enhance regional integration. Agreements in money and finance would mutually support trade issues, and those nations on a fast track could bring others on board.

V. CONCLUSION

I believe that East Asia's future growth will remain positive despite certain risks. At the national level, there is much to be done in many countries to consolidate and build on recent progress. The ADB will continue to work with developing countries in the region to strengthen fundamentals and provide a climate for continued growth and prosperity.

At the regional level, I see cooperation and integration playing an increasing role as countries become more and more engaged in the global economy. In my view, a deeper and broader integration within Asia and with the global economy is crucial. If you look at countries in the region that are growing quickly, they are part of the global economy. In this context, economic integration becomes even more important. A deeper and broader integration within Asia and the world allows countries to build on common strengths and reduce risks in a cooperative, systemic way, thus extending the benefits of growth more equally across the region. This process builds trust, enhances economic growth, and provides an impetus for lasting stability and peace. As a regional development bank president, I emphasize ADB's role as a catalyst and coordinator of these

efforts that will continuously move this agenda forward.

DISCUSSION

HUGH PATRICK

Governments and development banks can and should play important roles in developing the policies and institutions that support the deepening of East Asian economic integration. As Mr. Kuroda noted, the degree of economic integration among these countries in the region has become a very important and significant part of their total story as rapidly growing developing economies. I therefore have a few questions. How can Japan exercise leadership in East Asia when it continues to protect its agriculture and health care sectors and persist with its protectionist policies? Also, China and Japan are rivals, as well as cooperative leaders in East Asia. How can they work together when political relationships are so poor? Third, I also believe there is a disjunction between East Asia's financial cooperation reflected in ASEAN+3 and the FTA agreements that are on a completely separate (bilateral or subregional) track. How can these two separate tracks be brought together? As far as ASEAN+3 is concerned, the membership to this group is political and exclusionary. Where does the United States stand? What about Taiwan?

East Asian economic cooperation is predominantly a long-term process, and one of the most important aspects is the exchange of information.

It is an educational process for government officials and political leaders to learn about other countries. You learn a lot through this dialogue, and I think that it has to occur before you can engage in any sort of subsequent agreements with significant economic content. Thus far the focus appropriately, I think, has been on the policy dialogue process without much economic content. My own concern is that it may take some considerable time before East Asian countries come to trust each other enough to do the sorts of things that you say they have to do.

HARUHIKO KURODA

To start with the agricultural issue, the United States, Canada, and Australia all have competitive agricultural sectors. However, European countries, along with Japan and Korea, have a less competitive advantage, and this creates huge problems.

In Japan, agriculture is really concentrated on a few products, such as rice. The price of rice in Japan is perhaps seven or eight times higher than it is in the United States. In addition, the farmers in Japan are aging very rapidly, and they are finding it hard to get successors, since their sons and daughters are not taking over their businesses. So, at some stage, there will be dramatic decline in the number of farmers, and the government is expecting this change. It is trying to reduce agricultural subsidies and find other ways to assist farmers. So in time, the agricultural issue could become less problematic.

Health care is another major issue. As the nation rapidly ages, Japan will need more health care workers in a massive way. Thus, the big issue for Japanese FTAs is how many of these foreign workers would be allowed to come in. The initial agreements that have been made only allow a small number to come work in Japan, but a substantial expansion of all Japanese markets is required, and I believe it is only a matter of time.

The issue about China and Japan is quite difficult. The two countries are not looking at each other and instead are looking toward the United States. The Chinese are very attracted to anything American: the way of life, the way of managing companies, etc. For example, many Chinese people are increasingly commuting by car and not via public transportation. Indeed, the Japanese are also very attracted to U.S. culture, music, movies, and way of life. In the end, the Japanese, particularly young Japanese, do not know much about Chinese culture or politics.

For instance, when I was a high school student, I studied a bit of Chinese history, literature, and poetry, but that isn't mandatory in Japanese high schools anymore. Thus many Japanese high school students do not know much about Chinese culture and instead concentrate on American culture. I think the Chinese and Japanese cultures are moving further away from each other, and it's going to be a big challenge to bridge that gap for the younger generation, especially in politics.



Haruhiko Kuroda and Hugh Patrick

It is true that the current status of financial and trade cooperation in Asia is more bilateral than regional. But I hold the view that trade agreements will eventually become regional. Perhaps ASEAN+3 will expand to ASEAN+5 or 6, to include Japan, China, Korea, Australia, New Zealand, and India. This kind of regional trade agreement would be possible and likely in the long run. I also believe that the ASEAN+3 framework is not only about trade, but now extends to include almost every corner of policy like finance, trade, foreign policy issues, the environment, and so on. I don't believe that ASEAN+3 is exclusive, and it can, and does, include many other countries as well.

Finally, I believe that East Asian regionalism is a process that got started only after the 1997 currency crisis. It's been less than ten years, and yet there's been quite an improvement in financial, trade and investment cooperation. This is an on-going process and will take many years to develop,

but through this process, mutual trust can be achieved in East Asia.

QUESTION

I'm a Columbia M.B.A. student and director and owner of a private institute in Cambodia. We are currently working on irrigation projects and have some questions about the oversight of special project funds. What's the difference between the oversight of funds from specific countries and ones that are pooled within the ADB? How much oversight is needed to encourage better Asian cooperation?

