

**WORKSHOP ON
ASIAN ECONOMY AFTER THE GLOBAL FINANCIAL CRISIS**

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Luncheon Speech

By

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Distinguished guests, and ladies and gentlemen! It is a great honour to have the opportunity to deliver a speech here today. Before I begin, let me first thank, Mr. Duck-koo Chung, Chairman of the NEAR Foundation, and Dr. Masahiro Kawai and ADBI, for giving me this invaluable opportunity, and more importantly, for being the inspiration for the idea of Asian integration.

Today's subject, the Asian Economy after the financial crisis, is both most relevant and significant in view of recent events in the global economy. Today I would like to approach this subject from a larger and longer-term perspective, as details will be discussed by the experts gathered here today.

Let me start by quoting a couple of names, and ask you to think about what they have in common. Jim Rogers, a self-made entrepreneur, Anthony Bolton, a legendary fund manager from Fidelity, (Michael Geoghegan), HSBC CEO, and finally Stephen Roach from Morgan Stanley. Yes, they all moved to Asia, except Stephen Roach, who moved from Hong Kong to Yale, and yet the purpose of his move was to wake up a new generation of Americans to the

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growing might of Asia. Yes, these are people who all believe the future is in Asia. Nothing is stronger than the idea whose time has come. And Asian integration is the idea of the times.

For the last couple of centuries, the West has been at the center of the world economy and civilization. The progress of the Western Ascendancy, however, seems to have paused, while the last 20 years have witnessed “the rise of the rest.” The collapse of the Berlin Wall in 1989, the election of the reform-minded government in India in 1991, and the acceleration of China’s transition to a market economy in the early 1990s all worked together to fundamentally and structurally change the geography of the global economy. 2.5 billion people with 1.5 billion workers (1.2 billion from Asia) were integrated into the market economy. This doubled the number of workers in the global economy, and halved the capital/labour ratio. While often not fully appreciated, the economic impact of this transition is as large as that of the geographical discoveries of the 15-17th century. While the initial impact of this tectonic shift was wage repression and a jump in the number of low cost imports into Western economies, other impacts began to be felt in the financial area, turning many emerging economies from net-debtors to net-creditors. And Asia, particularly China, has been at the center of this historical transformation. One estimation shows that Chinese vendor financing has lowered the short-term interest of the US by 140 basis points in 2004, and another estimation says that cheap exports from China to the US is equivalent to giving \$1,000 every year to every household in the U.S.

Whether you agree with the concept of the Asian Century or not, it is undeniable that Asia’s relative economic importance in the global economy is increasing every moment, driven mainly by the rapid catch-up of China and India, and increasingly by other economies in the region. Many experts are competing among themselves in predicting when China’s GDP will

overtake that of the US. In fact, Asia's share of the world economy will be around 50% of the global economy before 2030, from the current one third. While this phenomenon of rapid catch-up is amazing, it is interesting to note that from an historical point of view this is nothing but a resurgence of a very old trend. Asia has accounted for more than half of the global GDP for 18 out of the last 20 centuries. Once again, the world is definitely tilting toward Asia, and will continue to do so, as Harvard historian Niall Ferguson has pointed out. It is really thrilling to know that you are living at the forefront of history, particularly on the winning side for a change.

And the current crisis, if anything, further confirmed the inexorable force of this historic trend. While experts are arguing about disintegration to integration and back to disintegration of the Asian economy from overall global economic performance, it is clear that the Asian economy has not only far outperformed that of the OECD countries, but has also provided the necessary boost to the world economy to overcome the current crisis. Around 7% growth both in 2010 and 2011 will be necessary to maintain global growth of over 4% during this year and the next.

And yet it would be premature to be complacent about the future. We have to be able to answer some hard questions before we let the success go to our head. In this light, let me share some of my ideas that are directly relevant to today's subject. First whether the current trend is sustainable, and secondly, whether we have the corresponding governance system, and finally how to further accelerate the integration of the Asian economy. These are, of course, all interrelated questions.

First and foremost, will this trend be sustainable in a broad sense, and will the export-oriented model or massive current account surplus be sustainable? To me, the historical trend of Asian resurgence is unstoppable, as long as Asia as a whole can maintain political stability and adapt wisely to new challenges, including climate change. The booming current account surplus of some Asian countries, however, is a different matter. The export-led model is inherently unstable and increasingly unsustainable as Western countries pursue austerity policies. Asia as a whole should develop the second engine of growth, “domestic demand.” If we want to progress far, we have to progress together, so that the “rise of the rest” should not be viewed as the “decline of the West”. China, we know, requires socioeconomic adjustment to encourage its vast base of consumers to spend more in addition to macroeconomic policy change. Recent incidents of labour strikes for wage increases in coastal China, if anything, can be a good sign that domestic demand will be expanding, and growth will be more balanced. Many smaller Asian economies, on the other hand, need to increase investment, which fell substantially after the Asian financial crisis, rather than consumption. Regional infrastructure projects can offer good opportunities and there is room for regional sovereign wealth funds to play a role. Another important element of macroeconomic adjustment, of course, is to address the volatility of capital flows which encourages reserve accumulation as insurance against this volatility. Here I do hope that the ongoing talk of a financial safety net in the G20 will provide some institutional improvement to reduce the need for this self-insurance. This leads me to the issue of global governance.

