



Opening Remarks

by

Masahiro Kawai

Dean and CEO

Asian Development Bank Institute

Trans-Pacific Rebalancing

A Conference Jointly Organized by

The Asian Development Bank Institute and The Brookings Institution

Tokyo, Japan

3–4 March 2010

Distinguished guests, ladies and gentlemen, good morning.

It is my pleasure to welcome you all to this conference on **Trans-Pacific Rebalancing**, which is jointly organized by the Asian Development Bank Institute (ADBI) and the Brookings Institution. For those who come from abroad, let me also warmly welcome you to Tokyo.

As you may already know, the debate over the global payments imbalance has been raging for a while and has intensified since September 2008 as the global financial crisis deepened and took its toll on the global economy. Many in the West take the view that the global payments imbalance was the primary cause of the global financial crisis. However, many in Asia disagree with this view and instead point out to policy mistakes made in the United States (US) and Europe as the primary cause of the crisis. This debate has not been resolved yet.

Global Payments Imbalance

Let me say a few words about the global payments imbalance and payments imbalances in the US and Asia, which the papers in the conference will discuss in greater detail later today and tomorrow.

The global payments imbalance from the late 1990s and throughout most of the 2000s was driven by the US current account deficit, on the one hand, and by Japan's and more recently, China's current account surpluses, on the other hand. The global imbalance peaked in 2006 when the US had a current account deficit of 6% of its GDP.

The domestic counterpart of the current account imbalance is the savings and investment imbalance. In the US, savings and investment have been declining as a trend since the 1980s, and savings have always been lower than investment. In Japan, the opposite holds true, with both savings and investment also trending downward since the early 1990s.

In China, there was an impressive growth in savings from the early 1980s up until the early 1990s, and then a decline thereafter. More recently, however, savings as a percentage of GDP have started to go up, reaching more than 50%. The investment to GDP ratio has also been very high close to 45%. Essentially, in China, both investment and savings have risen to high levels, and savings have been always higher.

In Asia's tiger economies—including Hong Kong, Korea, Singapore, and Taipei, China—the investment to GDP ratio went up to more than 30% before the Asian financial crisis of 1997, and then declined thereafter. However, the savings ratio has been mostly above the investment ratio.

The four ASEAN countries of Thailand, Malaysia, Indonesia, and the Philippines were severely hit by the 1997 Asian financial crisis. There was a massive drop in investment from about 35% of GDP to close to 15%. Although the investment ratio has trended up recently, it is still less than 25% of GDP. Even though it is unrealistic to expect the investment ratio to return to the precrisis level which was perhaps too high, recent investment activity has been well below the historical norm. The savings ratio has been relatively stable and has been well above the investment ratio since the Asian financial crisis, thereby leading to a current account surplus.

The Middle East is an oil producing region. Recently, savings have shot up as a result of oil price hikes. On the other hand, investment has been relatively stable. The primary

cause of the current account imbalance in the Middle East is, therefore, the rise in savings which are closely correlated with oil revenues.

In Europe, a close association exists between savings and investment. Although there are imbalances across countries within the region, Europe as a whole does not have a significant imbalance.

Everyone now agrees that the large global payments imbalance is unsustainable. The ongoing global financial crisis is forcing adjustment to trans-Pacific payments imbalances, but in a disruptive way accompanied by a sharp contraction of economic activity and rising unemployment. This is clearly not a desirable way of reducing imbalances. In addition, almost all governments—including the US and in Asia—have expanded fiscal deficits, which will eventually have to be unwound once private sector-led economic recovery is firmly in place. From a medium-term perspective, various structural policy measures will be needed to ensure that this rebalancing process promotes growth in both regions in a sustainable way. The reason is that trans-Pacific rebalancing should not simply mean a reduction of current account imbalances; it should mean achieving stable, sustainable growth with domestic and external balance. It is from this perspective that ADBI and the Brookings Institution have developed a joint research project to examine factors that could achieve balanced, sustainable growth in the two regions—the US and Asia—and the policy implications of these adjustments in both regions.

Let me outline briefly the major issues being addressed in the research project and will be discussed in the conference today.

The Issues

The research project focuses on several issues including the appropriate level of domestic savings-investment imbalance, the scope for structural policy measures to affect these imbalances, and the magnitude of exchange rate changes required to switch the allocation of demand between domestic and foreign sources and of supply between tradable and nontradable outputs. Of course, the specific issues confronting the countries in both sides of the Pacific could be different.

