

**Speech by**  
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**at the**  
**ADB-ADBI Joint-Conference on**  
**Emerging Asian Regionalism:**  
**The Challenges of Economic Integration**  
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**A Vision for Asian Economic Integration and Japan**

Distinguished guests, ladies and gentlemen;

I am honored to be in Tokyo for this conference on *Emerging Asian Regionalism: The Challenges of Economic Integration*. Today we gather to discuss the findings of an important knowledge product of ADB, a book on emerging Asian regionalism. This study – led by the Office of Regional Economic Integration– is an important flagship project of the knowledge departments of ADB.

The objective of my remarks today is to provide a backdrop for this conference. I will start with comments on the outlook of the Asian economy. I will then summarize key messages of the book, share with you my vision for Asian integration, and discuss a possible role of Japan in an increasingly integrated Asian economy.

**I. Asia's Economic Outlook**

Despite the slowdown in the world economy, developing Asia's performance continues to be robust. Economic growth is moderating this year, yet remains strong.

Last year's 9% GDP growth rate for developing Asia was exceptional. This year we expect it to slow to between 7 and 8%, a rate likely to be sustained into 2009.

Inflation has become the region's primary concern, due to hikes of international commodity prices and years of accommodative monetary policy. After an inflation rate of 4.3% in the region in 2007, it will likely rise above 7% this year, before easing somewhat in 2009. Recently, Asia's central banks have raised policy rates and cash reserve requirements to tighten monetary policy. Yet, in several cases real policy rates remain negative. Many of the region's central banks need to be more decisive in tightening monetary conditions.

While recently easing, I expect global commodity markets to continue to be tight in the medium-term as ample liquidity prevails. So the balance of risks is tilted toward inflation. A further drift of inflation expectations will hurt medium- to long-term price stability, and affect the region's growth prospects significantly.

Another concern is the continued turmoil in global credit and financial markets. Thus far, Asia's financial markets have weathered the storm reasonably well. But there is no guarantee that this will continue. Any further shocks could easily renew or increase market turbulence and there is a growing need for efforts to strengthen the resilience of Asia's financial markets. More needs to be done by Asian countries to ensure regional financial stability.

## **II. Key Messages from the Book**

Let me now move to the topic of our conference today – economic integration in Asia and how it can contribute to shared prosperity regionally and globally.

What does this book *Emerging Asian Regionalism: A Partnership for Shared Prosperity* say about regional integration in Asia? The book conveys five key messages on Asian regionalism:

First, Asian economic integration is an idea whose time has come, and the case for greater regional integration in Asia is broad, deep, and compelling.

Second, Asian integration has generally been market-led and private-sector driven; going forward, this market-led process would benefit from a helping hand from various types of inter-governmental economic cooperation.

Third, while Asia can learn some useful lessons from Europe, its model is unique and with distinct characteristics. Asia has to calibrate its own model of integration to suit its huge diversity – in terms of economic, social, political, cultural and historical conditions.

Fourth, Asia is following an outward-looking model of integration – what many experts call “open regionalism.” Building on this, the long-term objective should be to achieve an internally integrated, yet globally connected Asia.

Finally Asian integration is good for the countries involved, the region as a whole, and the world at large; the subtitle of the book – a partnership for shared prosperity – very aptly summarizes this.

These messages have important implications, because how Asian regionalism evolves will affect the lives of its 3.7 billion inhabitants. It will also impact the world as a whole. Asia's contribution to the global economy is growing faster than that of any other region. The emergence of Asian regionalism, powered by new generations of Asians who have been raised amid exceptional economic progress and cooperation among nations, will help establish a lasting prosperity and peace.

## **III. A Vision for Asian Integration**

When I speak on the subject of Asian integration, some may call me a dreamer. Well, I have grown to have a dream for our region. It is very much a vision of a more integrated Asia, one where Asia stands as a major player in the global economy, and an important partner in global trade, investment, finance and development.

