

**Asian Economy in a Global Context:  
Development, Integration, and Governance**

**Srinivasa Madhur**  
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**Lectures Given at the Graduate School of  
International Studies (GSIS), Seoul  
National University (SNU), Seoul, Republic  
of Korea  
March-August 2011**

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## Preface

These thirteen lectures were given by me in 2011 to the students at the Graduate School of International Studies (GSIS), Seoul National University (SNU), Seoul, Republic of Korea, when I was a Visiting Professor there. This course on *Asian Economy in a Global Context: Development, Integration, and Governance* was designed to familiarize the students on three somewhat intertwined dimensions of the subject – Asia’s postwar economic reemergence, regional and global integration, and role in global governance.

The course aims at giving students an overview of: (i) how successive economic miracles since the 1950s – starting with Japan and subsequently joined by many other countries at regular intervals – have enabled Asia to reemerge as a dominant force in the global economy, (ii) how economic miracles at the country levels have also led to a closer knitting of these economies both regionally and globally, and (iii) how Asia could leverage its historic reemergence and economic integration to play a bigger role in shaping 21<sup>st</sup> century global economic governance.

My efforts – both at designing and teaching this somewhat out-of-the-box course – were well worth it simply because of the extremely high quality of about 40 graduate students who took my course. About 25 of these students were Koreans, while the rest were drawn from the rest of the world – Australia, France, Germany, India, Mongolia, New Zealand, Slovakia, Spain, Thailand, and United States – a good mix of Korean and foreign. These students came with quite different academic backgrounds as well – economics, management, public policy, sociology, and political science, to name a few. I have kept this varied background of students in mind in pitching the technical economic jargons to the minimum, so that no student is left behind in the class. I have also used rather wordy and somewhat long sentences in the power point slides, departing from the global best practice of having fewer bullets and plenty of infographics, so that my young students could use these slides as a substitute for lecture notes. The presentations are also somewhat longer than usual, as the duration of classes at GSIS ran for three hours once a week.

Lecture 1 introduces the course, the reading requirements and the grading procedure for the students. Lectures 2 through 6 look at the analytics and empirics of postwar growth and development of Japan, the Newly Industrializing Economies, the ASEAN 4, China, and India in that order. Lectures 7 to 11 focus on four key dimensions of Asia’s regional integration – trade and production, monetary and financial, infrastructure, and institutions. Lecture 12 traces the postwar evolution of institutions and forums for global governance, while Lecture 13 wraps up the course by examining Asia’s role in 21<sup>st</sup> Century global economic governance.

I am indebted to many who enabled me in designing and delivering these lectures. First and foremost, my students at GSIS, SNU, who were such a competent and committed lot that they always encouraged me to think and rethink on many issues related to the subject of the course. Prof. Taeho Bark, who was the Dean of GSIS during 2010 was instrumental in hiring me for the position at SNU. Prof. Jin-Hyun Paik who succeeded Prof. Bark as the Dean of GSIS joined Prof. Bark in giving me continued support and guidance. I thank them for their help and encouragement. Ms. Minjeong Han, my Tutorial Assistant, provided able research assistance throughout the duration of the course. I should also thank the many faculty members at the GSIS who were always generous with their time for discussion, debate, and clarification on many issues covered in the lectures.

Srinivasa Madhur  
September 2011

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# **Asian Economy in a Global Context** **( *Development, Integration, and*** ***Governance* )**

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor

# Course Design

- Thirteen, three-hour lectures
- Lecture 1: Introduction and Asia Today, Yesterday, and Tomorrow
- Part I: Development (6 Lectures)
- Part II: Integration (5 Lectures)
- Part III: Governance (2 Lectures)



# Development

- Japan's postwar miracle (and later stagnation)
- The NIEs join the miracle club
- The ASEAN4 follow suit (and the other ASEAN countries catching up?)
- The China miracle
- India's late entry to the miracle club

# Integration

- Regionalization of production -- the genesis of Asian integration
- Monetary and financial cooperation and integration
- Infrastructure for Asian Integration
- Institutions for Asian Integration: why and what we have?
- Institutions for Asian Integration: what should and can be done?



# Governance

- The framework of global governance -- its historical evolution and the implications of the 2008 global economic crisis.
- Asia's future role and responsibilities in global economic governance

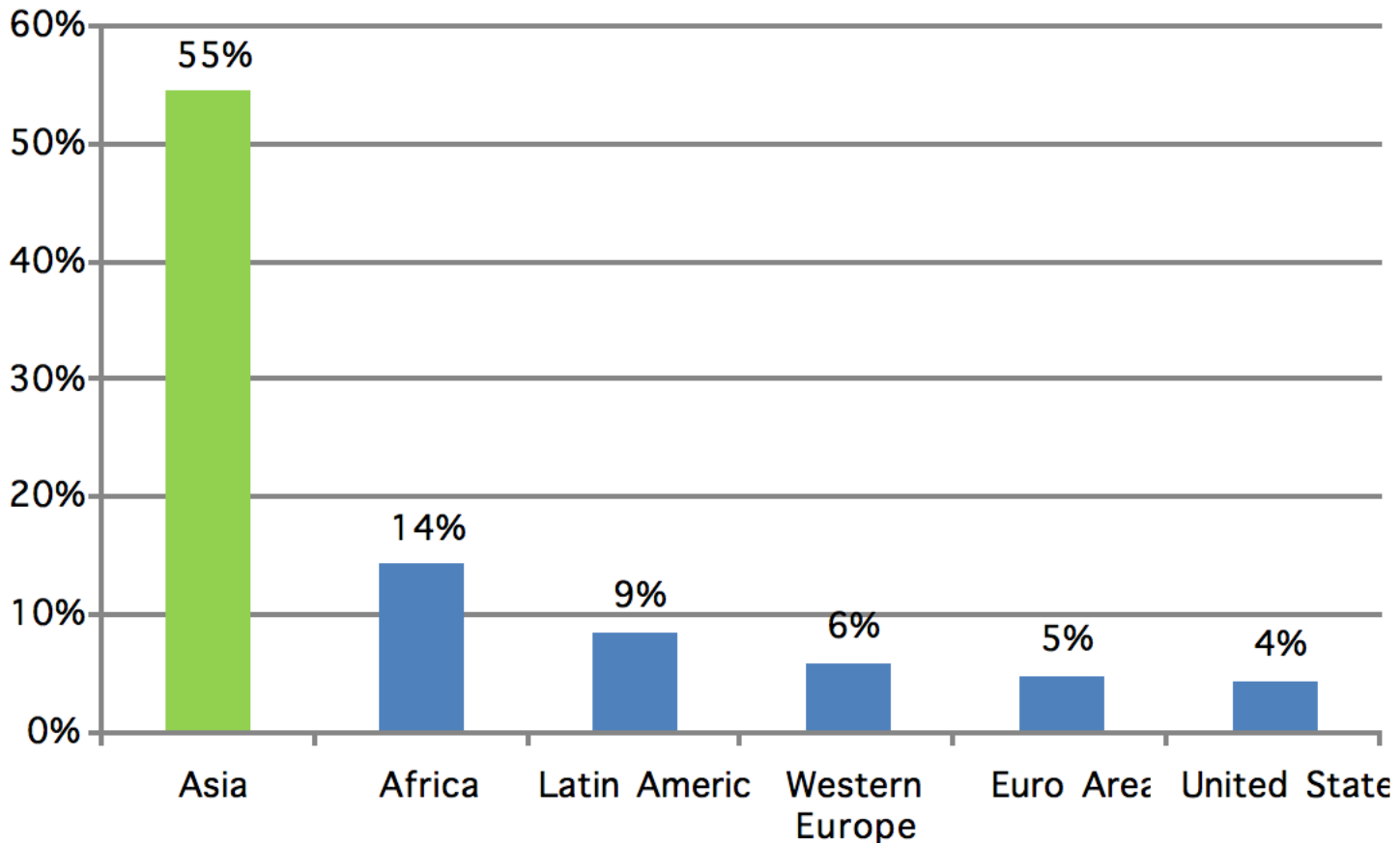
# Grading, Reading, Feedback

- Mid-term exam (Introduction and Part I -- 6 lectures): 40%
- Final exam (Parts II & III-- 7 lectures): 40%
- Class attendance & participation: 20%
- Required readings list in the syllabus
- Regular feedback encouraged from students

# Asia in a Global Context - Today, Yesterday, and Tomorrow

- Asia -- in its broadest sense is bounded by: Europe on the west, the Pacific Ocean in the east, the Indian Ocean in the south, and the Arctic Ocean in the north
- A flexible approach needed to make the course focused and manageable
- Covers east and northeast Asia, southeast Asia, South Asia, and central Asia
- But with a special focus on ASEAN 10 plus 4 (China, Japan, Korea, and India).

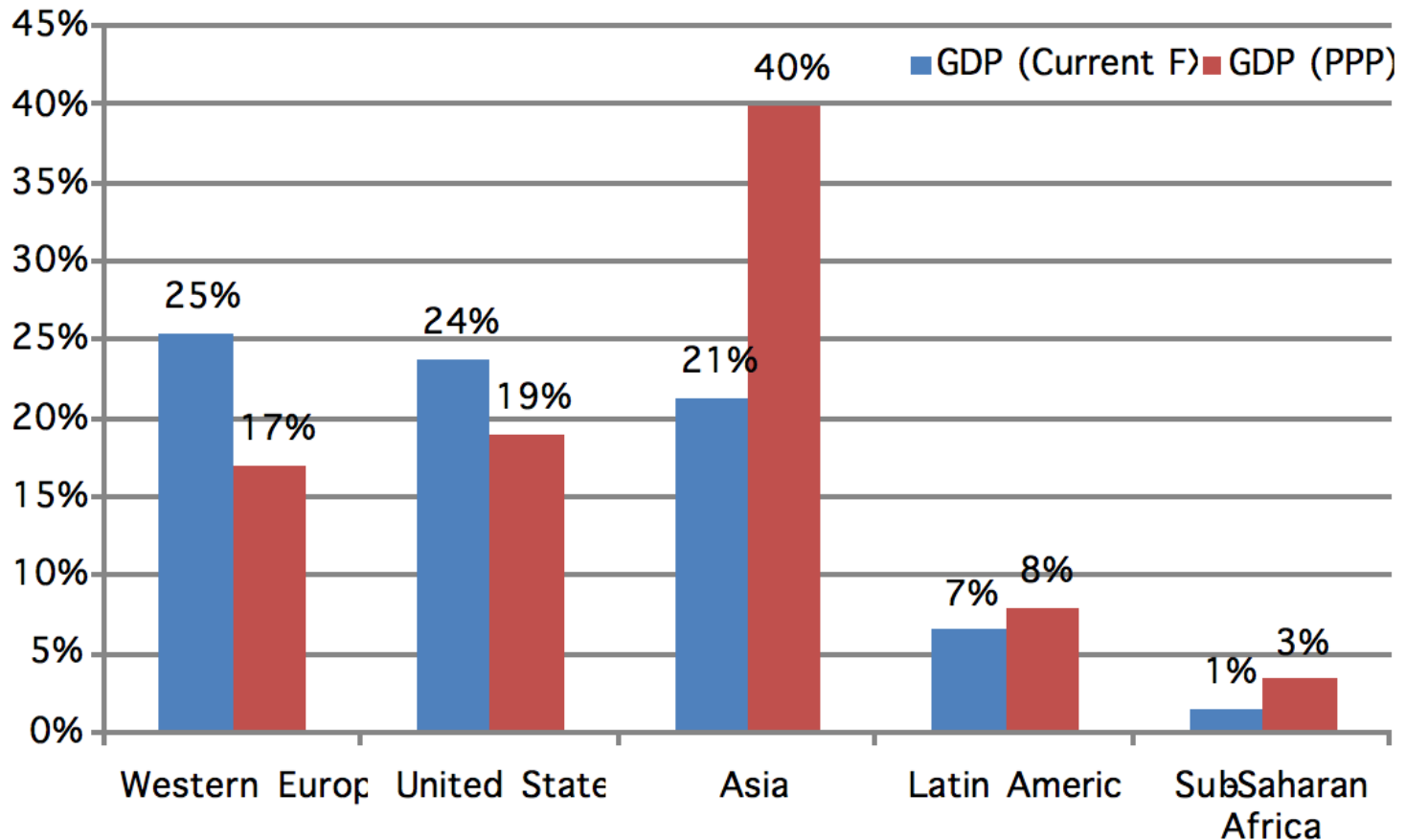
# Asia Today (2008) – Population Comparisons



% of World Population (~6.7B)