HARUHIKO KURODA

From the ADB's perspective, we would like to have multidonor funds, where various countries pool money together for a particular project. However, there are many member countries that insist a specific fund be from only one country, so that the donor country's officials have a say in how that money will be managed. The World Bank used to have several hundred funds that it managed, and most were one-donor funds. But to monitor the original objective and then the allocation and usage and to oversee the end result of the project using these funds turns out to be a tricky thing. ADB is currently reviewing policies and practices for donor funds.

QUESTION

You mentioned that China is following the U.S. economic model. Can't you say the

same for Japan in the last two or three years? I'm specifically talking about Japan dealing with its bank loan problems and engaging in corporate restructuring. It seems to me that it is also trying to duplicate existing financial laws in the United States.

HARUHIKO KURODA

I think it's quite natural, because countries tend to follow the most successful financial example they see. The U.S. had its share of financial problems before, but now it boasts one of the most efficient, competitive financial sectors in the world. So whenever other countries face long-term financial problems, they tend to learn from the U.S. example. Both Japan and Korea did.

QUESTION

You talk about economic cooperation between Asian countries, but with East Asian nations, aren't they, in the short term, in competition with each other?

HARUHIKO KURODA

If we look at Europe, the British, German, French, and Italian economies are all, of course, competing with one another. However, they were all able to develop a common marketplace at the same time. You can also say the same for Canada and the United States, especially about the auto industry. So, I don't think East Asia is any different. In the region, Japan and Korea are very competitive in certain sectors but not with everything.

QUESTION

Will you comment on the steps needed to realize Asian peace and economic development at the same time?

HARUHIKO KURODA

Many people draw lessons from the European model. They have argued that after World War II, Germany and France could have prevented the creation of a single market and currency system because of their mutual distrust toward one another. Political rapprochement between the two countries made the European integration possible. I don't think you always need the political groundwork to be laid first in order to achieve economic cooperation and integration. I think the gradual cooperative effort between the two countries was really more grassroots; it came from the general public. Look at China now. Japan is currently its largest trading partner, and that was built without overwhelming political trust. I believe this is so because trust exists, both on an individual and group level. I mean, after all, both Japan and China have been able to co-exist for thousands of years. Of course there were many tragedies that occurred within that timeframe. But I am hopeful that peace in the region will continue and believe progress has been made.

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—Harubiko Kuroda

躍動する東アジア- 経済発展と地域統合に関する進展と展望

アジア開発銀行 総裁

黒田東彦氏

(抄訳)

1997年のアジア金融危機以降、東アジアでは地域経済協力が政治課題として一層重要視されるようになった。金融危機から約10年が経つが、この間に個々の国家だけではなく地域全体にもたらされた変化は図り知れないものがある。外国資本への不信感、依然として無視はできないが、消えつつある。構造改革や合理化および拡大を通して開放化が進んだ市場もある。世界の他地域と同様に情報通信技術(IT)セクターの成長が経済を刺激する一方で、地域経済のエンジンとしての中国の台頭も注目されており、今後も中国は注視されるだろう。

東アジアの最近の経済成長には力強いものがあるが、景気循環、石油価格の上昇およびその他の要素が原因となり減速の兆しも出てこよう。東アジアには、各国間の相互不信の解消や安定した金融市場の必要性、および1997年当時のような危機が発生した際の政府・機構による援助体制の維持など、まだ様々な課題が残っている。東アジアの今後の方向性は何か？経済金融面の協力と統合を強化するためには、どのような道筋をたどるべきか？

アジア開発銀行総裁の黒田東彦氏は2005年9月12日にコロンビア大学ビジネス・スクール日本経済経営研究所が主催したシンポジウムにおいて、地域経済協力に関する見解と提言を述べた。標準的な道筋や戦略は無いとしながらも黒田総裁は、アジア開発銀行とASEAN+3リサーチ・グループの研究成果に基づき、いくつか提言した。初めに、チェンマイ・イニシアティブ(金融危機に陥った国家の資金流動性確保のために準備されている緊急融資資金)の即時増額を提案。準備資金の残高を現在の400億ドルから800億ドルに引き上げる点については各論あるが、黒田総裁は増額されてもまだ不十分との見解を示した。第二に、「ASEAN+3経済レビューと政策対話プロセス」は、金融危機を未然に防ぎ金融システムの安定を図るための地域内サーベイランス・メカニズム(監視機構)の継続のために、強化が図られるべきと提言。同時に、現時点での「ASEAN+3経済レビューと政策対話プロセス」は依然として脆弱だとも発言。各国が自主性を発揮しにくいグローバルな枠組みでなく、より自主性が発揮できる地域レベルの政治的対話の舞台を設定することで、各国の参加が一層促進されるだろう、と述べた。

もう1つの重要ポイントとして、地域内サーベイランス・システム(監視体制)の維持が挙げられた。このためには、加盟国がお互いの政策を率直に議論することが必要。どのような協力関係にも言えることだが、地域全体の利益のために各国政府がそれぞれの国家主権をある程度譲歩することも不可欠であり、また、現行のシステムの強化のためには地域内の政策対話を促す独立機構の設置も必要、と提言した。

貿易問題について黒田総裁は、二国間および地域内協定はおおむね有効であり、グローバルな貿易統合の妨げにはならないと指摘した。黒田総裁は、現行の自由貿易協定はそれぞれ適用範囲が異なるため、締結数の増加に伴い逆に問題点も現れてきているとし、アジア開発銀行ではこれら協定間の調整を進め、世界貿易機構(WTO)の貿易ガイドラインとの整合も図るために、アジア自由貿易協定の研究調査を開始したことに触れた。

(於:2005年9月12日 コロンビア大学ビジネス・スクール)

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