As many of you would agree, the center of gravity of the global economy is shifting toward Asia. Asia's remarkable rise is reshaping the world economy while relations among the region's economies are also evolving. Outward-oriented development, once aimed primarily at export markets outside the region, is now knitting Asia together. Asian economies will continue to increase trade and investment with each other and will be increasingly integrated through production networks and financial activities.

A dynamic and integrated Asia would contribute to economic progress both regionally and worldwide. I know that realizing the dream of a well-integrated Asia is a big

challenge. Yet I believe it is achievable. Like all big dreams, it will have to be realized through small, incremental steps. Implementing the strategy of achieving the big dream through small steps, however, requires some sort of goals or objectives for the foreseeable future. The book that we are discussing today develops the following goals to be achieved by, say 2020:

- an integrated market free of restrictions on regional flows of goods, services, and capital;
- deep and liquid financial markets open to cross-border capital flows and services, with high standards of oversight and strong protection for national and foreign investors;
- effective frameworks to coordinate macroeconomic and exchange rate policies, taking into account global challenges and differing national circumstances;
- collective efforts to address vital social issues, such as poverty, exclusion, income insecurity, migration, aging, health, and environmental threats;
- a consistent voice to project the concerns of Asian economies in global policy forums and help create responsible global governance; and
- establishment of vibrant institutions, adequately and professionally staffed, to provide first-rate analytical and logistical support for these efforts.

I believe ASEAN, with its long experience, is well-placed to be the regional hub for closer economic cooperation within East Asia and beyond. It carries economic weight, although not overwhelming—together, ASEAN's 10 member economies had, in 2007, a population of 576 million and a combined gross domestic product of almost \$1.3 trillion. ASEAN is also distinguished by its outward orientation vis-à-vis the rest of Asia and the world economy.

ASEAN+3 and the East Asia Summit are two powerful forums centered on ASEAN. ASEAN+3 includes the region's most dynamic economy—the People's Republic of China; its most advanced—Japan; and its largest newly industrialized economy—the Republic of Korea. To this powerful regional grouping of countries, the East Asia Summit adds India, another dynamic and large economy, and the two advanced economies of Australia and New Zealand. Intensifying regional cooperation in East Asia might gradually expand to include South Asia and other subregions of Asia, and ultimately the formation of an Asian economic community.

Asia's integration process is currently very light on institutions in comparison to Europe. As we move forward, we must develop an institutional framework. Rather than a single guiding institution, Asian leaders may opt for several that are more functionally or geographically oriented. Also, our sequencing of integration is different from Europe's. We are currently on a path, for example, where both financial and trade integration initiatives are moving ahead simultaneously. Cross-border physical infrastructure is expanding, yet requires significant future investment and financing. Monetary integration remains more of a longer-term goal.

ADB has been and will continue to be a trusted partner in the Asian integration process. In 2006, we adopted a strategy for regional cooperation and integration. Last year, we established a dedicated funding facility to provide grants for financing technical assistance projects that support regional integration.

Our new *Strategy 2020*, adopted this April, identifies regional integration as one of the key priority areas for our operations—both lending and non-lending. Under *Strategy*

2020, ADB is committed to acting as a catalyst and coordinator of regional cooperation and integration for its member countries.

We will also increase financial resources for regional projects, programs and related technical assistance, create and disseminate knowledge and information, and support institutional improvement and capacity building of member countries.

By 2020, we expect total lending for regional projects to account for at least 30% of ADB's total operations. We will continue to work closely with regional forums such as ASEAN, ASEAN+3, the East Asia Summit, APEC, and ASEM.

#### **IV. Japan and the Integration Process**

The underlying changes in Asia offer a window of opportunity for all economies in the region to tap the potential of deepening regional economic integration. Particularly, large economies can play important roles in accelerating this regional integration process. Here, I would like to say a few words about the role of Japan.