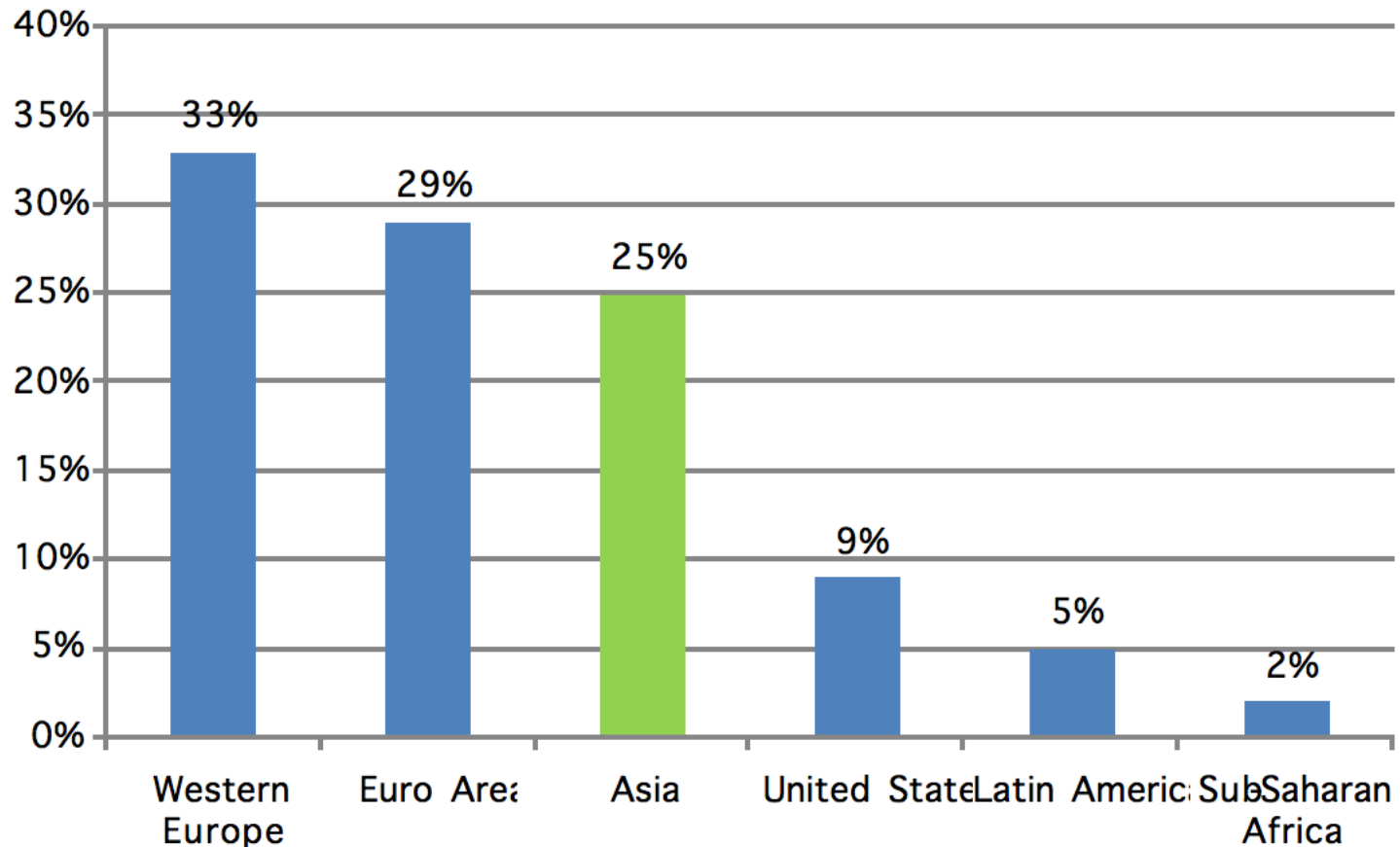


# Asia Today (2008) – GDP Comparisons



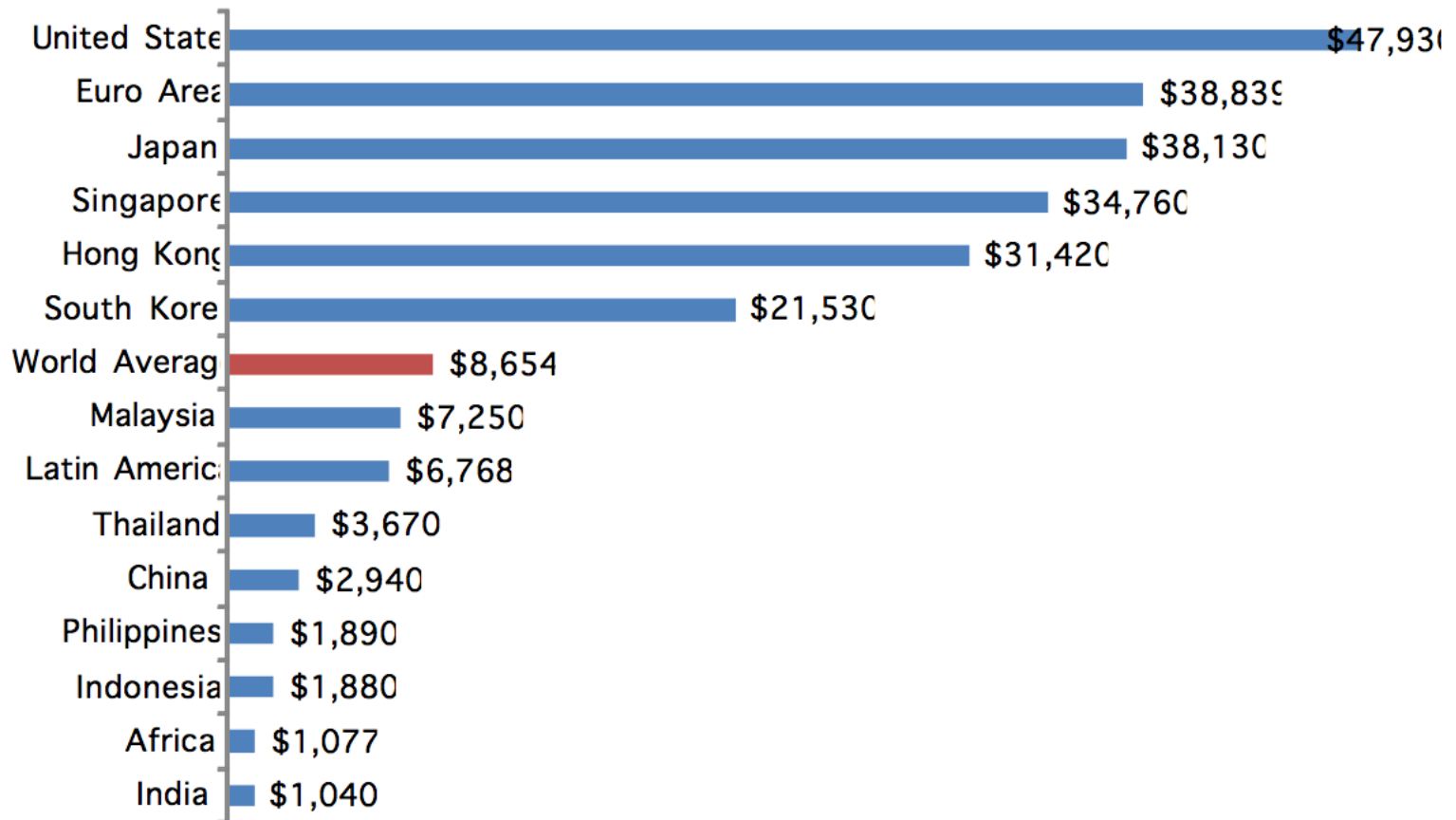
% of World GDP (\$58 trillion in 2008)

# Asia Today (2008) – Export Comparisons



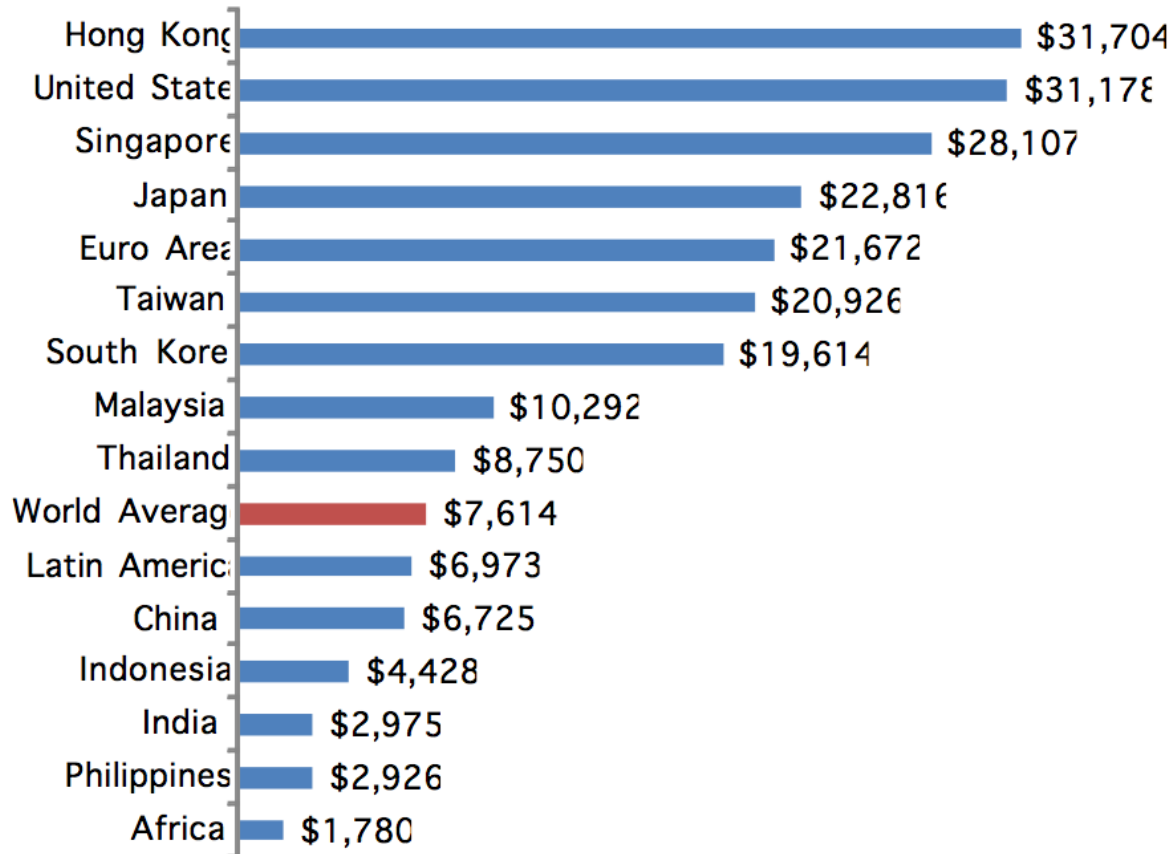
% of World Export (\$20 trillion in 2008)

# Asia Today (2008) – Per Capita Income (Current)



Per Capita Income at Current FX

# Asia Today (2008) – Per Capita Income (PPP)

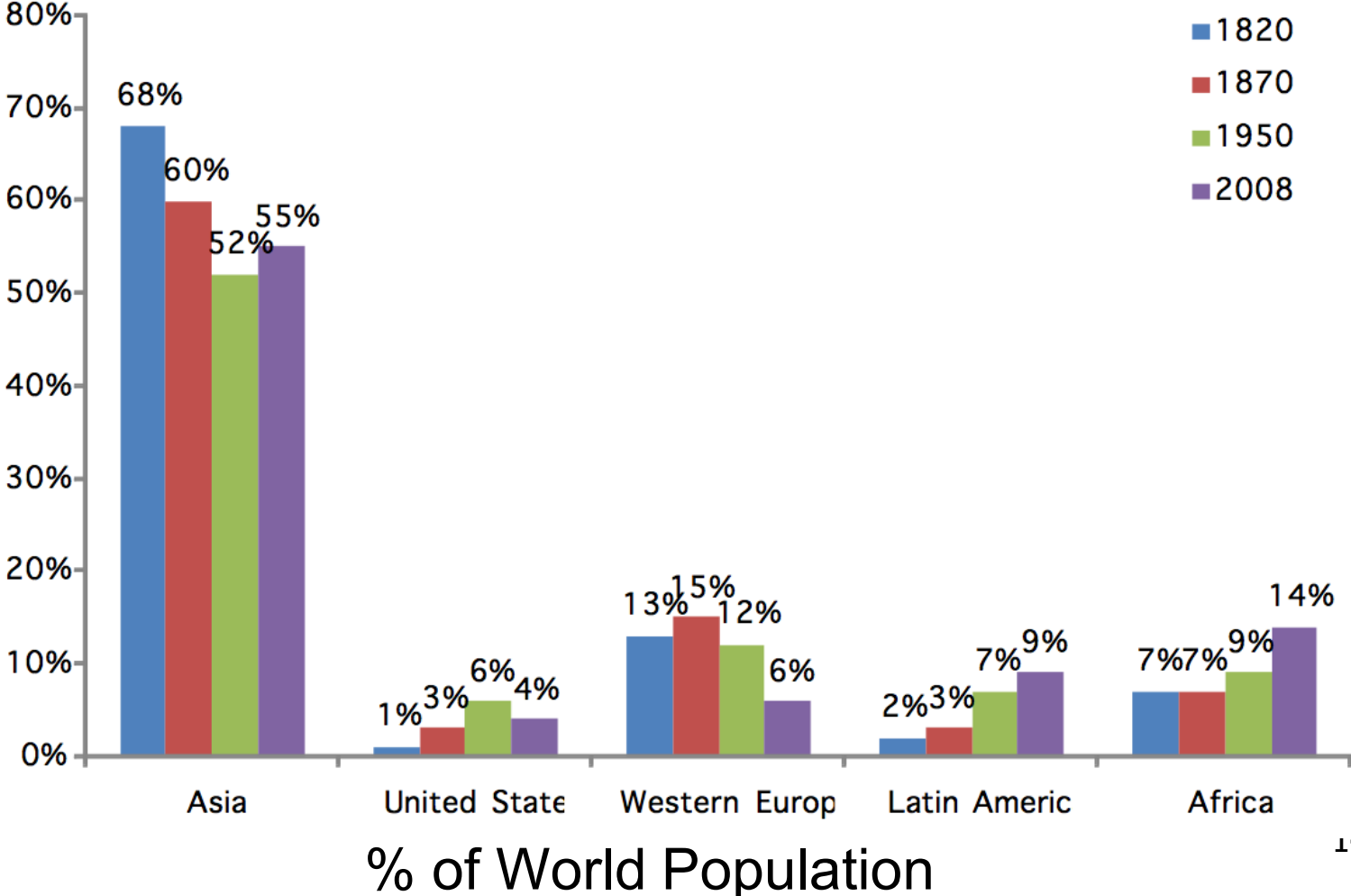


Per Capita Income, PPP (1990 Prices)

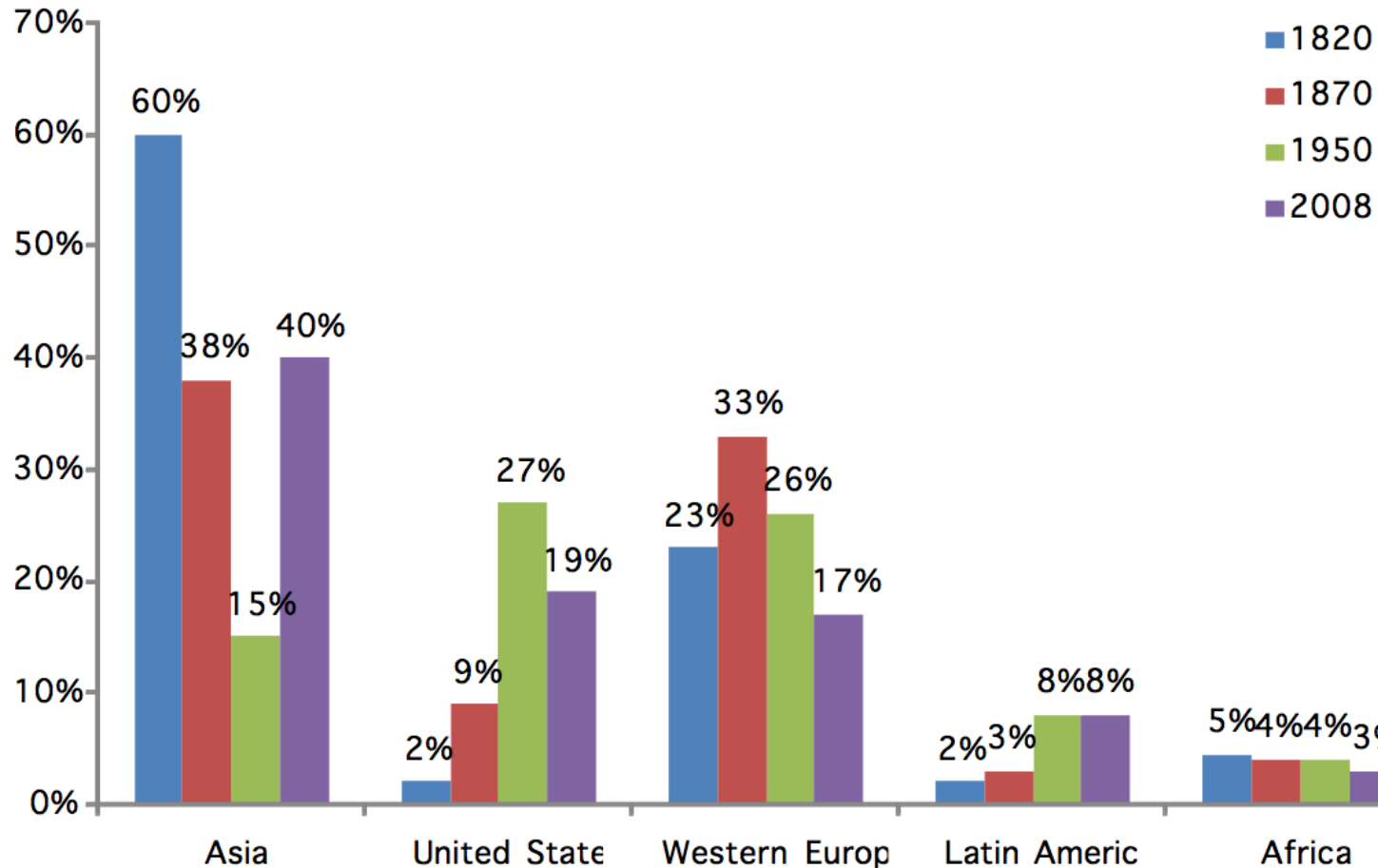
# Asia Today (2008) – Social Indicators

- Many countries in Asia have higher life expectancy than the global average (69 years)
- So is the case with adult literacy rate (world average of 86% for men and 76% for women) and other education indicators
- Many Asian countries rank high in overall human development index
- Exceptions are mostly from South and Central Asia and the less developed countries in the ASEAN

# Asia Yesterday – Population (Historical)



# Asia Yesterday – GDP Share (Historical)



GDP in PPP terms (1990 Prices)

# Asia Yesterday – Per Capita Income (PPP)

	1820	1870	1950	2008
Africa	\$420	\$500	\$894	\$1,780
China	\$600	\$530	\$439	\$6,725
Hong Kong	\$615	\$683	\$2,218	\$31,704
India	\$533	\$533	\$619	\$2,975
Indonesia	\$612	\$654	\$840	\$4,428
Japan	\$669	\$737	\$1,921	\$22,816
Latin America	\$692	\$681	\$2,506	\$6,973
Malaysia	\$603	\$663	\$1,559	\$10,292
Philippines	\$704	\$776	\$1,070	\$2,926
Singapore	\$615	\$682	\$2,219	\$28,107
South Korea	\$600	\$604	\$770	\$19,614
Taiwan	\$499	\$550	\$924	\$20,926
Thailand	\$646	\$712	\$817	\$8,750
United States	\$1,257	\$2,445	\$9,561	\$31,178
Western Europe	\$1,204	\$1,960	\$4,569	\$21,672
<b>World Average</b>	<b>\$667</b>	<b>\$875</b>	<b>\$2,111</b>	<b>\$7,614</b>

Below World Average  
 Above World Average



# Asia Yesterday – Between 1 AD and 1820

- Asia's share of GDP (in PPP terms) decreased from 76% in 1 AD to 60% in 1820 (in line with the decline in its population share from 76% to 68%)
- Western Europe's share of GDP increased from 11% in 1AD to 23% in 1820 (its population share increased from 11% to 13%)
- Latin America's share of GDP declined from 4% in 1000 to 2% in 1820 (also in line with its decline in its share of population from 4% to 2%)
- Africa's share of GDP grew from 7% in 1 AD to 12% in 1000 and then declined to 4% by 1820 (also in line with the trends in its population share during the period)

# **Asia Tomorrow – Will the 21st Century be an ‘Asian Century’?**

- Current assessments - Asia could regain its previous dominant position in the global economy by around the middle of this century
- Yet, this “Asian Century” is not preordained
- Key challenges -- fostering innovation, achieving inclusive growth, managing the environment, promoting regional integration, and improving governance
- Asia to become bigger and richer, but will it be better (quality of life) too?

