

A View from Japan of Asia's Impact on Global Economies

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During the last couple of decades the world economy has observed several developments of historic importance. The first was the emergence of the US economy as the single hegemonic superpower which was supported by military, diplomatic, technological, cultural and ideological might. The second was the creation of the European single market and the single currency. After fifty years of untiring efforts sustained by a strong political leadership Europe has made a historic achievement. Europe has created a huge and a strong economic bloc comparable to the US. The third was the phenomenal emergence of China as a world economic power. Under the remarkably skilful policy of opening and reform the Chinese economy, in twenty-five years time, has become a global centre of production, consumption and trade.

It is also important to recognize that these phenomenal developments have occurred on top of the change took place in the modus operandi of the world economy. With the collapse of the Soviet Union the economic system based on the market mechanism established the undisputable supremacy over the centrally-planned economy. Also, there was the informations revolution. Thanks to the revolutionary progress made in the informations technology such as internet and e-mail all consumers, shareholders, producers, traders, and voters are now able to make access to all sort of informations simultaneously and instantly. It changed the entire economic process of R&D, production, distribution and consumption. It made the global competition the order of the day. It also made such requirements as transparency, accountability and efficiency the rule of the game for the economic management. We need to recognize fully that these changes are irreversible. They will stay with us from now on.

Now what will happen to the world economy in the coming three decades? Admittedly it is not possible for anyone to foresee the world in thirty years from now. However, If I extrapolate what I see today into the future three things seem to be relatively certain. First, the US will still be the most powerful economy. However, its hegemonic status of today will have passed its apex and will have started a long and slow process of decline. The biggest concern of the US economy is obviously its ever growing budget deficit and current account deficit as the symptom of the excess consumption of the economy. The deficit is creating an increasing dependence on foreign financing and mounting external indebtedness. It will incur the ballooning debt service burden. Also, the hollowing of manufacturing, particularly in the consumer-related sectors, will make the US economy more vulnerable to external developments. Of course, the strength of the US economy will be hard to die. The US is still a relatively young country with the population growing and approaching 400 million by the middle of the century, the third largest after India and China by that time. Also, the US market will most likely remain as the biggest, the most open and the most competitive. A remarkable feature of the US market is that it is, compared with other markets in the world, better equipped with effective mechanism of self-correction which will function whenever the market goes astray. Thus, I reckon the US economy will remain as the leader of the world in the year 2030, but the relative decline of its hegemonic status will make the world economy less stable. Needless to say, if an abrupt adjustment is triggered its disruptive impact on the global financial market will be enormous.

Second, the situation of the EU in thirty years time seems less certain than that of the US. The EU is endeavoring to deepen and widen its integration and progress is being made, albeit slowly. However, fact remains that more they try to deepen and widen their integration more problems emerge to confront them. The structural reforms, if any, particularly in the labor market are progressing at a snail's pace. The fiscal

discipline, a core for an economic integration, is faltering. The clear sign of an improved competitiveness and a higher growth of the region's economy is yet to be recognized. It seems to be still premature to declare that the EU is on a solid track toward developing into a real global economic power which can overtake the hegemonic US economy. However, what is clear and important about the EU is that the process of the European integration will not collapse and that there will be no war in Europe anymore.

Third, the role of Asia in the global economy will certainly be further enhanced. Indeed, the presence of Asia has kept growing since the 1960's. In the 1960's Japan made a remarkable recovery from the destruction of the World War II. Implementing ambitious and successful programs such as the "Income Doubling Plan" Japan rebuilt its economy and made it the second largest in the world with highly competitive manufacturing industry. In the 1970's, so-called NIES, newly industrialized economies including Taiwan, Korea, Singapore and Hong Kong, started to grow rapidly by way of establishing and strengthening export-oriented light manufacturing industries. They were often dubbed as Four Tigers of Asia. In the 1980's other Southeast Asian countries in the group of ASEAN started their take-off. In fact ASEAN was formed as early as in 1967. However, its economic development as a sub-regional bloc was not quite remarkable due to the conflict of national interests. Since the 1980's, encouraged by the roaring four tigers and supported by surging foreign direct investment particularly from Japan, ASEAN countries embarked upon a rapid export-oriented and government-led process of industrialization. Then, in the 1990's China joined the Asian surge. The combined force of 1.3 billion population, strong leadership and dynamic entrepreneurship has propelled China up to the position of a world centre of production, consumption and trade in just a matter of twenty-five years. Now, in the 2000's we see India is looming up over the horizon as the leader of West Asian economy. The dynamic development as such will tell us that in three decades from now the presence of Asia will be most likely greater than it is today.