As for governance, we have to look at both external and internal institutionalization. It is deplorable that Asia, with the exception of Japan, has been largely excluded from the global economic governance system, despite its sterling achievements during the last decade. G 20 offers the best hope in this regard. It is no coincidence that the Seoul Summit adds two new

issues to its already heavy agenda , the financial safety net and development, which aims to address the difficulties of many emerging and developing economies, including many Asian countries. Thus it is imperative to make the G 20 with five Asian countries represented a more permanent feature of global economic governance as the premier forum for economic policy coordination. Recent discussion of setting up a permanent secretariat is welcome progress in the right direction. Likewise, Asian countries should collectively spare no efforts to raise their quota and their voices in correlation to their economic might in the IMF, by making sure that the promised transfer of a 5% quota from overrepresented countries to underrepresented ones does happen by the G 20 Seoul Summit. As Korean ambassador to the OECD, let me also point out the need to encourage China, India and Indonesia to expand their participation in the OECD. Under the so-called EE5 Initiative, China, Indonesia, and India are being actively courted by the OECD to expand their participation in the OECD, with an eventual membership in sight since 2007. So far, it has been a case of unrequited love despite some progress. And yet these countries should ask themselves whether it would be better to participate in the decision making process or to be at the receiving end of decisions taken.

Another important aspect of governance is the strengthening of the regional economic governance system. Here many experts point out the lack of internal institutionalization as one of major reasons that the idea of the Asian Century is premature. Some even go as far as to say that Asia is a geographical accident. To put it simply, Asian people would not root for, say, the Bangladesh soccer team in the World Cup, as Africans rally for the Ghana soccer team. For me, this fact is all the more reason to hasten institutionalization. While the CMM offers the best hope, it still needs to go a long way to become a permanent structure such as the AMF with real discipline, resources and teeth. For the time being, we have to focus on

building up a strong regional surveillance system, and the OECD's peer review system can offer a valuable model for this mechanism.

Finally, the issue of further integration. In the real sector of trade and investment, the volume of internal trade has been increasing, with China emerging as a major source of import demand. Accordingly, various FTAs are blooming in the region, creating a noodle bowl of FTAs. Two comments are in order. In terms of sheer size and sweeping coverage, discussion of a bilateral or trilateral FTA between China, Japan and Korea should be expedited with the goal of extending it later to include all ASEAN plus 3. Another comment concerns the huge potential of South-South trade. Between 1990 to 2008, South-South trade multiplied more than 10 times over, while world trade expanded only four times. Now South-South trade accounts for around half of developing countries' trade volume, and there are huge potentials to tap.

As for the more difficult issue of monetary cooperation, and an eventual introduction of common currency, I believe a lot would depend on the progress of integration in the real sector, the evolution of the international reserve system, and political commitment. For example, there is a fundamental question of whether Asia fits the conditions of OCA. As the Euro clearly demonstrates, monetary integration is not only a long term process demanding strong political commitment, it eventually involves giving up some sovereignty from its participants. Will Asian countries unite to overcome many political difficulties such as disputed territories, different political systems, and heterogeneous cultures in order to form a common currency area backed up by common resource ? Will Asia be ready for it in the next 20 years, or 30 years? These are fundamental questions to address. Of course, this does not mean that we should not think about it or discuss it. Quite the contrary, we should let a

hundred flowers bloom on this issue. In the meantime, let me also raise another critical issue: recycling of financial resources in the region. While Asia currently holds two thirds of the world reserves, Asian currencies only make up 3%.of international reserves. The fundamental anomaly is that the bulk of Asian reserves are invested in advanced countries at huge costs, while many Asian firms are borrowing heavily from abroad. This makes Asia vulnerable to volatile capital flows. Credit enhancement of regional bonds which would facilitate the recycling of reserves within the region is a largely underexploited area with huge potential. I have high hopes that a credit guarantee fund, and the ABMI initiative can make a breakthrough in this area. The increasing tendency of sovereign wealth funds to invest in the real sector of Asia is another area to further develop. These developments, if encouraged, with the ~~expected~~ ongoing discussion to mitigate the volatility of international capital flows, will either reduce the need for a common currency or make it easier to come up with one when necessary.

Closing

History belongs to the dreamer. While we cannot hurry history, we should be ready to catch its hand, when opportunity beckons. To make our dream come true, we need visionaries with insight and courage, and academics with knowledge and wisdom, and most of all, unwavering commitment to our shared destiny. I hope today's seminar will go a long way in achieving faster Asian integration.

Thank you.