# Asia Tomorrow – Fostering Innovation

- Innovation - key not only for middle income countries to grow rich but also for rich countries to stay rich
- With few exceptions, past strategy was one of “technological adaptation”
- Asia needs to move increasingly from “tech. adaptation” to “tech.leadership”
- Education system key - from “memorizing and learning” to “thinking” and “creative solution finding”
- Governments need to constantly strive to maintain a conducive environment for innovation

# Asia Tomorrow – Achieving Inclusive Growth

- Asia has generally done well in achieving inclusive growth
- Yet, some recent experiences show rapid growth accompanied by worsening inequalities
- Dimensions of inclusive growth - spatial, functional, and ethnical
- Focus on provision of basic infrastructure, high quality education, and sustainable social safety nets crucial

# **Asia Tomorrow – Managing the Environment**

- Rapid growth needs to be environmentally sustainable
- Focus on reducing natural resource (including energy) intensity of growth
- Tackle massive urbanization with developing livable cities
- Find creative solutions for urban transportation, water supply, and housing

# Asia Tomorrow – Promoting Regional Integration

- Asian growth in recent years has been helped by increasing regional integration in trade and production (factory Asia)
- Thus far, integration primarily private sector-led and market-driven
- Going forward, the integration process could benefit from a helping hand from governments
- Need for regional infrastructure development and institution building
- Ultimate objective -- regionally integrated and globally connected Asia

# Asia Tomorrow – Improving Governance

- Credible economic, political, and social institutions key for good economic performance
- Huge diversity in the quality of institutions across Asian countries
- Need for institutional convergence to best practices
- Triple dimensions of Asia's role in governance - national, regional, and global

# Conclusions

- Asia occupied a dominant position in the global economy for centuries since 1 AD
- But declined in importance, reaching a low point in 1950
- Has recovered some of the lost ground since 1950 - Asian miracle
- A growing consensus emerging that the 21 century could be an Asian century
- But formidable challenges lie ahead in making the 21st century an Asian century



***The Postwar Japanese Miracle  
and Subsequent Stagnation  
(1950-2010)  
Lecture 2***

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor

# Japan's Economy (2008)

- GDP: \$4.9 tril (current FX) and \$2.9 tril (PPP 1990 prices)
  - World's 3rd and Asia's 2nd largest economy in 2010
- Population: 127 mil; Labor Force: 65.6 mil
- Per capita income: \$42,500 (current FX) and \$22,816 (PPP 1990 prices)
- Exports: \$929 bil (19% of GDP)
- Mean tariff rate: 1.3% (w); 2.6% (uw)
- Highest life expectancy in the world (83 years), and 10th highest human development index
- A more equal income distribution than most other rich countries

# Japan's Economy (1950)

- GDP (PPP 1990 prices): \$161 bil
  - World's 9th and Asia's 3rd largest economy (amounted to 3% of the World GDP)
- Per Capita Income (PPP 1990 prices): \$1,921
  - Below the world average (\$2,111), 47th in the world, 3rd highest in Asia, and about 20% of the US level
- Life Expectancy: 61 years; global average (49 years), Asian average (40 years), US (68 years)
- Population: 84 mil; Labor Force: 36.8 mil

# The Japanese Miracle (1950 - 1990)

- GDP (PPP 1990) increased 15-fold between 1950 and 1990/91
- Per Capita Income (PPP 1990) doubled by 1960, quadrupled by 1968, grew 8-fold by 1985 and 10-fold by 1990/91
- As % of US per capita, it increased from 20% in 1950 to 40% by 1964 and to over 80% by 1990
- In 1964, the first Asian country to be an OECD member; in 1966, Japan took the lead in establishing the Asian Development Bank
- In 1967, overtook Germany to become the second largest (PPP 1990 terms) economy, next only to the US
- By 1990, it was already in the very high HDI group; at 0.918, ranked fifth and close to the US figure (0.923)

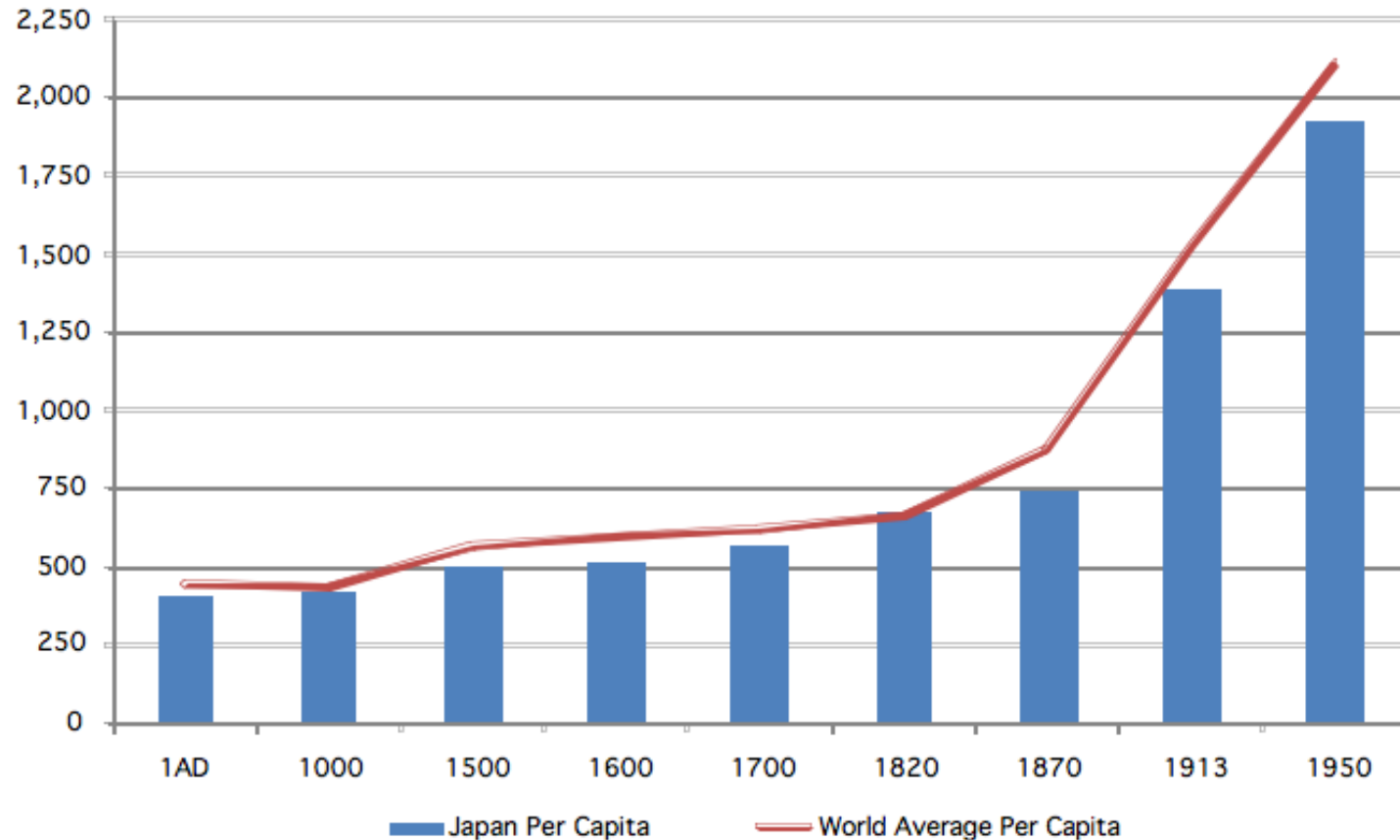
# **Japan's 1990 Per Capita Income Achieved by Others**

- Hong Kong - 1992
- Singapore - 1996
- Taiwan - 2005
- Korea - 2007

# **Japan's 1960 Per Capita Income Achieved by Others**

- Hong Kong - 1963
- Singapore - 1969
- Taiwan - 1977
- Korea - 1978
- Malaysia - 1983
- Thailand - 1989
- China - 2002
- Indonesia - 2006

# Was Japan simply re-emerging? Was it historically rich anyway?



# Factors Behind the Japanese Miracle

- Initial conditions and external environment
- Investment in infrastructure and people
- Openness to trade and investment
- Openness to foreign technology and adaptive innovation
- Macroeconomic stability



# Initial Conditions and the External Environment

- The Meiji era (1868–1912) provided the basics - trade liberalization, education reforms, private ownership of land, public finance and monetary restructuring, and institutions
- Pyramid-shaped population structure and a growing labor force
- Postwar reconstruction – a challenge as well as an opportunity
- Postwar global economic boom
- US's initial accommodative attitude to Japan's exports and exchange rate

# Investment in Infrastructure and People

- Post-war reconstruction and continued public infrastructure development under Fiscal Investment and Loan Program (FILP)
- By early 1990s, Japan had one of the best road, rail, sea, and air transport facilities among the Asian countries
- Second highest road network (295 km per 100 sq km); highest rail network (5.33 km per 100 sq km), and highest air freight transport (5,225 mil. tons per km); high quality port infra.
- By early 1990s, government health and education expenditures at over 9% was only marginally lower than US and European figures
- Made possible by low defense expenditures (1% of GDP compared to much higher figures by the US, UK, France and Germany)

# Gradual Openness to Trade and Investment

- Early postwar trade protectionism and selective industrial policy (Did MITI steer the economy?)
- Japan's 1955 GATT membership
- 1964 abolition of forex rationing and introduction of currency convertibility (CA)
- Tariff reductions on manufactures since 1967
- Liberalization of the FDI inflows since 1968 culminating in an almost free regime by 1980
- Continued US-Japan trade frictions, voluntary export restraints, the Plaza accord, and the US section 301

# Technology Adaptation and Innovation

- Technology imports and its adaptation to Japanese conditions in the early years
- Gradually moved from tech. adaptation to tech. leadership
- Globally ranked high on quantitative measures of innovation
- Developed a relatively robust national innovation patenting system

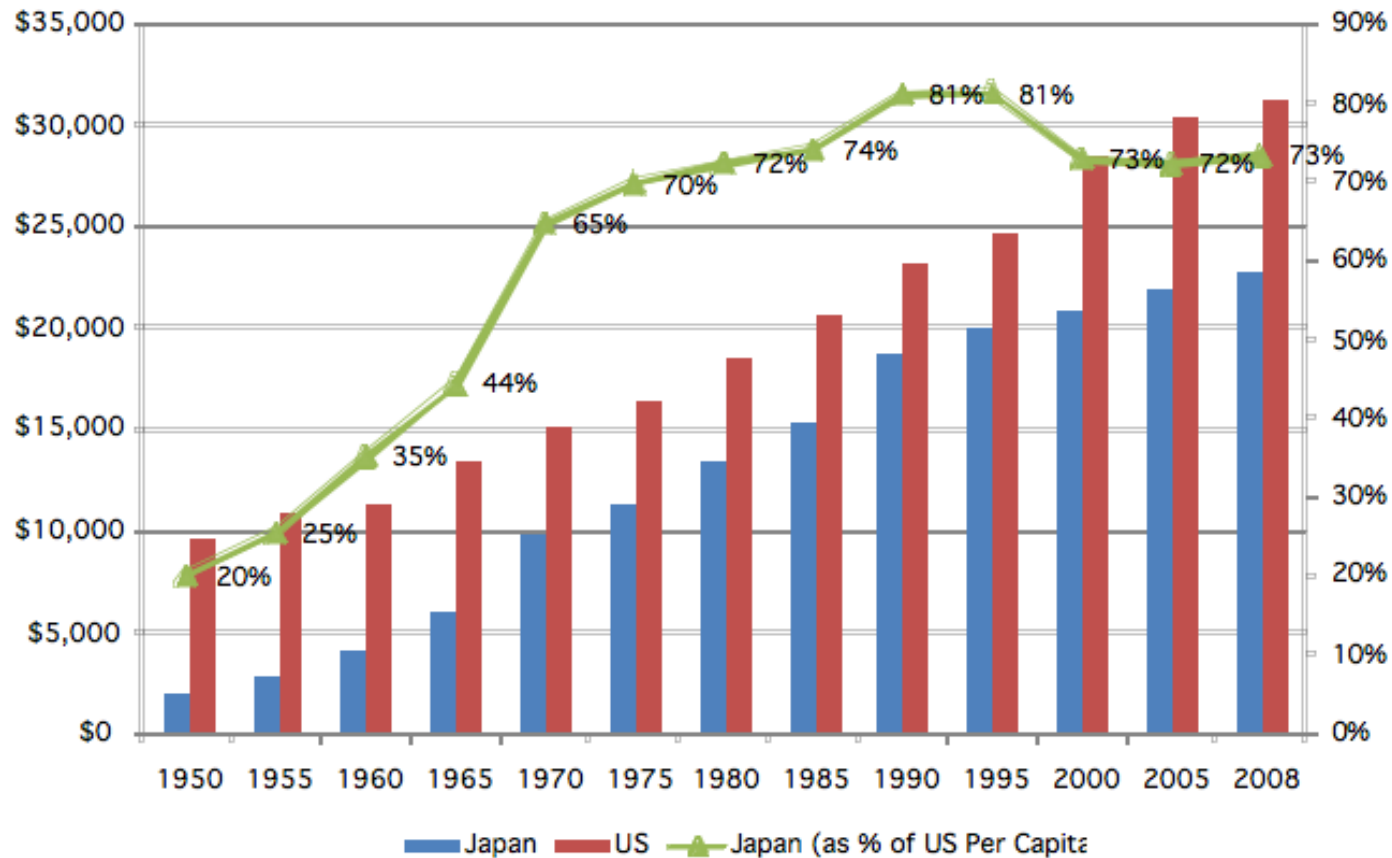
# Macroeconomic Management

- During the Bretton Woods period, monetary policy anchored on maintaining the yen-dollar exchange rate (at about 360 yen/dollar)
- Continued to maintain a stable yet gradually appreciating yen-dollar exchange rate during the post-Bretton Woods regime till the mid-80s
- Maintained relatively low and stable inflation for the first four decades since 1950 (except for the oil shock years)
- Post Plaza accord oscillations in monetary and fiscal management (more on this later)

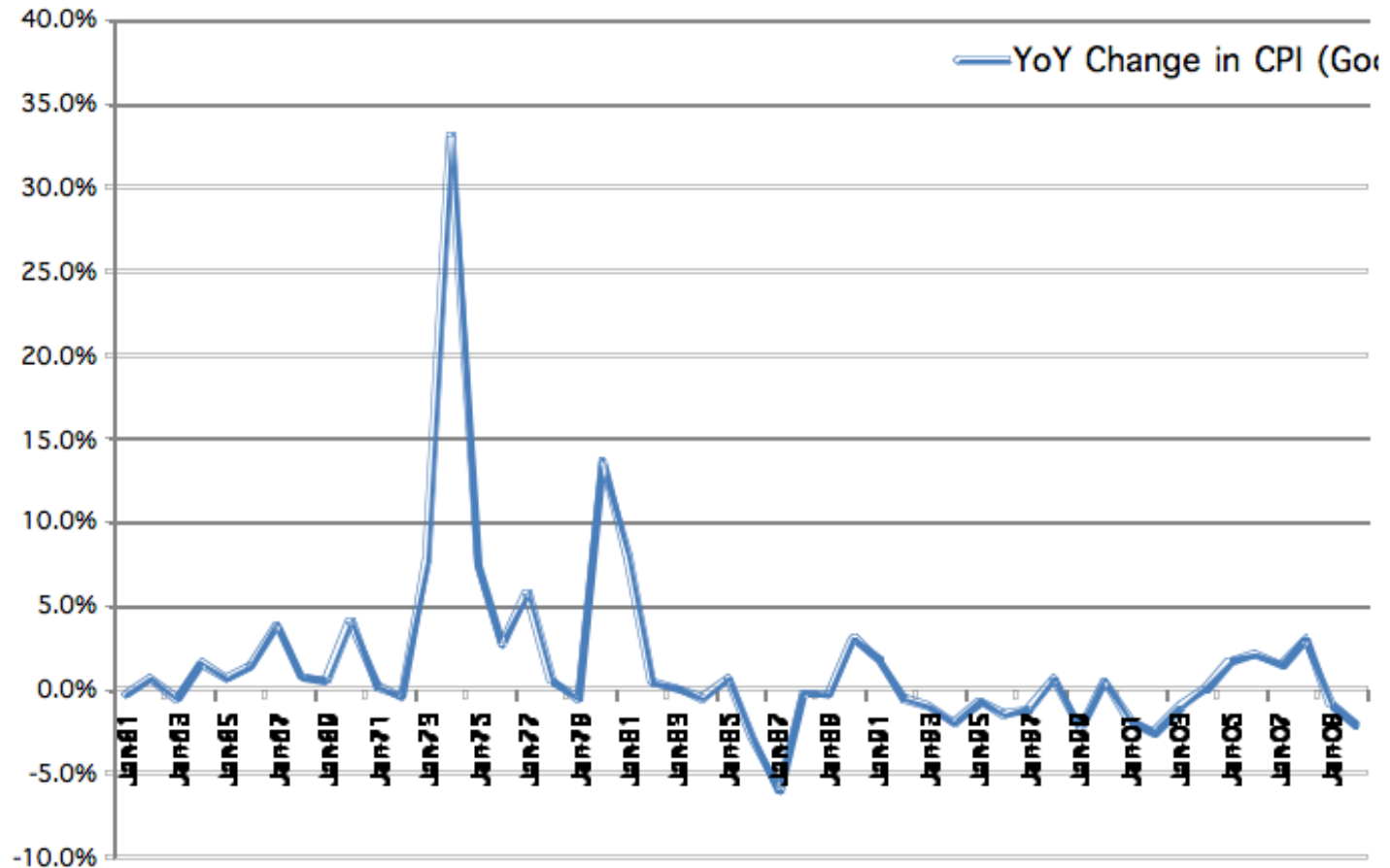
# Japan's Post-Miracle Stagnation: Is there a Rich Income Trap?