For the US side, a key issue is how a more balanced current account can be restored and, thus, stable, sustainable economic growth can be achieved. A lingering question is whether US consumers will revert to their previous pattern of low savings once the economy recovers, and what policy measures would be needed to prevent this recurrence. A further, related question is the expected trend growth rate of the US economy going forward. It is also important to identify the impact of unwinding the expansionary fiscal policy on the adjustment processes both in the US and in Asia. This question has to be cast in the context that Asian policymakers will also have to return the fiscal policy stance back to normal. The contribution of exchange rate adjustment to rebalancing demand and supply needs to be considered as well.

Turning to Japan, although the current account is shrinking and is expected to be subdued due to aging and low household savings, its prospective trend growth is low. Not only has growth been heavily dependent on exports over the past six to seven years, but the labor force is declining due to the advanced stage of population aging. Consumption growth is also stagnant. Areas of importance are the rising distribution of income away from labor (households) towards capital (firms), and the weak social security reform in a rapidly aging society, whose correction and reforms would be essential to the healthy growth of household consumption. Like many other Asian nations, the greatest potential for raising productivity lies in the services sector, where productivity levels are still low relative to manufacturing. Despite a program of deregulation, there remain many regulations, restrictions, and inefficiency, raising costs of operation in services such as healthcare. Green industries broadly defined may provide support for growth. Japan is one of the most energy-efficient countries in the world, has high levels of technological expertise in non-conventional energy sources such as solar and nuclear energy, and has achieved high levels of environmental improvement. A key challenge is to connect Japan's economy with emerging Asia and benefit from its dynamism, which requires further opening of the Japanese markets. A priority list for deregulation, liberalization, and industry promotion needs to be developed to revive economic activity in a rapidly aging society in Japan.

The main challenge for China is to reduce dependence on net exports—targeted at US and European markets—for economic growth. This chiefly involves dismantling current incentive structures that bias production toward enterprises and exports. In addition, our

analysis must focus on the fact that Japan and Asian tiger economies are using China as their export platform targeted at the US and European markets, implying that collective efforts may be needed among the Asian economies to reduce China's current account surpluses. Another challenge is to find ways to expand the share of household income and consumption in GDP and obtain a greater contribution to growth from this segment. There are three broad approaches here: redistributing income from the corporate sector to the household sector; redistributing income away from the rich (those in the coastal urban areas) to the poor (those in rural areas and inland provinces); and adopting policies to reduce precautionary savings of households.

Export-dependent Asian tiger economies suffered most from the abrupt shrinkage of external demand since the share of manufacturing trade in GDP was high, although they were competitive suppliers of parts and components needed for final assembly in China and elsewhere. If export-led growth—targeted at US and European markets—is hampered, what are their choices for their economic growth? Perhaps, for small open economies like Hong Kong and Singapore, international trade is a key part of their growth and there is only limited scope for domestic demand-led growth. Taipei, China is likely to deepen integration with the Chinese economy. Korea does not have a large current account surplus, and its challenge is similar to Japan's; how it can promote domestic demand in an aging society, while improving productivity in the services sector.

ASEAN as a group has an economy whose size is comparable to India's and should therefore be considered an economic powerhouse in Asia. Like the rest of export-reliant economies, some ASEAN countries—like Malaysia and Thailand—have also suffered from shrinking external demand. ASEAN may need to reconsider its export-dependent development strategy to cope with changes in the US and European markets and neighboring Asian economies' development paths. Unlike the Asian tigers, a few ASEAN member countries—such as Indonesia and Viet Nam—have relatively large potential domestic demand. A fundamental issue is whether ASEAN members can continue the outward-oriented growth strategy that has been so successful, or they will have to alter their development strategy towards domestic demand. ASEAN should at least focus on investment stimulus—through improvements in investment climates and promotion of public infrastructure investment—as its investment has not recovered since the Asian financial crisis.

At first blush India seems not relevant to the issues on trans-Pacific rebalancing because the country does not have the surpluses as other Asian economies have. However, India can provide a model for other Asian economies aiming to rebalance growth since it has a relatively low ratio of exports to GDP and also has a high contribution to growth from the services sector. The reasons for the relative success of the services sector in India need to be assessed, and policy lessons should be developed for East Asian economies. At the same time, India has a huge internal market, which is still ill-served due to the lack of developed infrastructure for transport and distribution networks.

Intra-Asian and Trans-Pacific Cooperation

Finally, there is a need to explore cooperative mechanisms to effect a smooth adjustment in both the US and Asian economies. This could include a discussion of the roles of *both* intra-Asian economic and financial cooperation *and* trans-Pacific economic cooperation.

I am sure that all these issues will be debated in the conference and I look forward to a very fruitful discussion.