

Towards Sustainable Growth of the Asian Economy

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Current Situation and Prospects of the Asian Economies

Rapid Recovery

The Asian economies were severely damaged by the Asian currency and financial crises, with many Asian nations posting substantially negative growth in 1998. In 1999, however, economic growth rates turned positive and V-shaped recovery was achieved.

The expansion of exports, the implementation of appropriate fiscal and monetary policies, and financial and corporate sector reform contributed to the recovery. The rise in demand for electronic goods due to the expansion of information technology (IT) has caused a surge in exports, which in turn has had a positive effect on economic activity through intra-regional trade in the Asian interdependent economic structure.

Japan's Aid to Asia

Japan has contributed to the recovery of the Asian economies through aggressive measures including the New Miyazawa Initiatives.

In October 1998, Japan announced that it would provide a package of support measures totalling \$30 billion, of which \$15 billion would be made available for medium-term to long-term financial needs for economic recovery in Asian countries, and another \$15 billion would be set aside for possible short-term trade financing needs during the implementation of economic reform.

Furthermore, in May 1999 Japan announced the “Resource Mobilisation Plan for Asia”, also known as the second stage of the New Miyazawa Initiative, to achieve full-scale, vigorous recovery in Asia. It consists of assistance measures to mobilise private-sector capital, the upgrading and promotion of Asian bond markets, and the provision of technical and human resources assistance.

Long-term Prospects and Problems to be Addressed by the Asian Economies

Strength of Asia's Economic Fundamentals

Asia's economic fundamentals, which supported high economic growth in earlier years, have basically remained unaffected by the currency crises. Indeed, Asian economies may well be able, through efficient resource allocation, to utilise their strong fundamentals to overcome the weakness of the financial and corporate sectors which was revealed in the crises.

The IT Revolution and Asian Economies

The long-term prospects for Asian economies will depend in part on whether Asian countries can make effective use of the merits of the IT revolution.

Cellular phones are spreading rapidly in Asia, and it is forecast that they will be widely used as Internet terminals. Although constructing good communications infrastructure is an important task for Asian countries, the diffusion of cellular phones offers a possibility to solve the bottleneck of the Internet.

The IT revolution will raise the efficiency of resource allocation by enhancing the volume, speed and scope of every kind of trading, and will make it possible to take advantage of the strong fundamentals and potential of Asian economies.

Upgrading of the Industrial Structure in the Asian Region

The high growth of Asian economies has been accompanied by upgrading of the industrial structure, as early developers are replaced by latecomers with a certain time lag. This chain brought continuous growth to the Asian economies for over 30 years, a sustained period of development which has not been seen in other regions.

Coping with Change in the Comparative Advantage Structure

To enhance the industrial structure by introducing foreign capital into Asian countries, it is important to shift from forming labour-oriented export production platforms, which utilise cheap abundant labour, to attracting corporations and industries which use high technology. Given the scale of the countries concerned, industrial development in each country cannot cover all industries; the countries of the region must therefore form technology networks in order to complement one another.

Increasing Interdependence in Asia

In ten major Asian economies (the four ASEAN nations, the NIEs, China and Japan), intra-regional trade accounted for 46 per cent of exports and 50 per cent of imports in 1997.

It is expected that interdependence in the Asian region will increase further with high economic growth and the expansion of the ASEAN Free Trade Area (AFTA), among other factors. The recent increase in interdependence in Asia shows that the region has entered a new phase in the international division of labour, based on expanding domestic markets and creating industrial networks.

Constructing a Stable Economic and Financial System

In the light of the Asian currency crises, it would be prudent to take measures to build a stable economic and financial system which is not vulnerable to any future currency crises, taking a three-dimensional approach: a global approach, an individual-country approach and a regional approach.

Strengthening the International Financial Architecture

The G-7 finance ministers submitted a report entitled “Strengthening the International Financial Architecture” to the Cologne economic summit. Efforts to implement the proposals in this report are being vigorously pursued in various fora, such as the IMF, G-20 and the Financial Stability Forum.

Measures Taken in Individual Countries

Financial and Corporate Sector Reform

Each Asian country has been energetically tackling financial and corporate sector restructuring; the non-performing loan ratio is declining; and gradual progress has been made in debt restructuring. However, there are still many outstanding issues to be tackled. The financial and corporate sectors need to be strengthened and restructured. In addition, the fiscal deficits arising from financial sector restructuring and other measures constitute a potential risk for the future.