- After the 15-fold increase in GDP (PPP 1990), GDP increased by an anemic 21% in the next 17 years (about 1% annually)
- The comparable figures for per capita income (PPP 1990) was ten-fold increase between 1950 and 1991, and 18% in the next 17 years (about 1% annually)
- Japan's share of global GDP which had increased from 3% in 1950 to 8.7% in 1991, but declined to 5.7% by 2008
- The last two decades also saw Japan caught up in persistent deflationary tendencies in prices
- Overall, the period since the early 1990s is referred to as Japan's lost two decades
- All this, much against the worldwide euphoria on the future of the Japanese economy prevailed during the late 1980s

# Stagnation in Per Capita Income since the Early 1990s

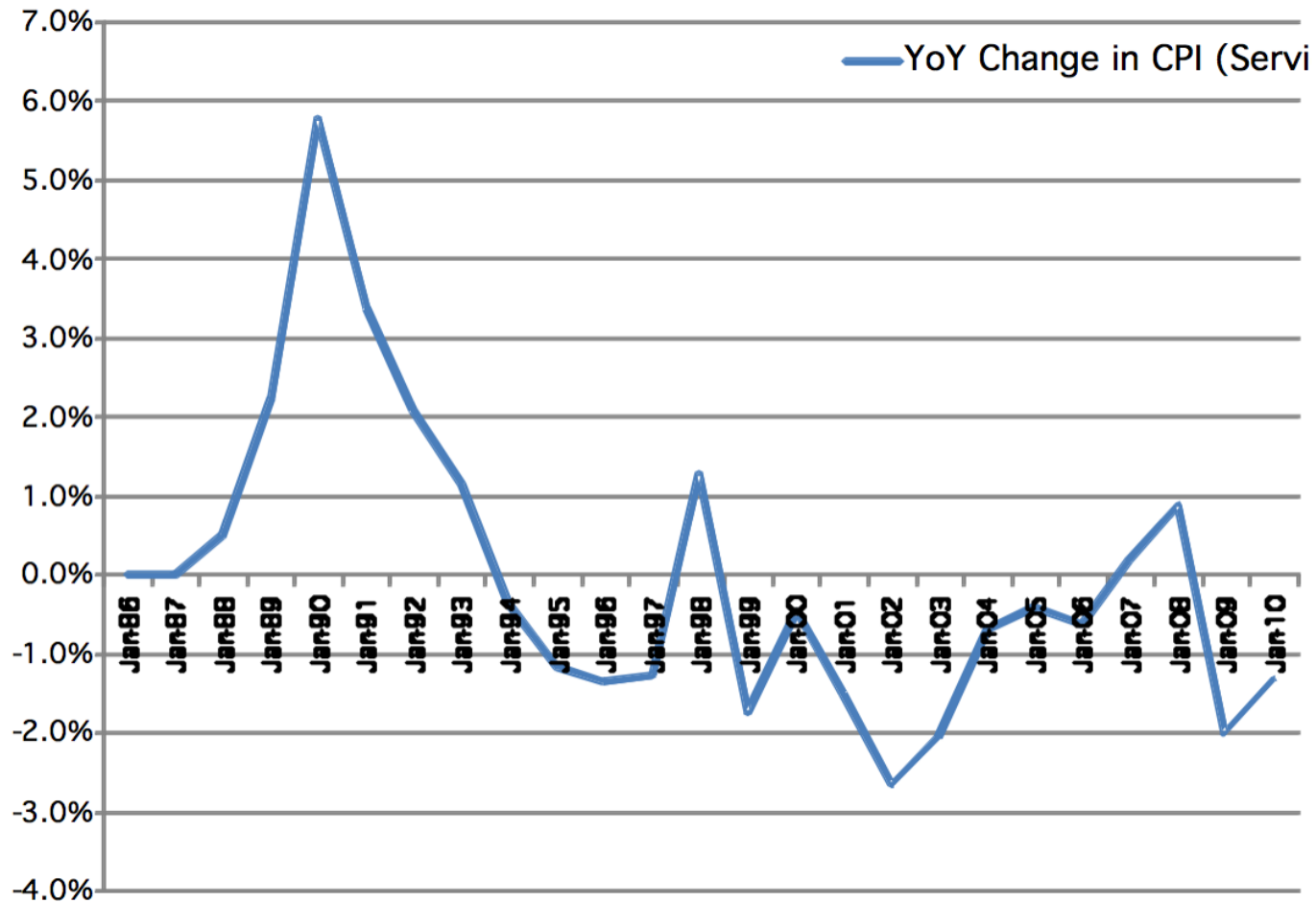


# Deflationary Trends since the Early 1990s (CPI Goods)





# Deflationary Trends since the Early 1990s (CPI Services)



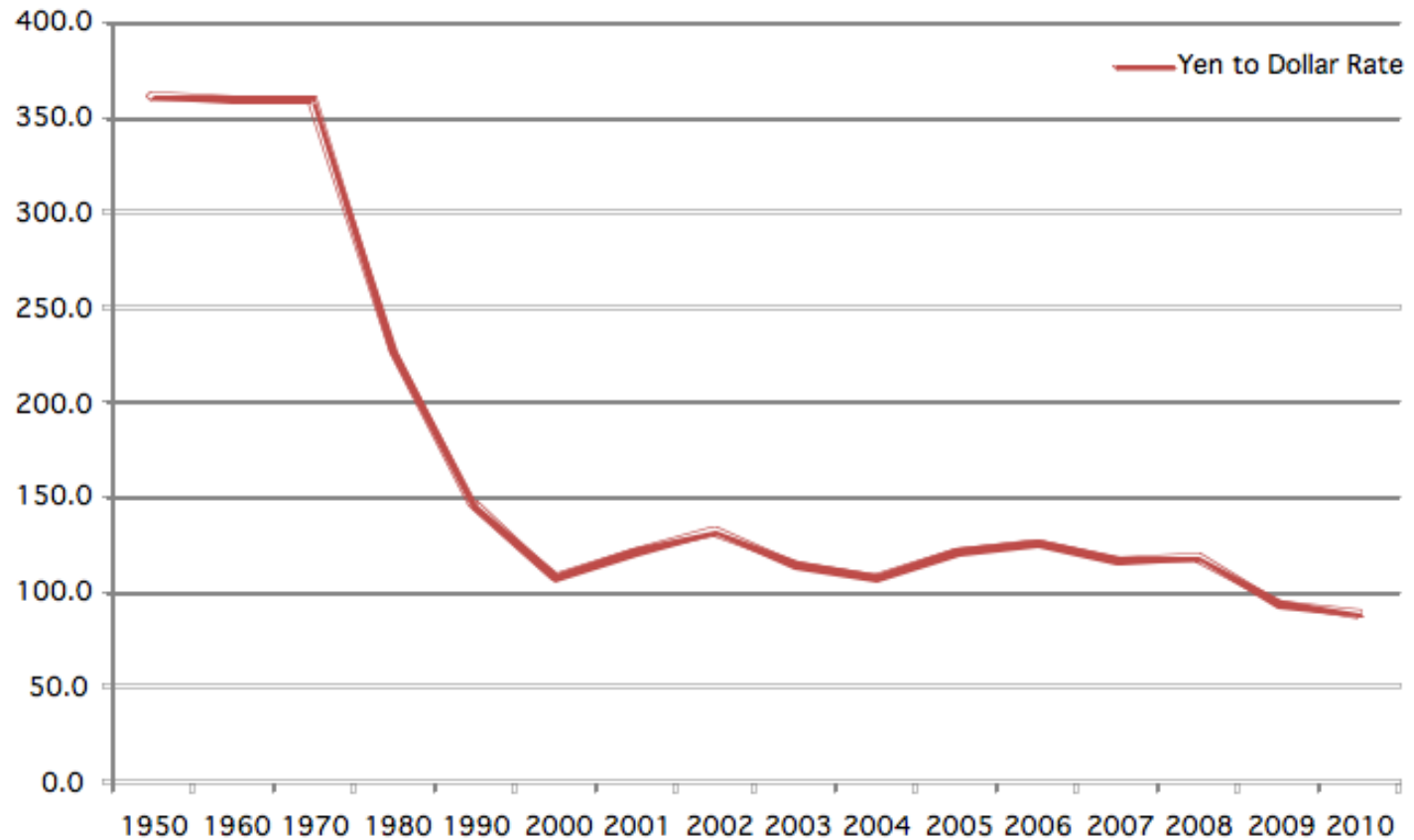
# **What Happened? Why the Two-Decade Stagnation after the Four-Decade Miracle?**

- The issue is still being debated with no clear consensus
- Did the Plaza accord cause the stagnation?
- Did macroeconomic management contribute to the stagnation?
- Has Japan's once respected business model become less suited subsequently?
- Did the Japanese innovative spirit subside?
- Was an ageing and stagnating population behind the stagnation?

# The 1985 Plaza (G5) and the 1987 Louvre (G7) Accords

- Trade frictions between Japan and its trading partners
- Textiles first, steel next, and automobiles afterwards and so on and on
- Then the need for more export opportunities to Japan
- Decision to engineer an Yen appreciation first (Plaza accord) and to stop that appreciation subsequently (the Louvre accord)
- What did it all mean for the Japanese economy?

# Yen-Dollar Exchange Rate



# Macroeconomic Management during the Post-Plaza Accord Period

- Initial monetary tightening to appreciate the yen
- Subsequent monetary loosening and the buildup of asset bubble
- The next round of monetary tightening and the bursting of the asset bubble
- Recession, deflation, liquidity trap, and quantitative monetary easing
- Shift to fiscal policy to stimulate the economy
- Build up of bad loans in the financial system and huge public debt

# Asset Price Buildup and its Crash: The Nikkei Stock Price Index



# The Japanese Business Model

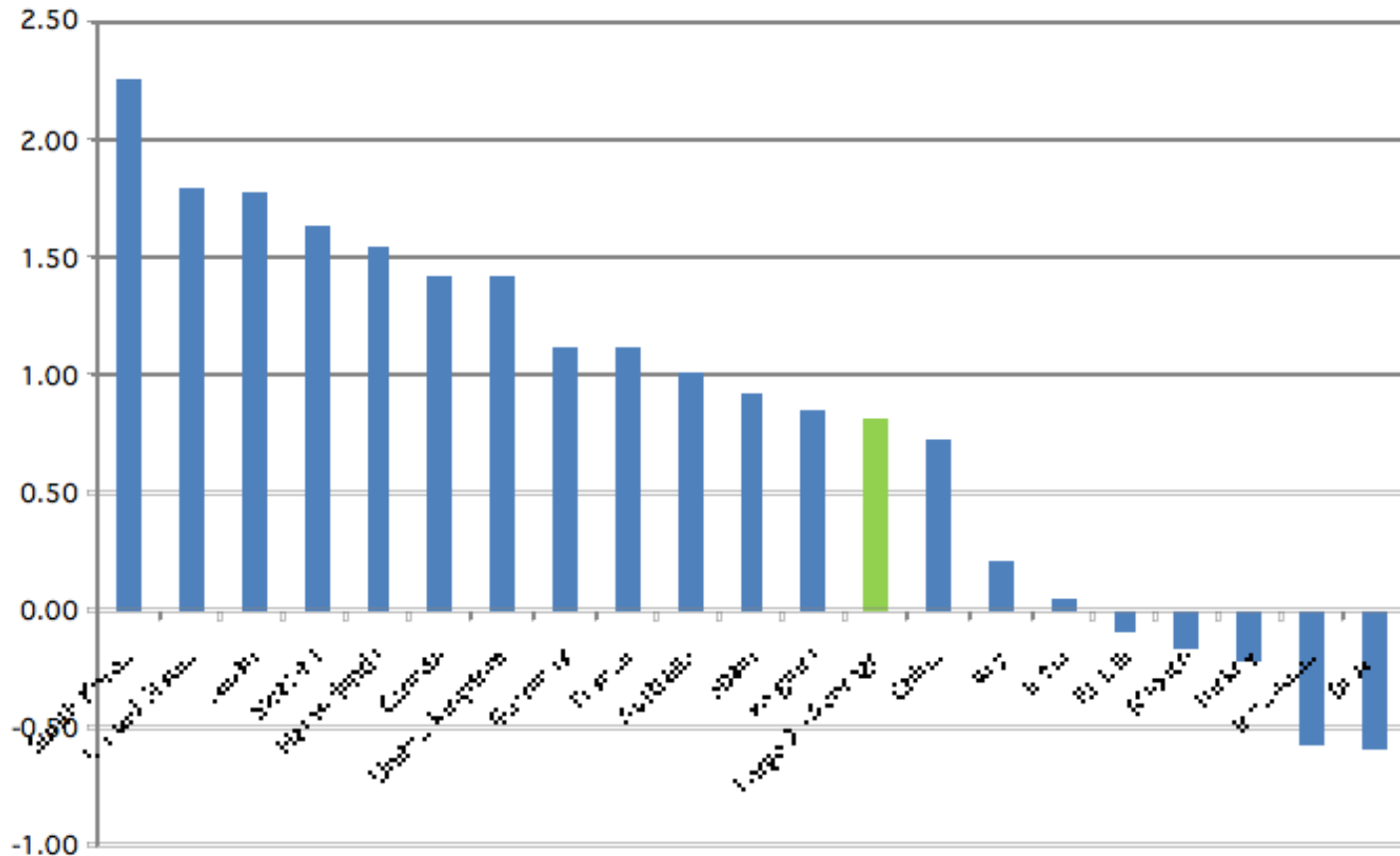
- Large conglomerates (keirestu), corporate-bank nexus, cross-share holdings, and corporate governance
- Life time employment, seniority-based remuneration, and inflexible labor market
- A dual economy: efficient globalized manufacturing and a much less efficient, inward-oriented service sector
- In more recent years, a model that strikes a balance between the Anglo-Saxan practices and the Japanese ways has been slowly emerging

# Japan and Innovation

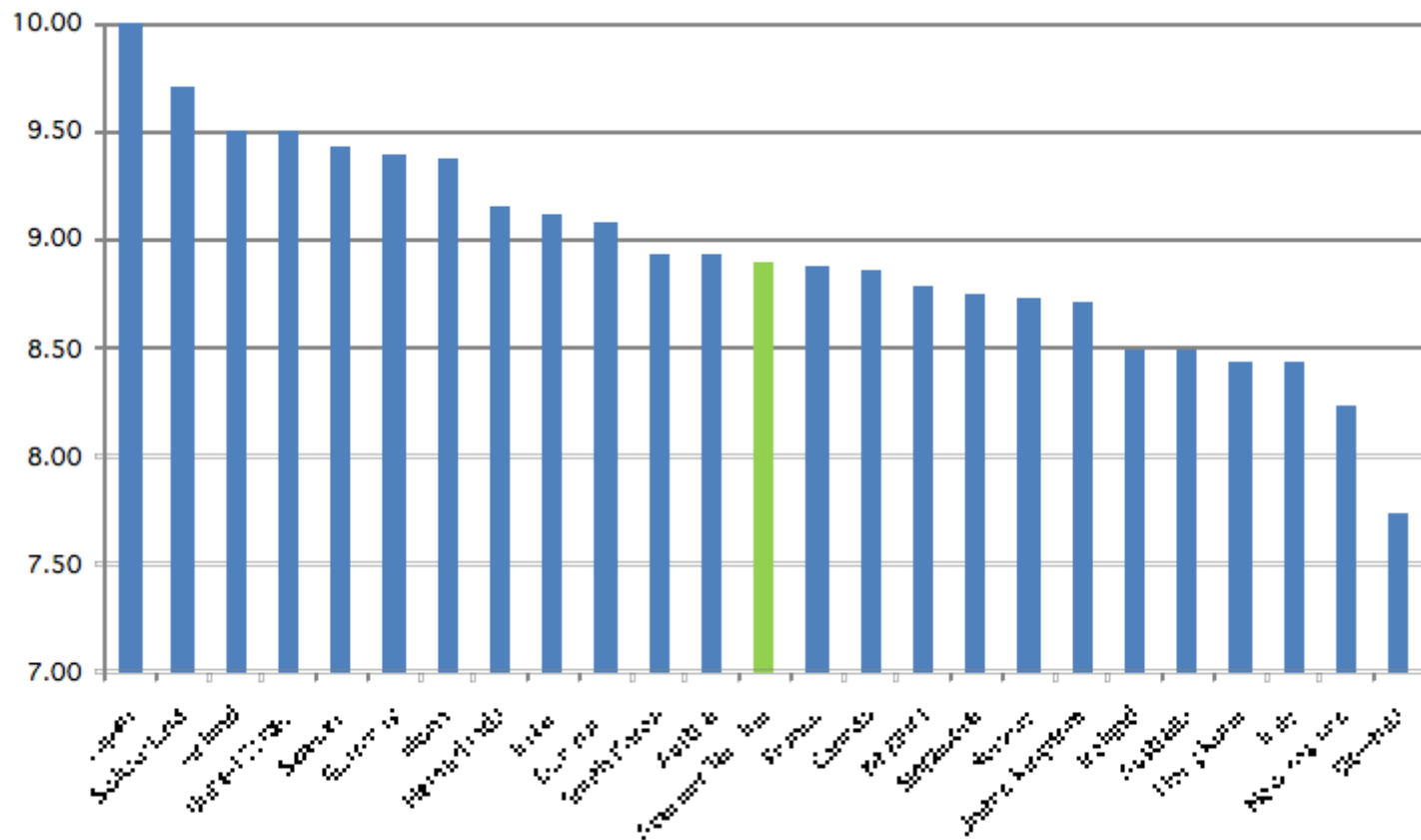
- By most quantitative measures, ranks high in the world (see next 2 charts)
- Qualitatively, however, the patent system encourages adaptation or incremental innovations than major innovations (radical breakthroughs)
- Japan could do better with more venture capital investment (\$2 billion a year compared to \$20 billion in US)
- It could also do better with more openness to FDI and ideas from abroad