Why we can be optimistic about the future of Asia? What are the factors which will continue to support Asia's growth which is faster than that of North America and Europe? Obviously, Asia's starting line was considerably lower than that of others' thus leaving a larger room for future growth. While situation differs from one country to another it is fair to say that in most of Asian countries there is a strong national aspiration for development which can generate a mighty upward momentum particularly when it is organized effectively by the political leadership. The labor force in Asia is generally young and motivated. Most of Asian countries welcome the introduction of foreign capital and technology. With all these factors combined Asia has a unique potential to continue to be the most dynamic region of growth in the coming decades.

On top of it, the important development which has been emerging strongly in East Asia, which is now defined as ASEAN + 3, in recent years is the movement toward a regional integration. Let me, at this point, elaborate a bit the current situation and the future prospect of the process of the economic integration in East Asia.

East Asia is recapturing the global attention as a dynamic growth center. China is still booming, Japan is recovering from the ten years of quagmire, and other economies in the region are, by and large, demonstrating a strong resilience which was severely tested during the Asian crisis of 1997. Today, the share of intra-regional trade in East Asia is close to 60%. Against the backdrop of the overall recovery the process of the economic integration is progressing gradually but steadily. There are four major areas where we see the biggest activities. First, the FTA (Free Trade Agreement), both bilateral and multilateral, in the region is proliferating. Second, the network of bilateral currency swap-arrangements between central banks in the region has almost been completed with sixteen of such arrangements amounting to \$ 40b. Further enlargement, institutionalization and enhancement are being studied. Third, the idea to create and develop regional bond market (Asian Bond Market Initiative) is expeditiously studied and negotiated at several fora, both official and private. The group of central banks in the region (EMEAP) has successfully launched the pilot project of an Asian Bond Fund.

Fourth, the idea of creating an Asian Common Currency is actively studied at various fora.

The motives behind the move toward integration are fourfold. 1) The first is to fortify the region's growth potential so that the region can play a leading role in the global economic development as one of the three pillars together with Western Hemisphere and EU. There is a strong sense of concern in the region that the steady progress of integration both in EU and Western Hemisphere may, before long, create a situation where the two giant blocs dominate the world economy while East Asia is either swallowed up or marginalized by them. Therefore, if East Asia wants to play independent and meaningful role in the global economy East Asia must step up its own process of integration so that it can make its voice heard in the global scene. 2) The second motive is to strengthen the financial system in the region. It is well known by now that the Asian crisis of 1997 was prompted by the weakness of the financial system, i.e. the unhealthy balance sheet and poor governance of banks, ineffective and corrupt regulatory apparatus, and underdeveloped market infrastructure. It is deemed imperative to develop and strengthen the financial system of the region in order to avoid the recurrence of the financial crisis. 3) The third motive is to make a better use of the region's own savings. East Asia is known for its high savings ratio over 30% of GDP. So far, however, the East Asians are investing the bulk of their savings in dollar or Euro denominated instrument of various kinds. Then, the money is recycled back to East Asia by American and European corporations and institutional investors in the form of direct investment and portfolio investment. In other words, although East Asia saves a lot, East Asia is not the master of its own savings. So far, the East Asian savings had to make a detour because of the lack of efficient and effective instruments, players, and markets. It is natural to see a growing aspiration in East Asia to make a better and more direct use of its savings for the development of the region. 4) The fourth motive behind the Asian integration is the growing concern about the dollar. The U.S. current account deficit is growing ominously. It has exceeded 5% of GDP and the net external deficit of the U.S. is now well over 2.5 trillion dollars. As the result, the future of the dollar is increasingly uncertain. Yet, the East Asia's dependence on the dollar is dangerously high. Today, Asian countries are investing well over 1.5 trillion dollars of their official reserves in U.S. Treasury bonds. This situation needs to be rectified and the ultimate solution will be to have Asia's own international reserve asset, which is the common Asian currency.