Due to slow growth in the past decade, the role of Japan in expanding regional demand has declined. Given the expected population decline and the weak economic prospect, the center of regional economic gravity likely continues to shift away from Japan to countries such as China, India and ASEAN countries as a group. The risk of being marginalized, amid the rapid regional integration process, is real, if Japan does not actively pursue economic cooperation with new regional growth poles.

Japan as the largest economy in Asia—with a GDP size 30% larger than that of China—is still a very important trade and foreign direct investment partner for most ASEAN and other East Asian countries.

Outward foreign direct investment by Japanese multinational corporations to emerging Asian economies since the yen appreciation following the 1985 Plaza Accord has played a vital role in shaping regional production networks and supply chains, especially in machinery sectors. Japan has played a leading role in such production networks in providing finance, technology, and marketing. Japanese bilateral economic partnership agreements (EPAs) signed with Singapore, Malaysia, Thailand, Indonesia, and the Philippines as well as its regional agreement with ASEAN indicate the shift of its policy focus to promote regional cooperation.

However, further efforts are needed to strengthen its economic ties with emerging Asia. The trilateral investment agreement, currently negotiated by Japan, China, and Korea, should be concluded, and this agreement could be expanded to embrace the ASEAN Investment Area so that a region-wide, ASEAN+3 Investment Area can be formed. In addition, a successful completion of the trilateral investment agreement can provide a conducive environment to form a trilateral EPA—or a set of bilateral EPAs and free trade agreements (FTAs)—among the three countries. This would make it easier to forge a region-wide EPA, whether it is an ASEAN+3 FTA (called the East Asia Free Trade Area) or an ASEAN+6 FTA (called the Comprehensive Economic Partnership in East Asia).

For Japan to play a larger role in regional integration, significant efforts at domestic adjustments are necessary.

First, domestic agricultural reforms are needed to increase agricultural competitiveness and reduce import protection, which benefits both Japan for food security and

developing Asia for further economic development. Japan should be ready to provide technical assistance to agricultural exporting countries so that they can improve on food safety and standards, which is essential to have market access in Japan.

Second, Japan needs to reform its labor market to absorb more labor forces from Asia. The issue of migration is pressing for Japan because of its rapidly aging population. Rather than relying on illegal immigrants, an open—yet rigorously implemented—immigration policy will be needed for sustaining Japan’s economic growth and competitiveness.

Given the substantial demographic and economic imbalance between Japan and other Asian countries, there are huge potential gains from regional cooperation in facilitating labor migration. In this context, I am pleased to see that some recent EPAs signed between Japan and a few Asian countries, such as the Philippines and Indonesia, have incorporated the provisions for migration of nurses and old-age caretakers. To promote such labor migration, Japan can consider providing technical assistance to potential labor sending countries so that they can invest more on potential migrants for human capital building, say in nursing and old-age caretaking.

Third, in view of the rise of some emerging new manufacturing powers such as China, Japanese multinational firms need to reformulate their regional networking strategy. They need to make larger efforts to tap the creativity of local workers, managers, and engineers of Asian countries and diversify R&D activities in the region to use local talent. These will help not only Japanese multinational firms to better respond to the rapidly changing regional markets, but also facilitate technology transfer, including low-carbon technology, and organizational skills to developing countries.

## **V. Conclusion**

Ladies and gentlemen,

In closing, let me stress again that Asian economic integration is a challenging task but achievable. Each step toward closer integration will require innovation, leadership, and support from major economies. Asia is poised to take these steps.

Although the region currently faces global shocks and risks, its economies are sound and have strong fundamentals. Asian nations have strengthened cooperative relations with each other and with other global centers. We are all becoming more confident about the potential of Asian regionalism to contribute to both Asian and global welfare.

All this favors the emergence of a strong, prosperous, outward-looking Asian economic community, regionally integrated yet globally connected. Asian regionalism is a partnership that can ensure the region’s continued, peaceful progress, and help power its shared prosperity and that of the global economy.

I look forward to your questions and the panel discussions that follow, to glean from you a better understanding of how we can all work together as we move forward on the path toward a more integrated Asia.

Thank you.