# Patents-based Country Rankings on Innovation



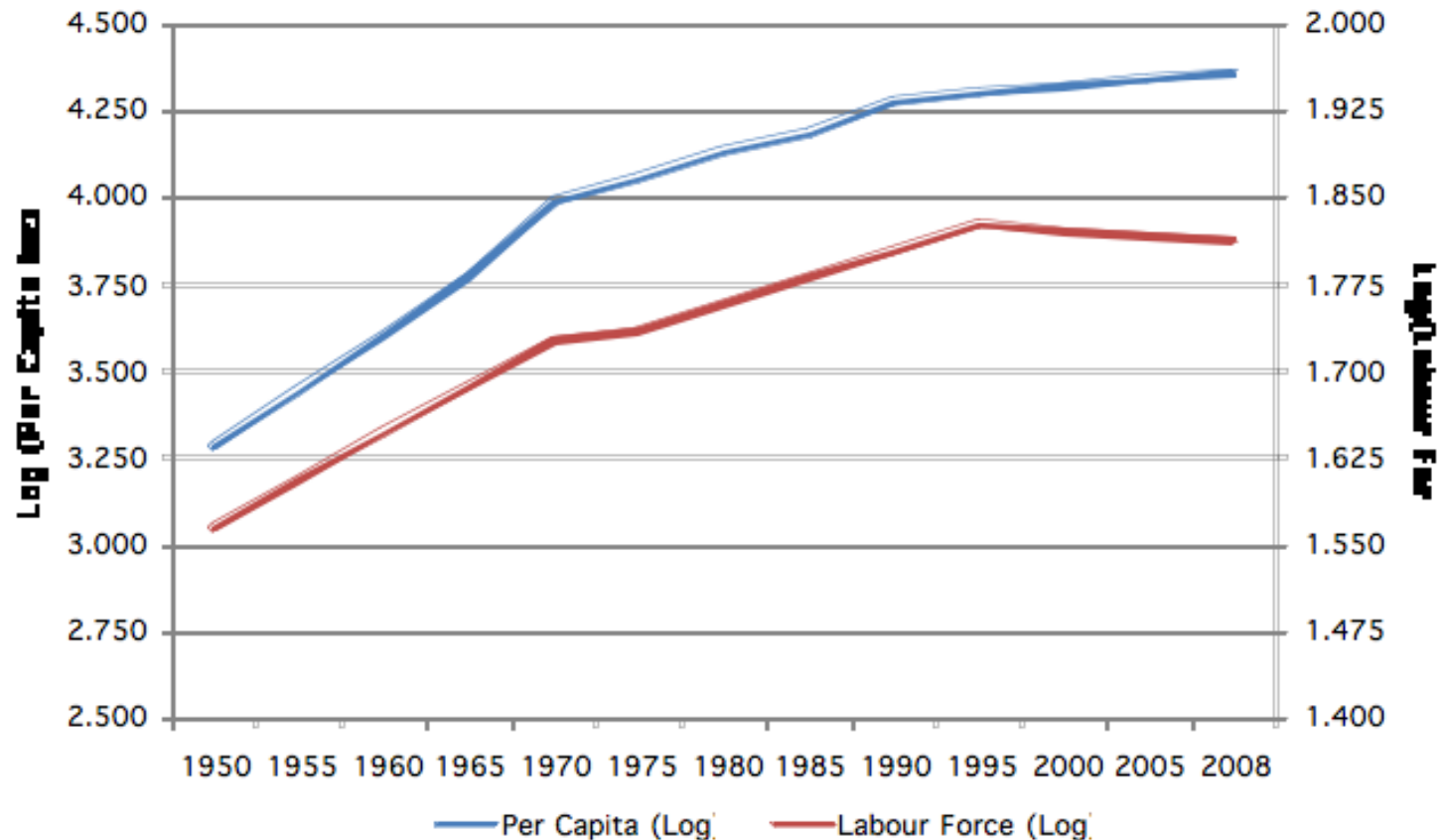
# Survey-based Rankings on Innovation (The Economist)



# Ageing Population and Stagnant Labor Force

- Japan's demographics has undergone big changes - population has now started to decline in addition to ageing
- Labor force has stagnated putting pressure on the long term growth potential (see chart next)
- Some scope for better women's participation in the labor force
- Japan could also benefit from more openness to people (through a more liberal immigration policy)

# Japan's Labor Force and Income Growth



# Conclusions

- Postwar Japanese economic achievements - roughly spanning four decades 1950 to 1990 - have been nothing short of a miracle (the first postwar Asian miracle)
- The stagnation since the early 1990s has been equally unprecedented
- Japan has reformed its business model, corporate governance, and labor market practices
- Building on these, a more leadership role in innovation and more openness to investment, ideas, and people from abroad would be to Japan's benefit
- Lest, an ageing population and potentially declining labor force could prolong the two-decade old stagnation
- Down but not out yet?

***The NIEs Join the Miracle Club***  
***Lecture 3***

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

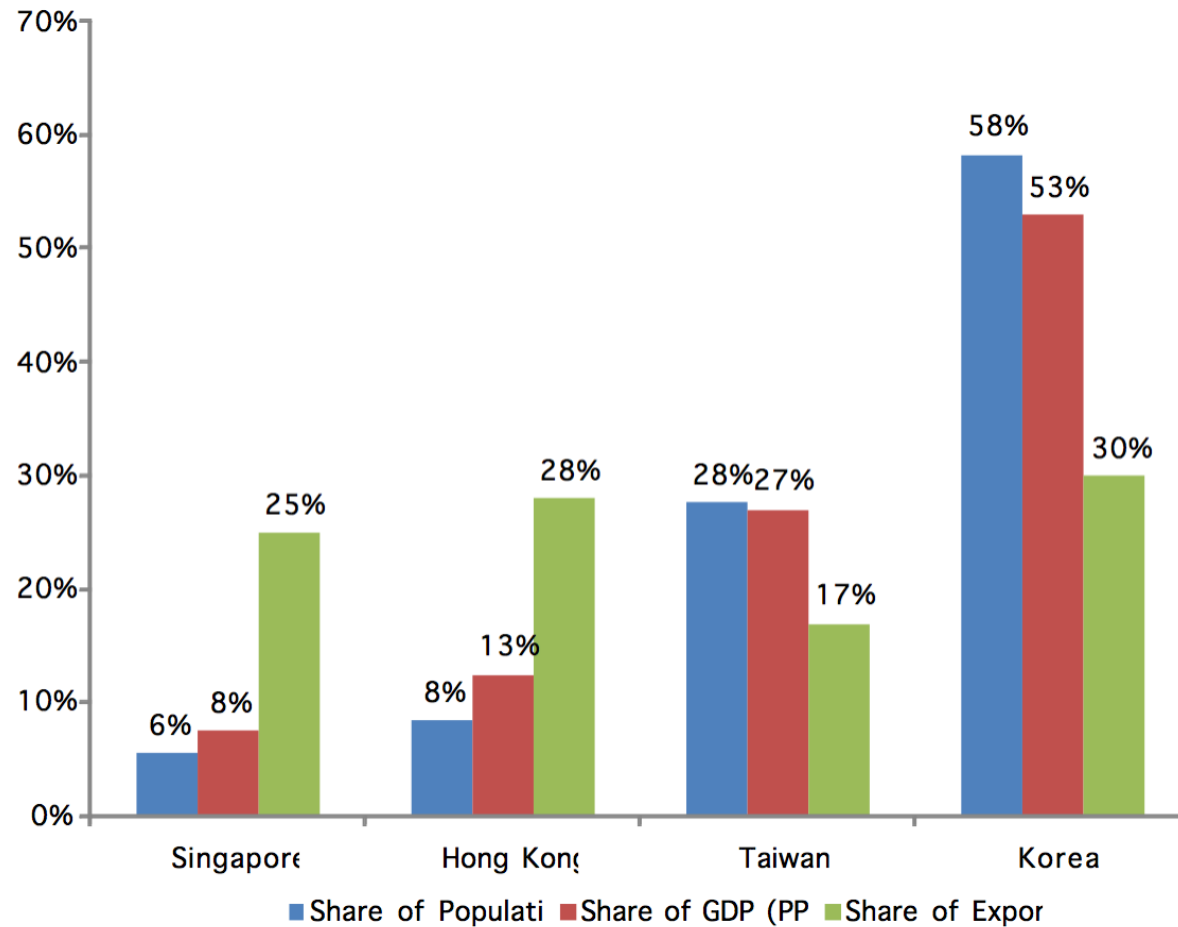
**Srinivasa Madhur**

Visiting Professor

# Know Your NIEs (2008)

- NIEs – Hong Kong, Korea, Singapore and Taiwan
- Combined Population of 83 million people
- Combined GDP of \$1.9 trillion at current FX (3.2% global share) or \$1.8 trillion in PPP, 1990 terms (3.5% global share)
- Average Per Capita Income – \$22,419 (current FX) or \$21,472 (PPP 1990)
- Combined Exports of \$1.7 trillion (8.4% global share); almost double Japan's \$929 billion (4.8% global share)

# Know Your NIEs (2008)





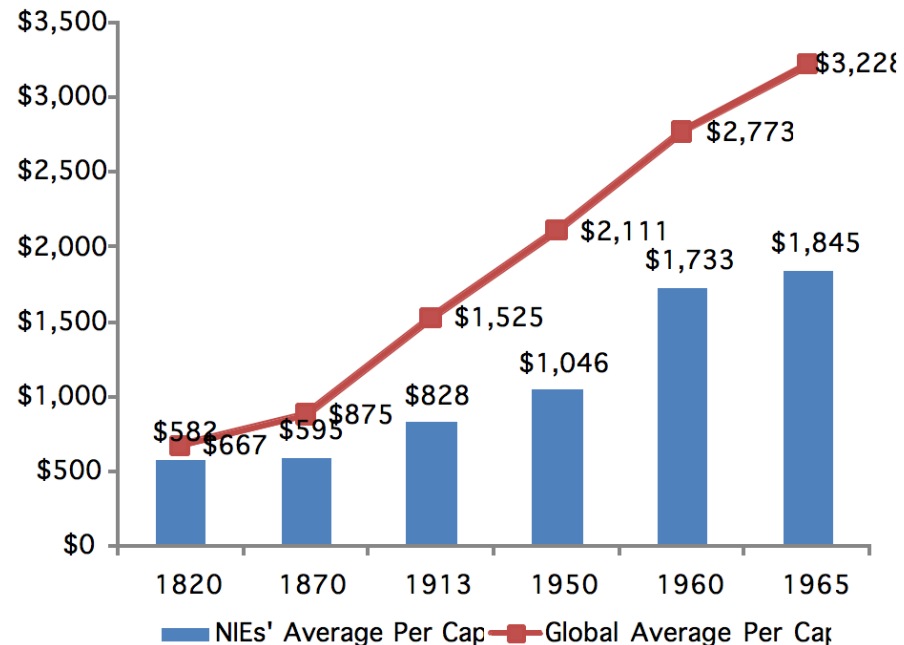
# Know Your NIEs (2008)

- Average per capita income (PPP) higher than Japan (\$20,616) and Western Europe (\$21,672), and about 70% of US
- Belong to the very high HDI group (life expectancy of ~80 yrs, and impressive education indicators)

	Per Capita Income (PPP)	Life Expectancy	Avg. Yrs of Education	Simple Mean Tariff Rate
Hong Kong	\$31,704	82.0	9.7	0.0%
Singapore	\$28,107	81.0	8.5	0.0%
Taiwan	\$20,296	78.0	NA	NA
Korea	\$19,614	80.0	10.6	8.3%
<b>NIE Average</b>	<b>\$21,472</b>	<b>80.3</b>	<b>9.6</b>	<b>2.8%</b>

# Know Your NIEs – Small and Poor Until the Mid-Sixties

- NIEs' share in global GDP (PPP 1990) was 0.6% in 1950, and 0.8% in 1960 and 1965
- Korea accounted for 55%, 60%, and 48% of the NIEs GDP (PPP 1990)
- In 1965, only HK had a per capita (\$4,825) higher than the global average while Singapore (\$2,667), Taiwan (\$1,810), and Korea (\$1,436) were below the global average
- Grew up watching the Japanese miracle though



# **NIEs Join the Miracle Club (1965-1995)**

- Between 1965 and 1995, NIEs' share in global GDP increased more than 4-fold from 0.8% to 3.3%
- Their average per capita income (PPP1990) increased more than 7-fold (from \$1,845 to \$13,345)
- Korea's per capita income increased more than 8-fold, Taiwan's and Singapore's 7-fold, HK's more than 5-fold
- By 1995, NIEs' share in world exports was more than 9%, up from 1.5% in 1965
- NIEs achieved a niche in electronics, computers, shipbuilding, automobiles, & financial services

# Behind the NIEs Miracle: Are There Common Elements?

- Did similarities in culture, Confucianism in particular, matter?
- Has strong leadership under semi-authoritarian political regimes help?
- Balancing individual freedom and discipline to foster collective action?
- What about high savings and investment?
- The importance of education and health? Building human capital?
- Fiscal prudence and macroeconomic stability?

# Gross Domestic Savings (and Investment) as % of GDP

**Note:** In 1965, saving rates in the NIEs were lower than in Latin America

<b>Gross Domestic Savings (and Investment)</b>			
<i>% of GDP</i>	<b>1980</b>	<b>1995</b>	<b>2008</b>
Hong Kong	34 (35)	33 (34)	30 (20)
Singapore	38 (46)	52 (34)	46 (31)
Korea	25 (32)	36 (38)	31 (31)
Japan	31 (32)	30 (28)	29 (24)
Philippines	25 (29)	19 (22)	NA (15)
India	17 (21)	27 (27)	38 (40)
South Asia	15 (20)	25 (25)	35 (36)
Latin America	23 (25)	18 (19)	22 (23)
<b>World</b>	<b>25 (24)</b>	<b>20 (22)</b>	<b>21 (22)</b>

# Investment in People

- By mid-1960s, already achieved universal primary education
- Since then, impressive progress on secondary and tertiary education (slide 10)
- Similarly people's access to health care, safe water, and sanitation improved substantially
- Made possible by robust public investment in education (slide 11) and health and efficient service delivery

# Secondary (and Tertiary) Enrollment Rates in NIEs

<b>Secondary (and Tertiary) Enrollment Rates</b>			
	<b>1980</b>	<b>1993</b>	<b>2008</b>
Hong Kong	64 (10)	NA (21)	83 (34)
Singapore	58 (8)	78 (NA)	NA (NA)
Korea	78 (15)	93 (48)	97 (96)
Japan	93 (31)	96 (30)	100 (58)
United States	91 (56)	97 (81)	94 (82)
Latin America	42 (14)	51 (15)	88 (35)
India	30 (5)	NA (NA)	57 (13)
China	46 (1)	52 (6)	74 (22)

# Public Spending on Education (% of GDP)

<b>Public Spending on Education</b>			
<i>% of GDP</i>	<b>1980</b>	<b>1992</b>	<b>2008</b>
Hong Kong	1.8	2.5	3.3
Singapore	2.2	NA	3.2
Korea	2.8	2.9	4.2
Japan	3.3	NA	3.5
United States	6.8	4.9	5.7
India	2.1	2.5	3.2



# Macroeconomic Management

- Generally avoided boom-burst economic cycles
- Kept budgets and current accounts in balance
- Inflation moderate and stable (with the exception of Korea)
- Moderate taxation and low tax evasion
- External debts under check

