



**Conference on
Global Financial Crisis: Regional Cooperation and Architecture**

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Welcome Remarks

by

**Masahiro Kawai
Dean
Asian Development Bank Institute**

Distinguished guests, ladies, and gentlemen. Good morning. Let me express my gratitude to all of you for taking time off from your busy schedule to participate in ADBI's conference on the ***Global Financial Crisis: Regional Cooperation and Architecture***.

Today's conference will address various implications of the global financial and economic crisis for the development of regional cooperation and architecture in Asia. Let me provide three background factors behind today's conference.

First, even though the crisis did not originate in Asia, Asian economies have been hit hard by the downturn in export demand, and, in some cases, by turbulence in foreign exchange and capital markets as a result of a sudden withdrawal of capital. Exports have declined sharply, often by 30 to 40% year-over-year in many Asian economies, although most are now showing some signs of recovery. Many Asian economies responded with aggressive measures to ease monetary and fiscal policy and to support financial systems. However, these responses were largely national and uncoordinated. We must assess the need for additional policy responses at the national level, and the need for regional cooperation for policy responses, economic management, and macroeconomic and financial stability.

Second, the global financial architecture that evolved in the postwar period, with the establishment of the Bretton Woods institutions—the International Monetary Fund (IMF) and the World Bank—has reached a turning point. Big changes have taken place because of the

rapid financial globalization and the emergence of BRICs (Brazil, Russia, India, and China) in the global economy and finance. The whole architecture needs to be rethought from the ground up, including the mission and governance of various international financial institutions such as the IMF, the need for more effective global economic and financial surveillance, the role of the Financial Stability Board in its coordinated supervision of systemically important international banks and other institutions, and the need for a stronger framework for macroeconomic policy coordination at the global level. These issues also require consideration of which regional institutions are necessary to support the global efforts, and how they should relate to both national and global institutions.

Third, Asian economies benefited tremendously from export-led growth centered on US and European markets in recent decades. This growth model can no longer be relied upon to sustain the region's economic growth beyond the crisis. I believe US consumer spending will remain sluggish over many years to come, and this will be a structural phenomenon, not a temporary one. US personal consumption was excessively large until mid-2008 because households spent too much as a result of the inflated housing equity produced by the housing price bubble. The US consumption to GDP ratio historically was about 66–67%, but it has gradually risen to 72% over the last ten years. This over consumption in the US is now likely to be adjusted, and I expect that the consumption to GDP ratio will drop about five percentage points back to its historical norm.

Asian economies need to adapt to this more difficult environment and to take up the challenge of rebalancing growth toward greater reliance on domestic and regional demand. Policymakers in Asia should focus on three essential areas:

- Structural measures to strengthen household consumption will be the first priority, particularly the strengthening of social sector protection systems—including those for health, education, unemployment, and pensions—to reduce household needs for precautionary savings.
- The second priority should be to stimulate the supply side, particularly the services sector so that domestic production is better aligned with domestic demand. This can be done through promoting not only the traditional services sector, but also green growth focusing on renewable energy development, energy conservation, and environmental improvements. Small and medium-sized enterprises often play a significant role in these areas.
- Third, regional market integration is essential to encourage regional trade in goods and services, and liberalization of cross-border investment, thereby enhancing the potential for long-term growth in Asia. Integration of financial markets is also crucial to mobilize

the high level of savings within the region and promote investment spending in areas such as infrastructure.

While the challenges are substantial, the crisis could be an opportunity for Asia to fundamentally restructure its approach to development and bring about a more sustainable, balanced growth. This presents a new development paradigm for Asia where Asia could become not only a major source of goods and services in production, but also a major source of demand. Without intensive policy cooperation and architecture building among Asian economies, this rebalancing cannot be achieved.

First, fiscal policy can play an important role in facilitating a new development paradigm by focusing on areas of long-term growth. Some part of fiscal policy may be directed to stabilizing output and employment in the short term through support of consumption and investment. But a substantial part of fiscal resources should be directed to laying foundations for long-term growth through, say, the building of credible social sector protection systems and the promotion of green industries. If Asian economies can jointly embark on these initiatives, the actions can provide not only simultaneous fiscal stimulus but also a stage for future sustainable growth.

Second, creation of an Asia-wide free trade and investment area going beyond the ASEAN Free Trade Area and Investment Area can contribute to the goal of rebalancing growth. This initiative would expand markets for Asian firms and create greater business opportunities within the region. Currently, there is an array of overlapping bilateral and plurilateral free trade agreements in the region, posing the Asian “noodle bowl” challenge. Consolidation of the Asian “noodle bowl” into a single agreement is a high priority as it would enable Asian business firms to enjoy the benefits of freer trade and investment. In addition to goods trade liberalization, services trade liberalization is also critical as its growth can further expand regional markets and demand. Asian governments should take concrete steps toward establishing an Asia-wide Economic Partnership Agreement, while re-starting the Doha trade round.

Third, further deepening and integration of financial markets can also help support the region’s long-term growth. It facilitates the recycling of Asia’s high savings for investment, particularly when capital flows from other regions are shrinking. Further development of Asian bond markets—through the establishment of a credit guarantee and investment mechanism to provide credit guarantees for local-currency bond issuance—is key to the acceleration of domestic currency financing of investment. A recent study by ADB and ADBI

recommends the creation of an Asian Investment Infrastructure Fund as a mechanism by which infrastructure projects in the region can be prioritized and funded. Setting up an Asian Financial Stability Dialogue, designed to facilitate policy coordination for financial sector stability and development at the regional level, will be critical in complementing the global effort to strengthen cross-border financial supervision and regulation through the Financial Stability Board.

Fourth, regional economic surveillance and regional reserve pooling—under the Chiang Mai Initiative (CMI)—is a potentially powerful mechanism to complement the global role of the IMF. The recent agreement by ASEAN+3 finance ministers to set up a surveillance unit is a positive step for effective regional economic surveillance. Once the CMI multilateralization (CMIM) is fully implemented and the effectiveness of regional surveillance improved, CMIM may be de-linked from IMF programs. A credible CMIM is essential to support the rebalancing process of the Asian economies, as the reduction of current account surpluses needs to be met by the reduced desire of individual economies to accumulate foreign exchange reserves. As growth rebalancing will probably be accompanied by a weaker US dollar, East Asian economies should undertake greater exchange rate policy coordination to avoid intra-regional currency misalignments.

Finally, given the size and scope of potential regional integration measures, there is an urgent need to analyze the politico-economic aspects of the integration process. It is important to assess the costs and benefits of such an activity, as we need to understand why progress of some aspects toward regional economic and financial integration in Asia have been slow compared with developments in Europe, to develop recommendations for easing various roadblocks to integration, and to offer key insights and advice for Asian policymakers to facilitate regional integration and cooperation.

I believe that all of these important issues will be debated here in today's conference. Hopefully, these discussions can point toward key cooperation measures and institutional developments that can be taken by Asian governments to achieve balanced and sustainable economic growth for all. I thank you for your kind attention.