While the economic integration in Asia is desirable and necessary and the increasing Asian aspiration is indeed genuine and valid, when we compare the situation of East Asia with that of Europe or Western Hemisphere we have to recognize that the integration of East Asia is a daunting task. I can immediately think of three difficult issues East Asia is confronted with. First of all, members of East Asia are very much diverse in terms of size, stage of development, and background. It is crucial, although admittedly difficult, to generate a strong common recognition of the need and the desirability of integration. Secondly, East Asia must know that it is different from EU the structure of which is broadly horizontal with many members with comparable status. East Asia is different also from Western Hemisphere the structure of which is broadly vertical with the US as the dominant leader. Thus East Asia has to look for a stable structure of its own. After all, East Asia is a group of disparate members. The stable structure of the region as such can only be maintained by flexible and compromising posture on all side. The third hurdle for East Asia is that East Asia must foster much stronger political will to support integration. It is crucially important for East Asia to understand fully that the economic integration inevitably implies certain surrender of sovereign right and sacrifice of own interest. In the case of FTA the participating members must relinquish tariffs and import quotas maintained for the purpose of protecting domestic industries. If we want to create a workable regional monetary fund the first thing we need is the transparency of economic policy, the full disclosure of economic data, the comprehensive surveillance of economic performance and the willingness to accept peer pressure. Without some sort of institutionalized obligation built upon a strong sense of mutual trust the apparatus such as a regional monetary fund will not operate successfully. If we are to establish a regional bond market which can

attract issuers and investors globally we need to create an internationally standardized market infrastructure such as accounting, auditing, rating, clearing, settlement, legal procedure, etc. A single Asian currency requires the abandonment of national currency and the exchange control and other monetary measures to go with it. All in all, integration is a serious venture which requires not only a full work of preparation but also a firm commitment at the highest political level and the public will to support it. Frankly speaking this is what East Asia is still lacking seriously. It is strongly hoped that the recent sign of a growing awareness will lead to a solid and unfaltering commitment by the political leaders in the region.

It should be noted that the East-Asian economic integration so far is very much market-driven and not adequately institutionalized as in the case of EU. Also, the East-Asian integration is advanced mainly in the manufacturing but not in other areas such as finance, currency, legal practice and other services. Admittedly, the vast divergence among Asian countries will undoubtedly make the Asian integration much more difficult than the European integration. It must be a gradual and time-consuming process. Nevertheless, broad-based and mounting enthusiasm toward a regional integration will certainly add a strong momentum to Asia's dynamism.

All in all, I would argue that it is neither realistic nor appropriate to try to measure the success of East Asian integration using the same rigid scale applied in the case of Europe. East Asian integration ought to be a slow process. Its structure ought to be a soft and open one. At the same time I believe that, because of the very conditions as such, East Asian integration can well be more resilient and viable.

What is the major challenge which Asia must face during the process of its global ascendance? In my view it is the challenge of establishing a stable balance-of-power structure in the region. Toward the middle of 21c the broader Asia will have five major economic powers, i.e. Japan, China, India, ASEAN and possibly United Korea. The U.S. and Russia will remain as close neighbors. They will maintain strong interest in the region and will compete to exercise leverage. It is crucial for Asia's further development to secure a reasonable assurance of stability. Since Asia is still far away from political convergence we need to make deliberate effort to establish some sort of framework of stability. It is obvious that in the core of the framework there must be a peaceful and constructive relationship between Japan and China. The development of China during the last two decades was truly remarkable. China is already a major economic, military and diplomatic power in the world. Many people anticipate that by 2030 China will become the second biggest economy in the world and will assume the leadership role in Asia. Although the jury is still out on this prospect it is inevitable that there will be a rivalry between Japan and China. In this respect, both Japan and China must be aware of the following three points. First, neither Japan nor China can be the hegemonic and dominant leader in the near future. Both have strength and weakness. Second, hostile relationship between Japan and China is extremely damaging to the stability and harmonious development of the region. Third, Japan and China have so much to benefit from the friendly and cooperative relation as is clearly demonstrated by the recent spectacular strengthening of their bilateral economic interdependence.