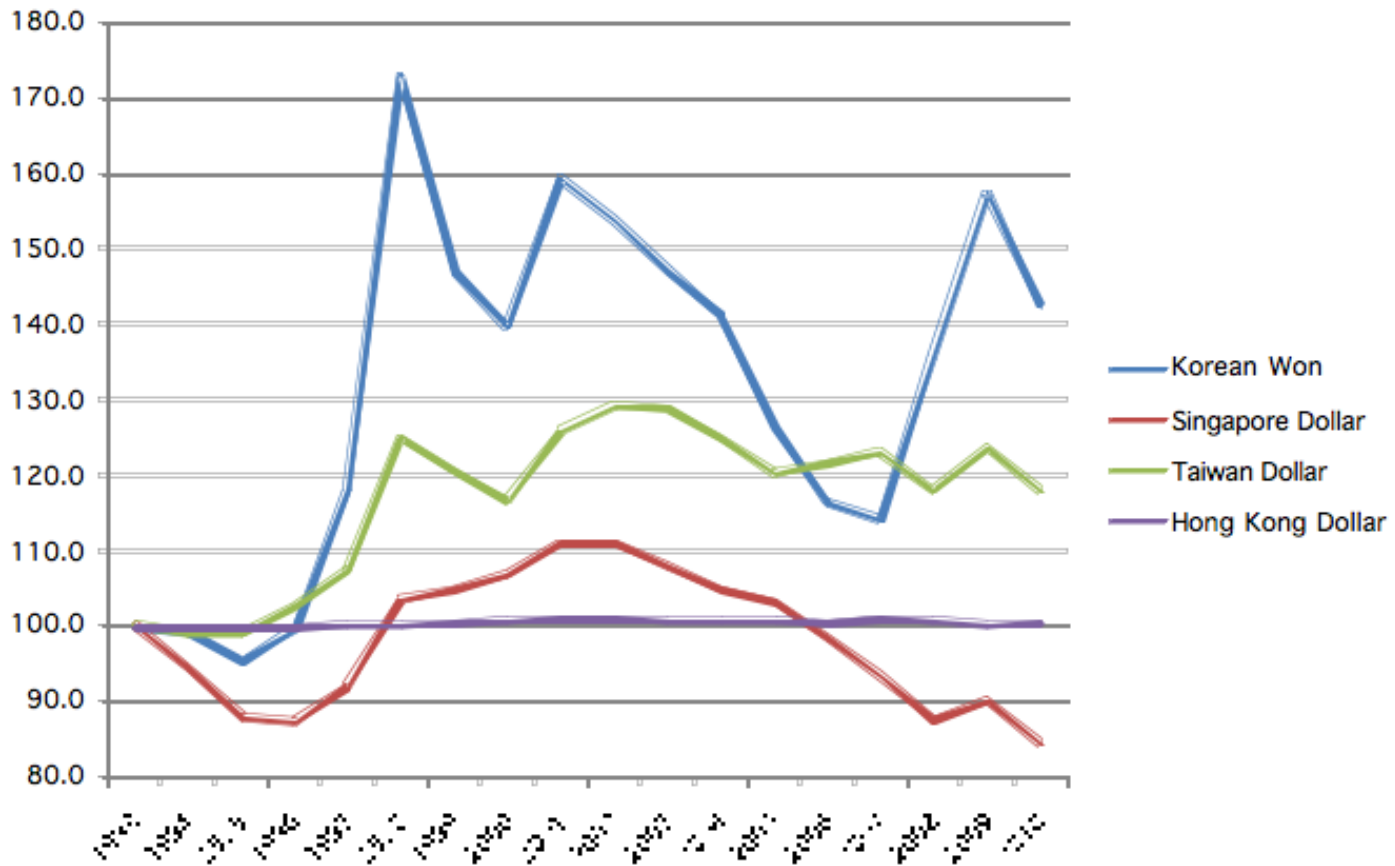
# Dissimilarities: Tale of City States and Bigger Economies

- HK had minimum state interventions
- Singapore quick in reducing state interventions and external opening up
- Korea much more interventionist; also slower in trade and investment liberalization
- Taiwan somewhere in the middle
- Between Korea and Taiwan:
  - conglomerates verses small and medium enterprises
  - heavy industry verses consumer industries

# **NIEs since the 1997/98 Asian Financial Crisis (AFC)**

- Korea was affected the most by the AFC
- Others felt the reverberations too
- The genesis of the Korean crisis: Was it only a liquidity crisis or an insolvency crisis too?
- Korea's response to the AFC
- Postcrisis evolution of the NIEs
- A hick up or a major setback?

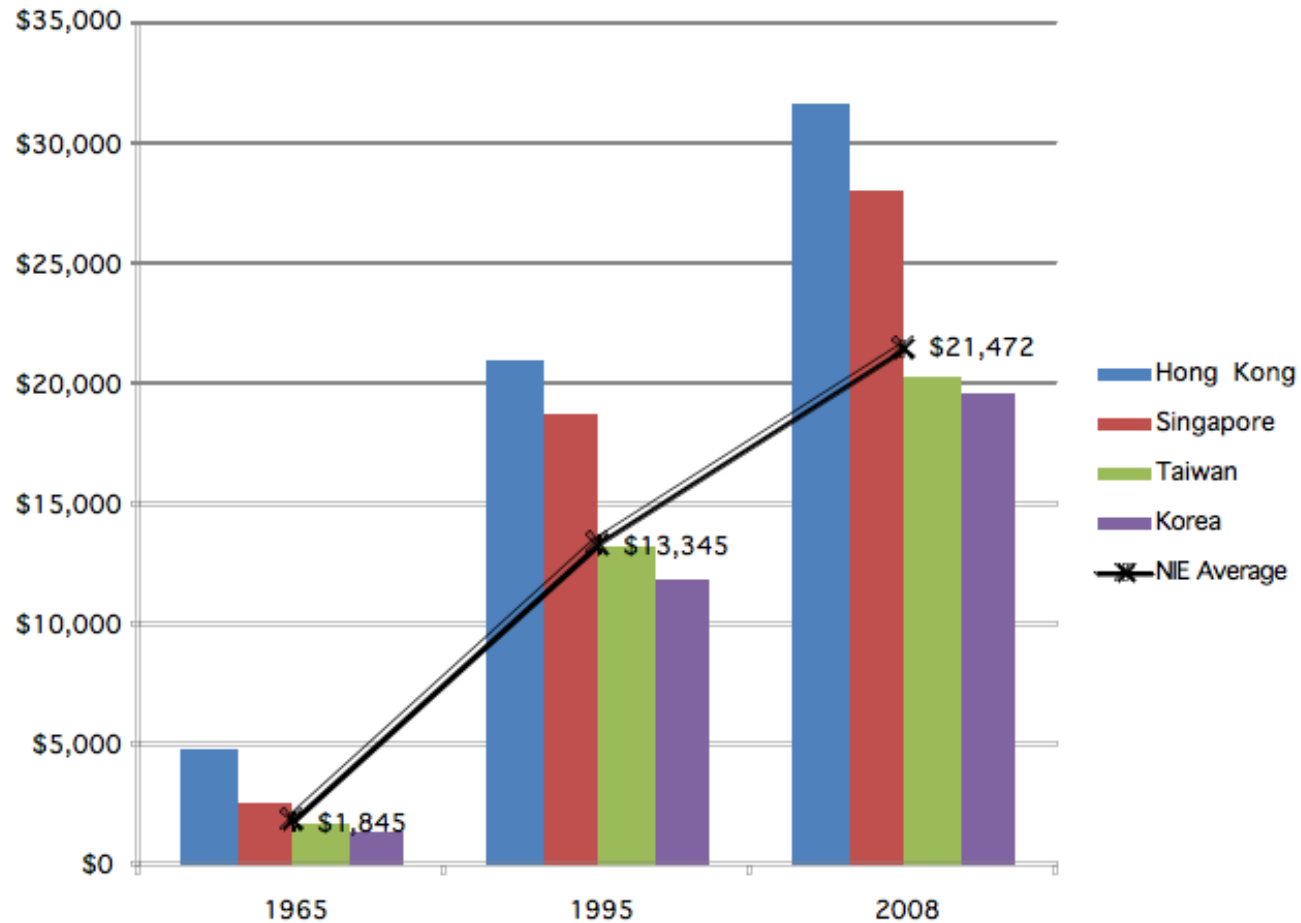
# NIEs Exchange Rates (Base Year = 1993)



# **NIEs in the Post-Crisis Period (Between 1995 and 2008)**

- NIEs' share in global GDP increased marginally from 3.3% to 3.5%
- Share in world exports moderated somewhat from over 9% to 8.4%
- Average per capita income increased by 61%, from \$13,345 to \$21,472 (slide 17)
- Korea saw the largest gain in per capita income - 66%; Taiwan (56%), HK (51%), Sing. (50%)
- Savings and investment rates moderated somewhat from very high levels (slide 8)

# NIEs Per Capita Income (PPP) Between 1965 and 2008



# How Did the NIEs Avoid the Middle Income Trap?

- Sheer Luck?
- Did China's emergence and regional integration help?
- Post-AFC reforms and restructuring?
- Moved up the technological ladder - from tech. adaptation to innovation?
- Any other factors?

# China's Emergence, Regional Integration, and the NIEs

- China's emergence both a challenge and opportunity, more the latter for NIEs?
- Regional integration, production networks, Factory Asia, gravity, and the NIEs
- Exploiting comparative advantage as well as scale economies in the IT era
- Educated labor force and the ability to adapt to changing environment



# Post-AFC Reforms and Restructuring

- Korea led the way, but was a wakeup call to other NIEs too
- Reforming the business model – making *Chaebols* more flexible
- Rebalancing debt and equity – imparting more ownership to enterprises
- Reforming corporate governance
- Fixing the financial sectors

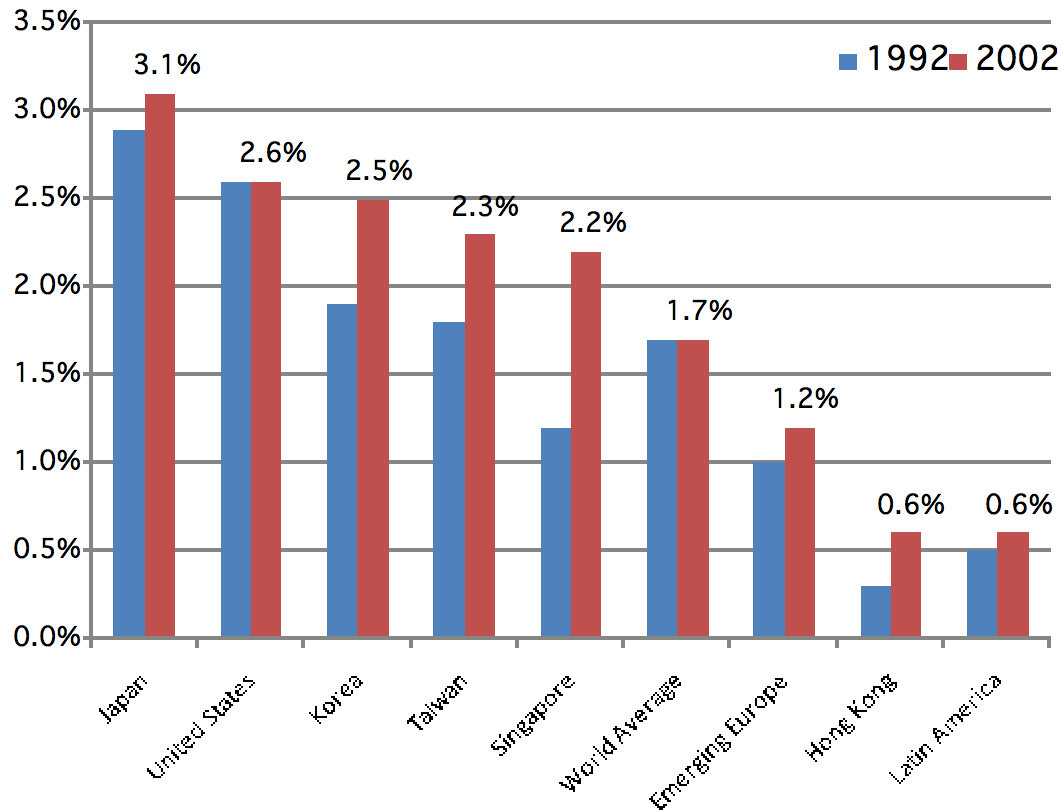
# NIEs as Innovators: Creativity – A Renewable Resource

## Number of Patents Granted by USPTO, Annual Averages

*Source: M. Brahmhatt and A.Hu, August, 2010*

	1990-94	2000-04
NIEs	2,160	11,600
Hong Kong	184	616
Singapore	36	382
Korea	633	4,009
Taiwan	1,307	6,593
Japan	22,647	35,687
United States	59,024	97,104
Latin America	173	368
Emerging Europe	205	348

# R&D Spending as % of GDP (PPP)



Source: M.Brahmbhatt and A.Hu, August, 2010

# Qualitative Aspects of NIEs' Innovation

- Comparative advantage in electrical and electronics products and computers and communication
- Korea scores very well on originality and generality indicators of patents (esp. electronics and mechanical prod.)
- Taiwan excels in computers and communications
- Increasing inter-country sharing and diffusion of innovation among the NIEs

# Conclusion: Nimble NIEs?

- NIEs poor and small until the mid-sixties
- Joined the miracle club in the next 3 decades
- Shared some common features of strategies and policies but also had dissimilarities
- Despite the 1997/98 AFC (Korea most affected), NIEs performed well in the last decade
- Overall, the nimble NIEs avoided the middle income trap
- Their focus on technology and innovation in particular served them well

# Sources of Data

- The World Bank, World Development Indicators, 2010 and 1997
- UNDP, Human Development Report, 2009
- Angus Maddison, Historical Statistics of the World Economy: 1950-2008, OECD, 2010
- Angus Maddison, The World Economy: Historical Statistics, OECD, 2003
- CEPII, The World Economy in 2050: A Tentative Picture, Working Paper 27, December 2010 (for average years of education)
- Milan Brahmbhatt and Albert Hu, "Ideas and Innovation in East Asia", The World Bank Research Observer, August 2010 (for patents, innovation and R&D expenditures)
- <http://www.oanda.com/currency/historical-rates> (for exchange rates)

***ASEAN4's Two-Speed Miracle***  
***Lecture 4***

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor

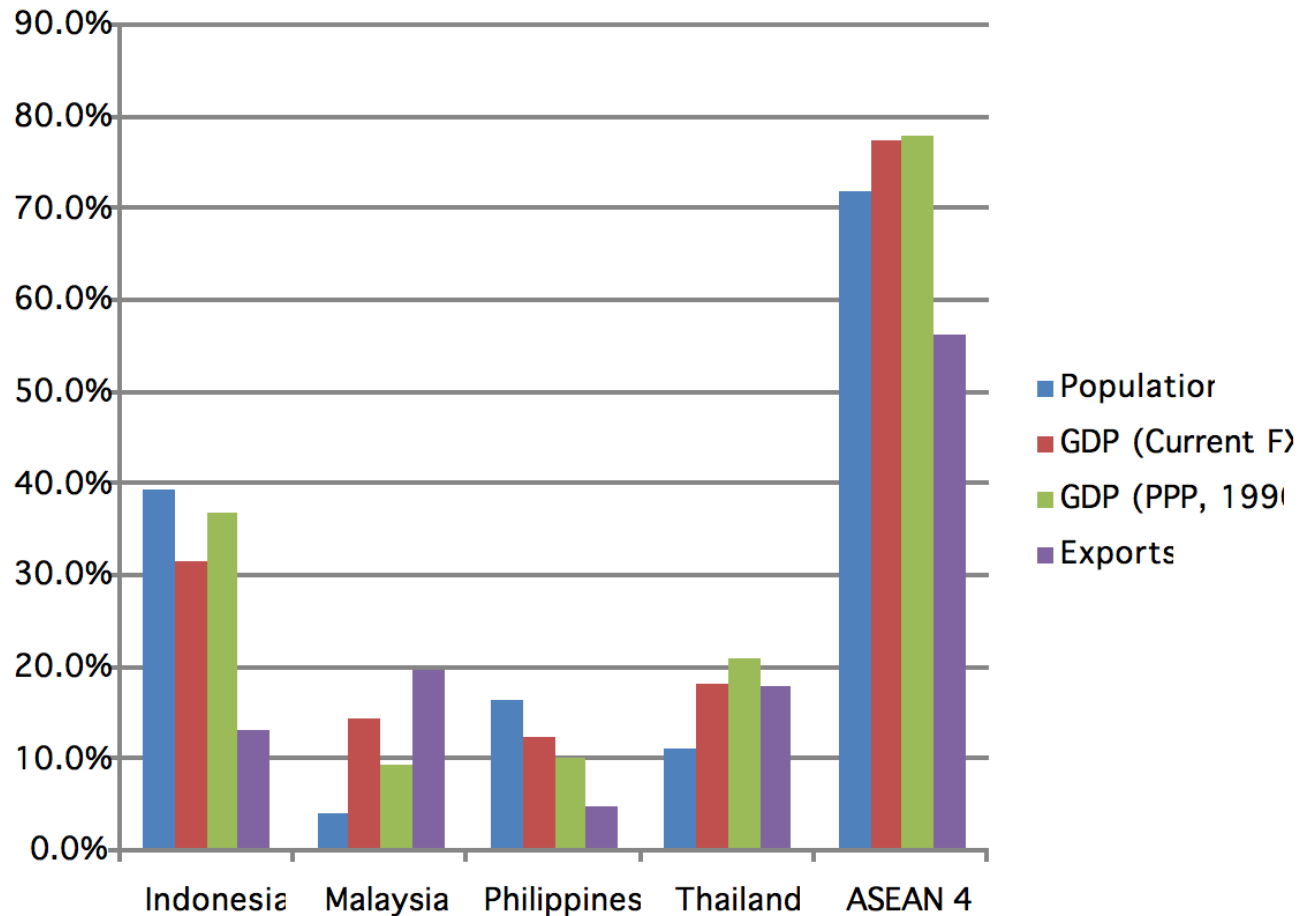
# The ASEAN Economy (2008)

- ASEAN – a group of 10 Southeast Asian countries forming a regional economic bloc
- Building on their regional free trade area (AFTA), plan to form an economic community (AEC) by 2015
- Combined population of 574 million (8.6% global share)
- Combined GDP (at CER) of \$1.3 trillion (2.3% global share), while combined GDP (PPP 1990 prices) of \$2.7 trillion (5.3% global share)
- Combined exports \$1.2 trillion (5.8% global share)