Creation of an Appropriate Exchange Rate Regime

Each country decides on an appropriate currency system in the light of its individual circumstances, such as its economic scale, trade structure, economic situation, policy targets and so on. An appropriate exchange rate regime for Asian countries is an important issue because the previous exchange rate system, which was virtually pegged to the dollar, brought about unstable trade and excessive capital inflows.

Asian countries have a variety of partners — the United States, European countries and Asian countries including Japan — in their trade and other economic activities. One option, then, is to peg their currencies to a currency basket composed of the dollar, the yen, the euro and other currencies, each of which would be assigned a weighting according to the volume of trade and other economic factors, while retaining a degree of flexibility through a mechanism such as a sufficiently wide band.

Capital Liberalisation

Capital liberalisation measures must be properly sequenced in developing economies. Before these countries implement capital liberalisation, the domestic financial system must be shored up by strengthening prudential rules and supervision for financial institutions, along with sound macroeconomic management. The liberalisation of long-term capital should precede that for short-term capital. In particular, restrictions on foreign direct investment must be abolished as completely and as soon as possible.

Each country also needs to manage foreign debt risks. Obtaining better data on capital flows and foreign debt and improving the monitoring system are essential prerequisites for risk management.

Social Safety Net

An appropriate social safety net has not only the short-term effect of providing support to the poor, but also long-term effects which make it possible to take necessary risks to cope with changes in markets, and to promote productivity and economic growth by enabling poor people to invest in education and health services even during crises.

The government of Japan decided to make a contribution in this field by setting up funds for poverty reduction at the Asian Development Bank and the World Bank. These funds aim to provide basic social services for the poor and to support the capacity-building efforts of local governments and NGOs.

Co-operation in the Asian Region

Improvement of Bond Markets

It is important to have some mechanism allowing long-term capital to flow from capital-surplus countries to capital-deficit countries in the region. For this purpose, efforts to improve regional financial markets, including bond markets, are required.

Exchange Rate Stability

The virtually dollar-pegged currency systems which Asian countries had adopted before the monetary crises brought exchange rate stability to the region, which contributed to the development of intra-trading and intra-investment. However, the monetary crises clearly demonstrated the risks of such systems. Asian countries must seek a new, stable exchange rate mechanism to develop exchange rate stability in the region.

The AFTA is to be completed by 2018. The experience in Europe suggests that intra-regional exchange rate stability is essential for promoting trade and investment in a free trade area. One option would be to peg these countries' currencies to a common currency basket with a sufficiently broad band. Even if a strict common currency basket is not adopted, the concerted adoption by the ASEAN nations of a virtually basket-pegged currency system would contribute to exchange rate stability in the region.

Promoting Policy Dialogue

It is important to develop a relationship of mutual trust and to exchange frank views within the region through many fora on various levels, such as dialogue between the public and private sectors, bilateral and multilateral meetings, conferences and seminars.

In the "Joint Statement on East Asia Co-operation" issued by the ASEAN+3 (i.e. China, the Republic of Korea and Japan) leaders at their informal meeting in Manila in November 1999, they agreed "to strengthen policy dialogue, co-ordination and collaboration on financial, monetary and fiscal issues of common interest". This is a significant first step for promoting policy dialogue in the region.

Establishment of a Regional Financing Co-operation Network

In view of the deepening interdependence of Asian economies and the need to counter the contagion effects of financial crises, it is necessary to set up regional financial arrangements to supplement existing international financing facilities, including those of the IMF.

At their May 2000 meeting in Chiang Mai, Thailand, the ASEAN+3 finance ministers agreed:

- to use the ASEAN+3 framework to facilitate the exchange of consistent and timely information on capital flows;
- to strengthen the existing co-operative frameworks among monetary authorities through the “Chiang Mai Initiative”.

The initiative involves an expanded ASEAN swap arrangement covering the ASEAN countries, and a network of bilateral swap and repurchase agreement facilities among the ASEAN countries, China, Japan and the Republic of Korea.

Close co-operation among these countries, involving the use of a part of their foreign exchange reserves, will contribute to the stability of monetary and financial markets in the region.

Concluding Remarks

The currency and financial crises did a great deal of harm to Asian countries, but they also fostered a sense of solidarity in the region because people had common problems and sought solutions together. The crises may yet prove to have been an opportunity to strengthen regional co-operation and to establish a stable and prosperous Asian economy in the 21st century.