The biggest problem with China is that while China is certainly a country full of hopes it is also a country full of risks and uncertainties. Since you must know all about the hopes of China I will not repeat them. Rather, I will enumerate some of the economic challenges for China. First, China has to resolve the dilemma between excess investment and adequate growth. The high growth of the Chinese economy is mostly supported by excessive investment which accounts for more than 40% of the GDP. The excessive investment is causing many problems such as excess supply of certain industrial products, severe environmental deterioration, shortage and high price of material and energy, etc. Investment needs to be curtailed. At the same time, however, China needs a high growth sufficient to create new employment. Second, the non-performing loans in the banking sector need to be reduced further. Although there were some improvements the level of NPL is still too high in many banks thus hindering

their sound operation. The reduction of NPL will eventually imply a large fiscal burden. Third, the excessive dependence on foreign capital and technology needs to be rectified. Although China's exports are growing rapidly almost 60% of them are conducted by foreign-affiliated companies. In order to make the growth more stable the indigenous industry needs to improve efficiency and competitiveness. Fourth, agricultural sector must be strengthened. The lack of farmland, low productivity and heavy tax burden are undermining the viability of Chinese agriculture. The large scale exodus of farmers who have no land, no job and no assurance is creating a serious source of social instability. Since it is expected that the process of urbanization will continue for many more years the strengthening of the agriculture is indeed a major challenge for China. Fifth, the widening inequity and the rampant corruption and economic crimes need to be arrested. The authorities are trying to improve the situation by means of public education and harsh punishment. However, as history tells us, the fundamental cure must be carried out at the level of the mind-set of the entire society. If the ominous trend goes unarrested it will endanger the social and political stability of the country.

In spite of all these serious challenges it is nevertheless clear that China is now in the phase of a historic national ascent. It is quite likely that China will continue to grow at least for another couple of decades and will become one of the major global powers and a leader in the Asian region. What is crucially important and desirable for Asia and the world is to see China assume such an important role as a peaceable, stable, and responsible partner. The Asian integration, which benefits all members in the region, will not be successful without China's partnership as such.

To put it more pointedly, the heart of the matter is whether China will eventually develop into a truly democratic country, i.e. a country which believes in the inviolable value of the plural political party system and the respect of individual human right, or will try to challenge that set of value standard by maintaining the dictatorship of the communist party and by restricting individual human right for the sake of collective stability.

Those who live in the industrial democracy, particularly in the US, tend to believe that the standard of value they abide by is the only viable standard of value for the human being and those who have not agreed to it yet will sooner or later come to covert themselves. However, I hope I am wrong to express my concern that sometime during the 21st century the industrial democracies may face a major challenge to their standard of value. The challenge may come from China and/or the Islamic world. If it comes it will certainly be more than matter of simple economics.

In practical term, if China becomes a great democratic country by our definition, Japan will feel comfortable to get along with China even as its junior partner. If not, however, Japan and other Asian countries for that matter will have to exercise a fundamental reappraisal of their future course of policy.

In concluding, I would like to summarize what I have argued today. Asia can and will develop further to play the role of one of three pillars of the world economy. With rapid development of China, India and other populous countries Asia will enhance its clout as a global centre of production, consumption and trade. In that process, the growing aspiration and the accelerating efforts to achieve a regional economic integration will play a key role. The Asian economic integration is a daunting task, it requires considerable amount of time and the strong concerted political will. The ultimate form of integration will need to be different from that of EU and Western Hemisphere. For the enduring prosperity of Asia a stable balance-of- power structure in the region will be a sine qua non which can be attained through a tireless effort based upon the sharing of common value and common objective among major countries.

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