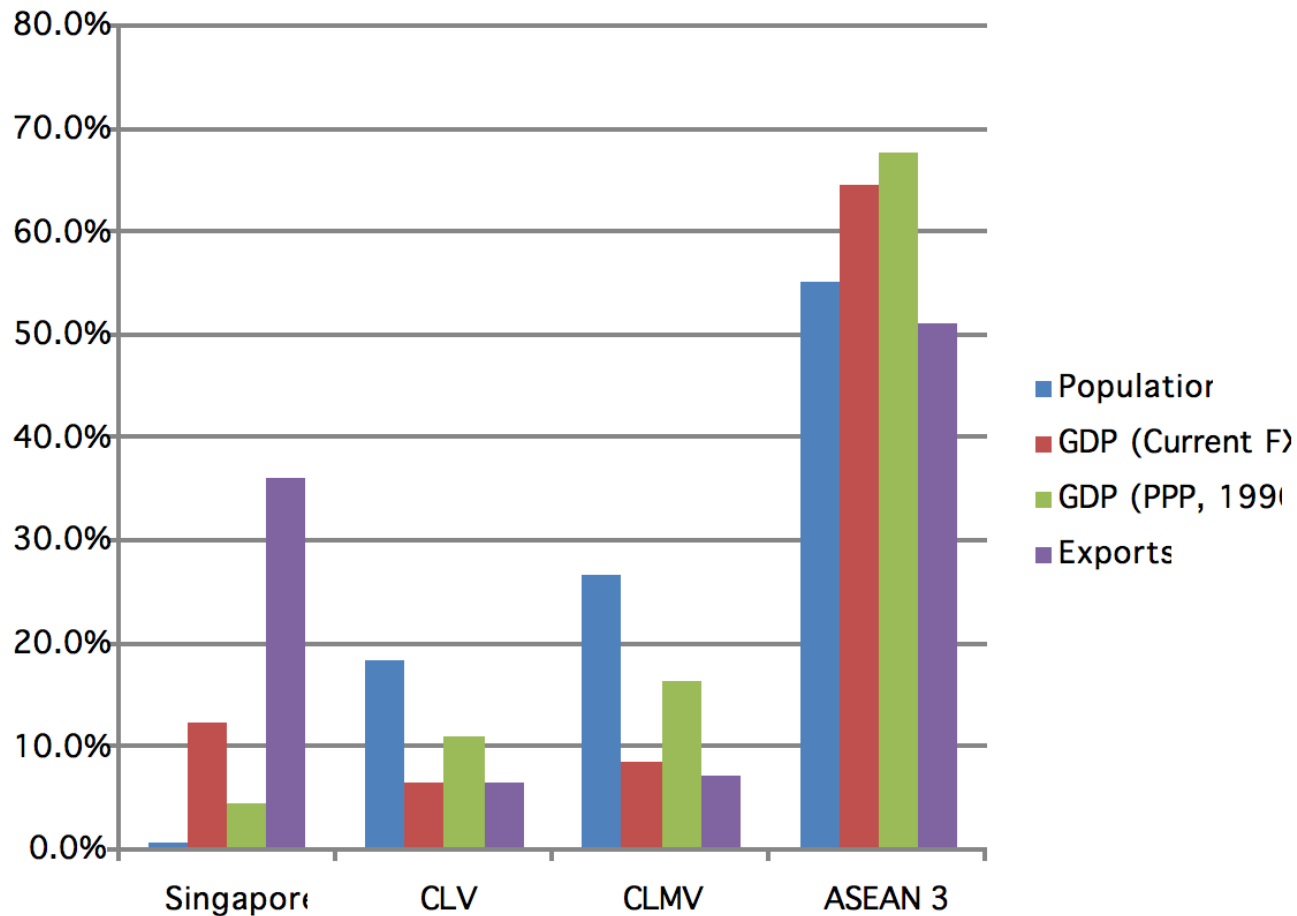
# Know Your ASEAN4 (2008)

## (% of ASEAN Total)



# Know Your ASEAN (2008)

## (% of ASEAN Total)



# Know Your ASEAN (2008)

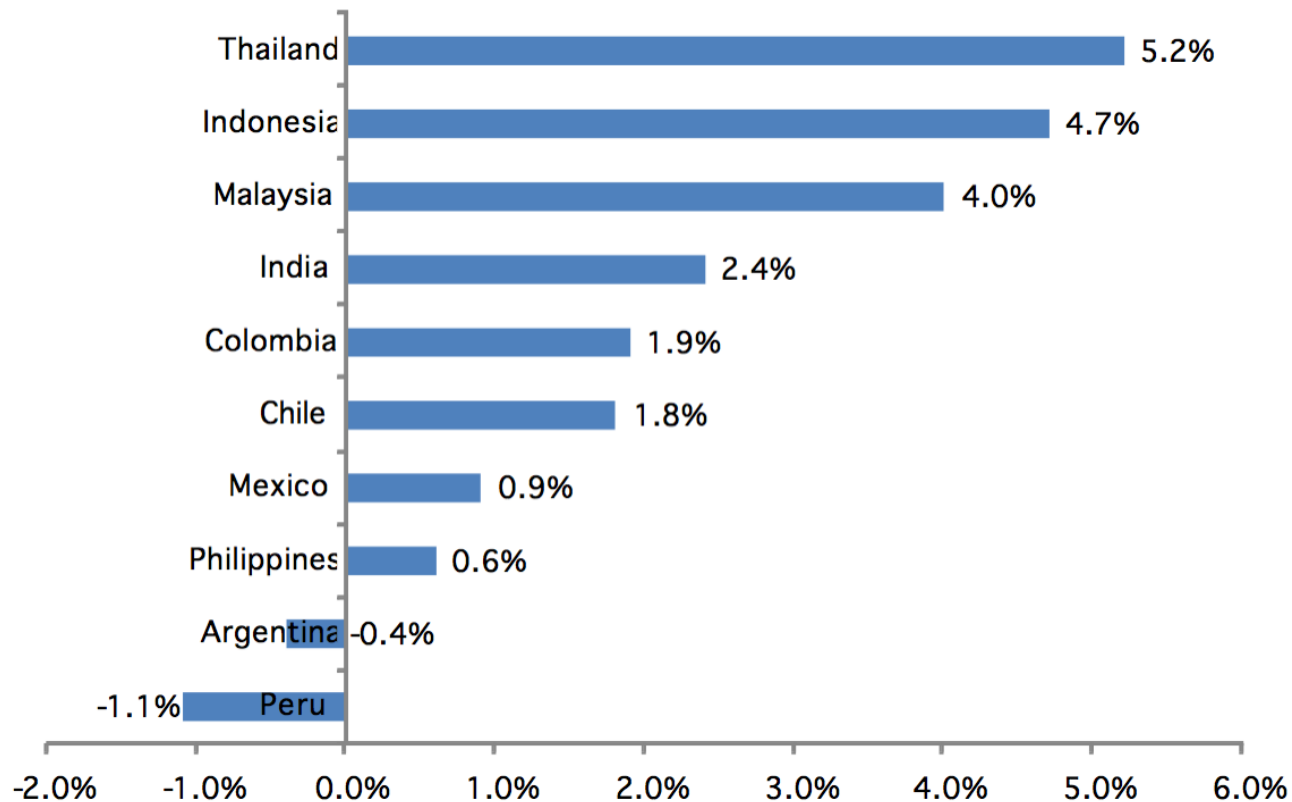
	Per Capita (Current FX)	Per Capita (PPP)	HDI (Rating)
Indonesia	\$1,880	\$4,428	0.734 (M)
Malaysia	\$7,250	\$10,292	0.829 (H)
Thailand	\$3,670	\$8,750	0.783 (M)
Philippines	\$1,890	\$2,926	0.751 (M)
<b>ASEAN 4</b>	<b>\$2,510</b>	<b>\$5,120</b>	<b>0.750 (M)</b>
<b>ASEAN 3</b>	<b>\$2,732</b>	<b>\$5,782</b>	<b>0.752 (M)</b>
Cambodia	\$640	\$2,482	0.593 (M)
Laos	\$760	\$1,669	0.612 (M)
Vietnam	\$890	\$2,970	0.725 (M)
<b>CLV</b>	<b>\$849</b>	<b>\$2,825</b>	<b>0.700 (M)</b>
<b>Singapore</b>	<b>\$47,940</b>	<b>\$28,107</b>	<b>0.944 (VH)</b>

# ASEAN's Multi-Track Development Path

- Singapore part the NIEs miracle and by now a rich country
- ASEAN4 started rapid growth and development since the early 1970
- Produced another Asian miracle in the next quarter century (the Philippines drops out by mid-eighties)
- The 1997/1998 AFC – a major disruption to the miracle
- CLV – still poor but Vietnam produces a mini-miracle since the early 1990s

# The ASEAN4 Miracle: 1970-1995 (A Two-Speed Race)

*Annual average growth in per capita GDP at constant domestic prices*



# **ASEAN4 Miracle: 1970-1995**

## **(A Two-Speed Race)**

- ASEAN4 saw a 3-fold increase in its average per capita income (PPP 1990)
- Thailand: 4-fold; Malaysia: 3.5-fold; Indonesia: 3-fold
- The ASEAN3's average per capita income thus increased by more than 3-fold
- Philippines lagged behind, with an increase of only 24% in 25 years
- Around the early to mid-1980s, Philippines dropped out of the miracle club

# ASEAN 3 Miracle in a Global and Historical Perspective

*Per Capita Income in PPP 1990 Dollars*

	<b>1820</b>	<b>1870</b>	<b>1913</b>	<b>1950</b>	<b>1965</b>	<b>1970</b>	<b>1995</b>
Indonesia	612	654	904	840	983	1,181	3,369
Malaysia	600	604	820	770	1,804	2,079	10,292
Thailand	646	712	841	817	1,308	1,694	8,750
Philippines	704	776	1,053	1,070	1,633	1,764	2,194
India	533	533	673	619	771	868	1,553
Latin America	692	681	1,481	2,510	3,447	3,996	5,493
Africa	420	500	637	889	1,181	1,335	1,334
<b>World</b>	<b>667</b>	<b>875</b>	<b>1,525</b>	<b>2,111</b>	<b>3,228</b>	<b>3,729</b>	<b>5,446</b>

# Beyond GDP, PPP, and Per Capita (Progress in Poverty Reduction)

## Percentage of People below Poverty: Initial Year (and the Latest Year)

	<b>\$1-A-Day</b>	<b>\$2-A-Day</b>
Indonesia: 2005 (2007)	21.4 (29.4)	53.8 (60.0)
Malaysia: 1997 (2004)	2.0 (2.0)	6.8 (7.8)
Thailand: 2002 (2004)	2.0 (2.0)	15.1 (11.5)
Philippines: 2003 (2006)	22.0 (22.6)	43.8 (45.0)
India: 1993 (2004)	49.4 (41.6)	81.7 (75.6)
China: 2002 (2005)	28.4 (15.9)	51.1 (36.3)
Brazil: 2005 (2007)	7.8 (5.2)	18.3 (12.7)



# ASEAN3 Miracle: Explanations

- Learning from Japan and the NIEs
- Japan's post-Plaza accord outward FDI to ASEAN – a helping hand?
- Prudent macroeconomic management (low fiscal deficit, low-to-moderate inflation, moderate current account deficit and external debt)
- High savings and investments
- Investment in human capital
- Trade and investment liberalization
- (Investment, Infrastructure, and Institutions)

# ASEAN3: Investment (and Savings) (% of GDP)

	1970	1980	1995	2008
Indonesia	16	24 (37)	32 (28)	28 (20)
Malaysia	22	30 (33)	44 (34)	22 (38)
Thailand	26	29 (23)	42 (34)	29 (29)
Philippines	21	29 (24)	22 (19)	15 (NA)
India	17	21 (17)	27 (27)	40 (38)
Colombia	20	19 (20)	26 (19)	25 (19)
Brazil	21	23 (21)	18 (16)	19 (17)
Mexico	21	27 (25)	20 (19)	26 (25)
Peru	16	29 (32)	25 (16)	26 (22)

# Focus on Human Capital

- Like the NIEs before them by early to mid seventies, achieved close to universal primary education
- Further improvements in the next decades in secondary and tertiary education (slide 13 )
- Partly due to robust public spending on education (slide 14)
- Good progress in health care, safe water, sanitation, and life expectancy, and other human development indicators

# ASEAN3: Secondary (and Tertiary) Enrollment Rates

	1980	1993	2008
Indonesia	29 (NA)	43 (10)	76 (18)
Malaysia	48 (4)	59 (NA)	NA (30)
Thailand	29 (13)	37 (19)	NA (NA)
Philippines	64 (24)	79 (26)	81 (28)
India	30 (5)	NA (NA)	57 (13)
China	46 (1)	52 (6)	74 (22)
Colombia	41 (9)	62 (10)	91 (35)
Brazil	34 (11)	43 (12)	100 (30)
Mexico	48 (14)	58 (14)	87 (26)
Peru	59 (17)	65 (40)	98 (34)

# ASEAN3: Public Spending on Education (As % of GDP)

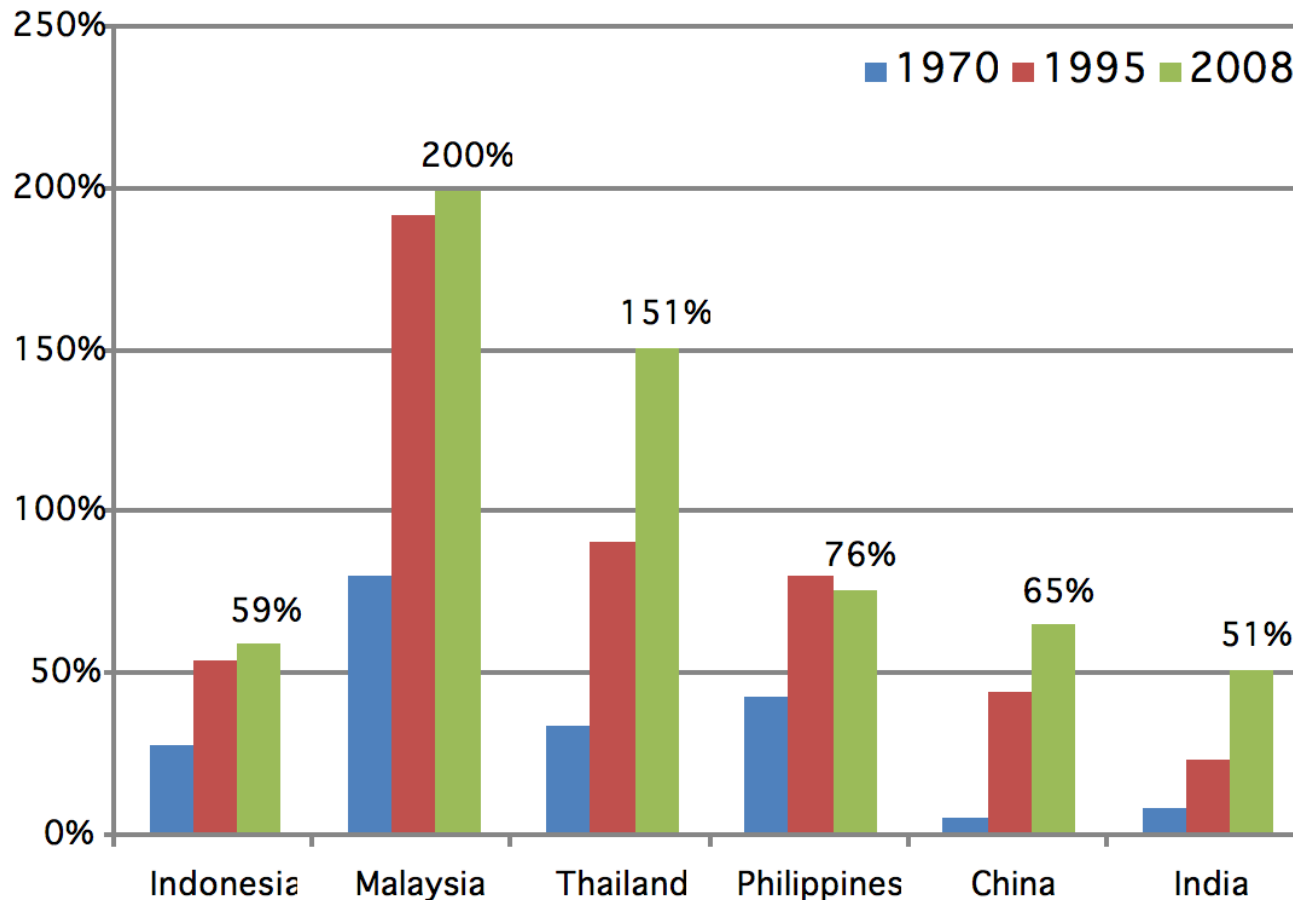
	1980	1992	2008
Indonesia	NA	NA	3.5%
Malaysia	3.9%	4.1%	4.7%
Thailand	2.3%	2.7%	4.0%
Philippines	1.7%	NA	NA
China	1.7%	3.0%	NA
India	2.1%	2.5%	3.2%
Argentina	2.0%	2.9%	5.5%
Brazil	2.6%	NA	5.0%
Mexico	2.0%	2.2%	4.8%
Colombia	1.7%	3.0%	3.9%
Peru	2.0%	NA	2.5%

# ASEAN3: Trade and Foreign Investment Liberalization

*Mean Tariffs % and % Covered by NTBs*

	<b>1990-93</b>	<b>2006-08</b>
Indonesia	19.4 (2.7)	5.8 (NA)
Malaysia	14.3 (2.1)	5.9 (NA)
Thailand	23.1 (5.5)	10.8 (NA)
Philippines	20.0 (NA)	5.0 (NA)
China	36.3 (11.3)	8.6 (NA)
India	56.3 (62.6)	9.7 (NA)
Latin America	NA	8.0 (NA)

# Foreign Trade (As % of GDP)

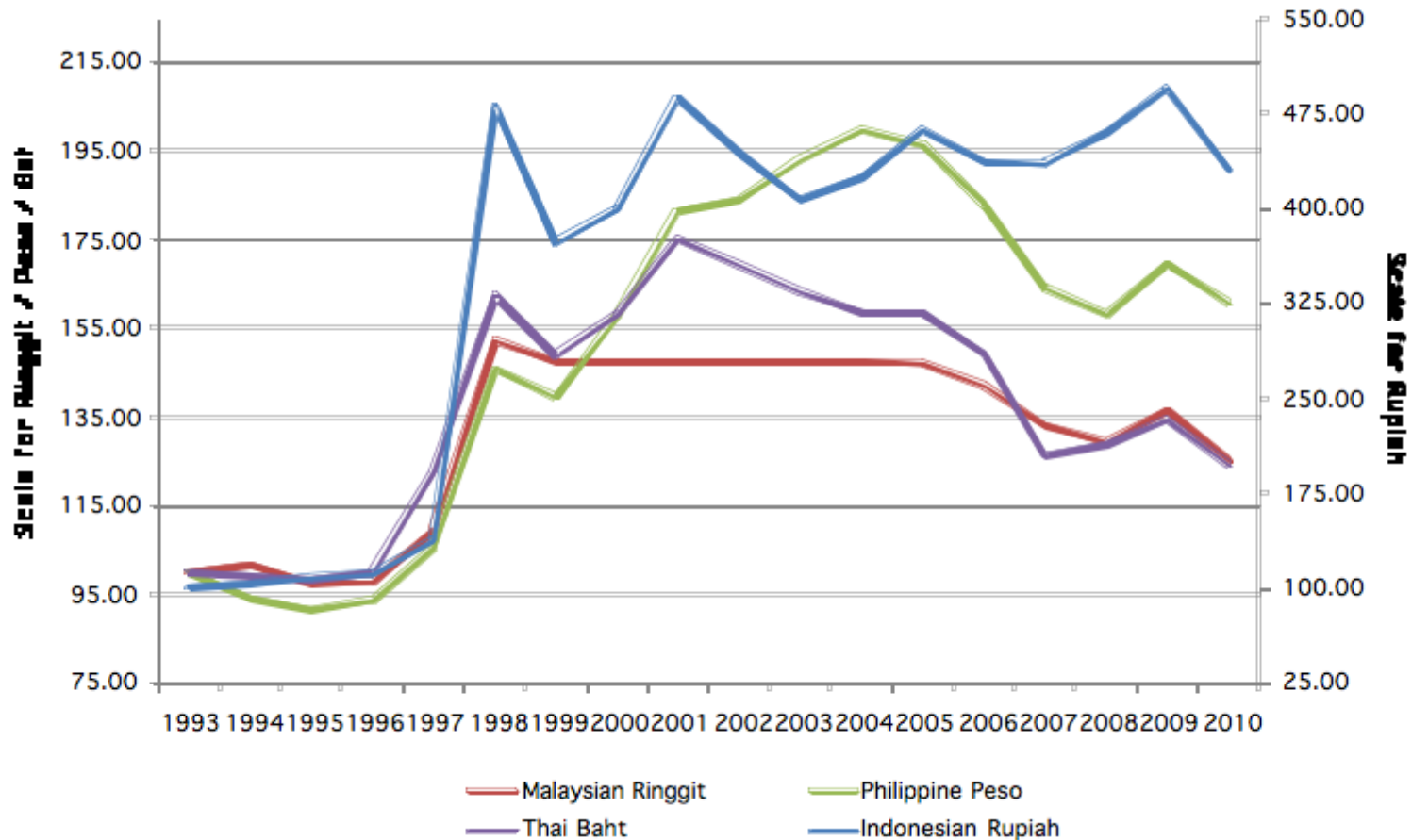


# **ASEAN3: After the Miracle A Crisis (The 1997-98 AFC and After)**

- The genesis of AFC – Baht under attack in July 1997
- Crisis contagion from Thailand to other countries
- One deficit but twin mismatches – currency and maturity mismatches
- From currency crisis to a banking crisis, and even to a corporate crisis
- Currencies plunged (slide 19) and an unprecedented region-wide recession followed
- Was it simply a liquidity crisis or an insolvency crisis too?
- The IMF, the Asian crisis, and aftermath – the beginning of the end of the Washington Consensus?



# AFC and the Currencies (Base Year = 1993)



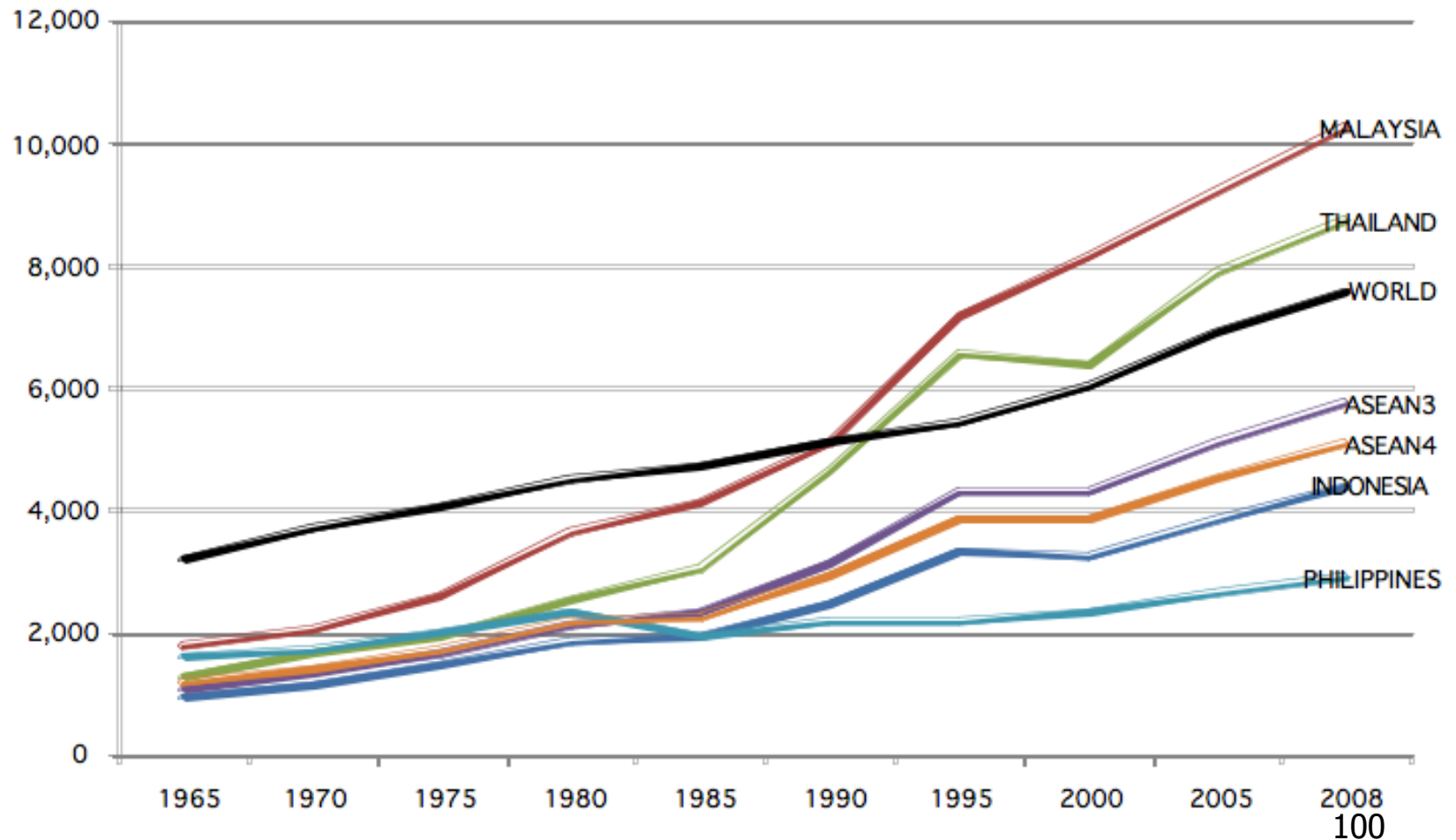
# ASEAN 3 and the AFC

- Both Thailand and Indonesia went to IMF and other multilaterals for rescue packages
- Countries had to first contain the capital flight and stabilize the currencies
- Then dealt with the banking problems of nonperforming loans, capital adequacy, and accounting and disclosure inadequacies
- Introduced corporate reforms and restructuring
- Indonesia and Thailand introduced more flexible exchange rate regimes
- While Malaysia introduced the then controversial capital controls and a pegged exchange rate regime

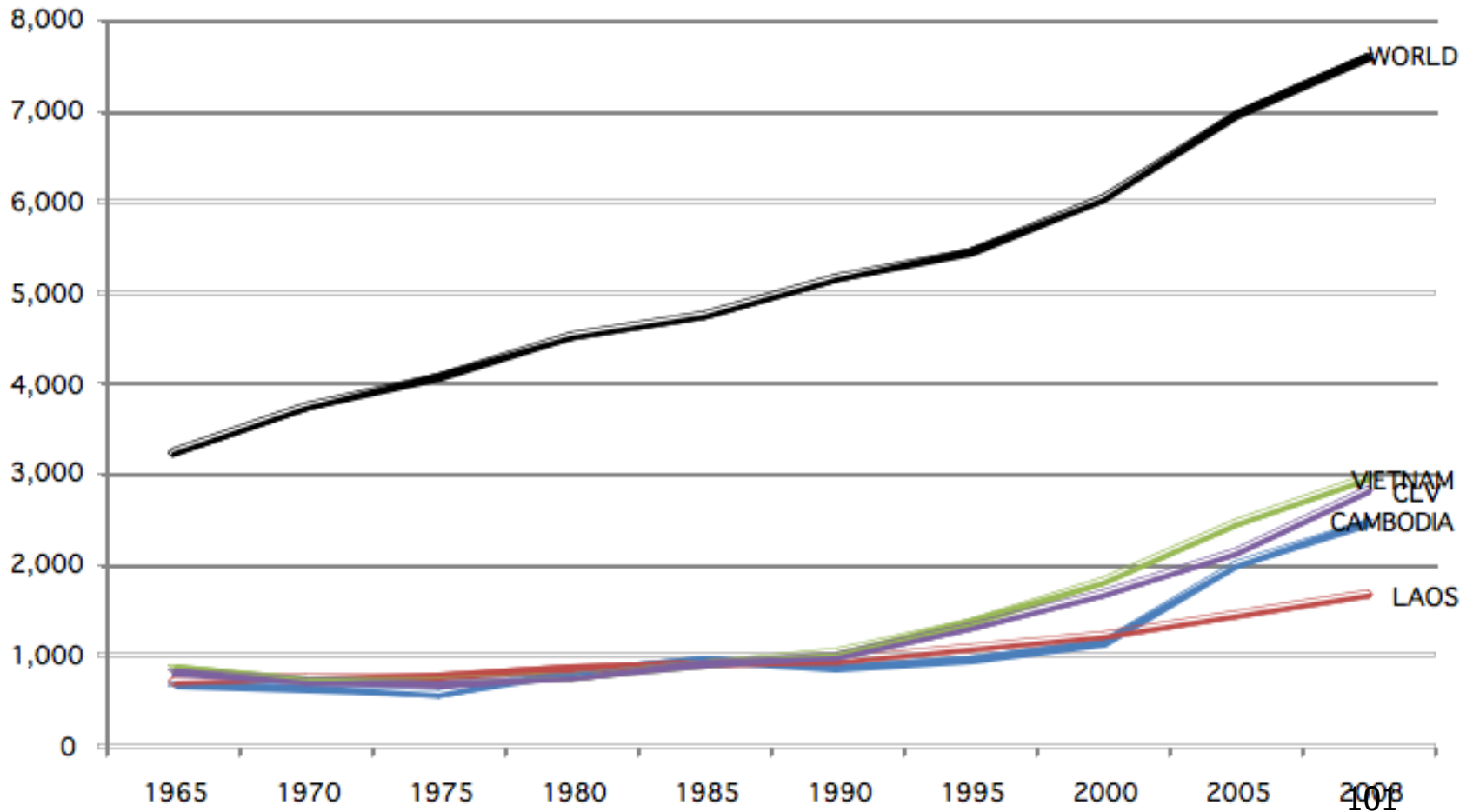
# ASEAN3 After the AFC

- AFC - A major disruption to the ASEAN3 Miracle
- Incomes declined (in some cases for prolonged periods)
- AFC also a major setback to poverty alleviation
- Investment fell sharply in the aftermath of the AFC and not recovered much even now (slide 12)
- Economic growth has returned to the region in recent years (slide 22)
- While the poorer CLV countries have started a mini-miracle of catch-up growth (Slide 23)

# ASEAN3 Since the AFC (per capita GDP (ppp 1990 \$))



# CLV Countries: Per Capita Income (ppp 1990\$)



# ASEAN3: Caught in the Middle Income Trap (MIT?)

- Avoiding the MIT - a major challenge for ASEAN3
- Plenty of historical precedents for ASEAN3
- Could be squeezed between China, India, Vietnam (and even distant countries like Brazil) the on the one hand
- And the NIES on the other
- Key Challenges - Reviving investment, fostering innovation, integrating regionally

# Facilitate Investment (Days Required To)

- **Start business:** Indo: 60; **Malay: 11**; Thai: 32; Phil: 52; Korea: 14; China:37; India:30; (Australia:2; Guinea-Bissau:213; World:36)
- **Close business: (years):** Ino:5.5; Malay:2.3; Thai:2.7; Phil:5.7; Korea:1.5; China:1.7; (Ireland:0.4; India: 7; World:3)
- **Register property:** Indo:26; Malay:144; **Thai:2**; Phil:33; Korea:11; China:29; India:44; (Netherlands:2; Haiti:405; World:65)
- **Enforce contract:** Indo:570; Malay:585; Thai:479; Phil: 842; Korea:230; China:406; India: 1420; (N.Zealand:216; Afghan:1642; World:607)
- **Trade logistics index (1-5):** Indo:2.76; Malay:3.44; Thai:3.29; Phil:3.14; Korea: 3.64; China: 3.49; India:3.12; (Germany:4.11; Somalia:1.34; World: 4.1)

# Foster Innovation

- Average years of education compares well with other countries (5.1 yrs in Indo, 6.6 in Thai, and over 8 in Malay and Phil)
- Building on this, foster higher education, esp. in science and technology
- Need to graduate from tech. adaptation stage (eg, low patents) to the innovation stage
- Step up R&D spending (currently ranging from 0.1% of GDP in Indo. to 0.7% in Malay)
- Overall, model on, say, Korea and Taiwan



# Integrate Regionally

- First, focus on internal integration within the ASEAN
- Take the lead in expediting the formation of a functioning AEC
- Simultaneously integrate with the rest of Asia, including East Asia and India
- Fortify the position as an integral part of "Factory Asia"
- Cooperate regionally, even as you compete regionally - "Co-opetition"

# Conclusions

- Close on the heels of the NIES, ASEAN3 perform an economic miracle up until the mid-1990s (even as the Philippines drops out of the race in the mid-1980s)
- Despite a major blow from the 1997-98 AFC, growth has returned to ASEAN3 in recent years
- Key challenges to avoid the MIT - reviving investment, fostering innovation, and integrating regionally (priorities will differ across countries)
- Will the “adaptive ASEAN3” address the challenges effectively and move up from middle income to high income status?

# Sources of Data

- The World Bank, World Development Indicators, 2010 and 1997
- UNDP, Human Development Report, 2009
- Angus Maddison, Historical Statistics of the World Economy: 1950-2008, OECD, 2010
- Angus Maddison, The World Economy: Historical Statistics, OECD, 2003
- CEPII, The World Economy in 2050: A Tentative Picture, Working Paper 27, December 2010 (for average years of education)
- Milan Brahmbhatt and Albert Hu, "Ideas and Innovation in East Asia", The World Bank Research Observer, August 2010 (for patents, innovation and R&D expenditures)
- <http://www.oanda.com/currency/historical-rates> (for exchange rates)

***China Joins the Miracle Club:  
Lecture 5***

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor

# China Today (2008)

- Population: 1.3 billion (20% global share)
- GPP CER: \$3.9 trillion (6.7% global share)
- GDP PPP 1990: \$8.9 trillion (17.5% global share)
- Per capita income (CER): \$2,940 (52% of global average)
- Per capita income (PPP, 1990): \$6,725 (88% of global average)
- Exports: \$1.6 trillion (8% of global share) and trade to GDP ratio: 65%
- Life Expectancy: 73 yrs; HDI: 0.772 (M)
- Poverty (2005): \$1-a-day: 15.9%; \$2-a-day: 36.3%

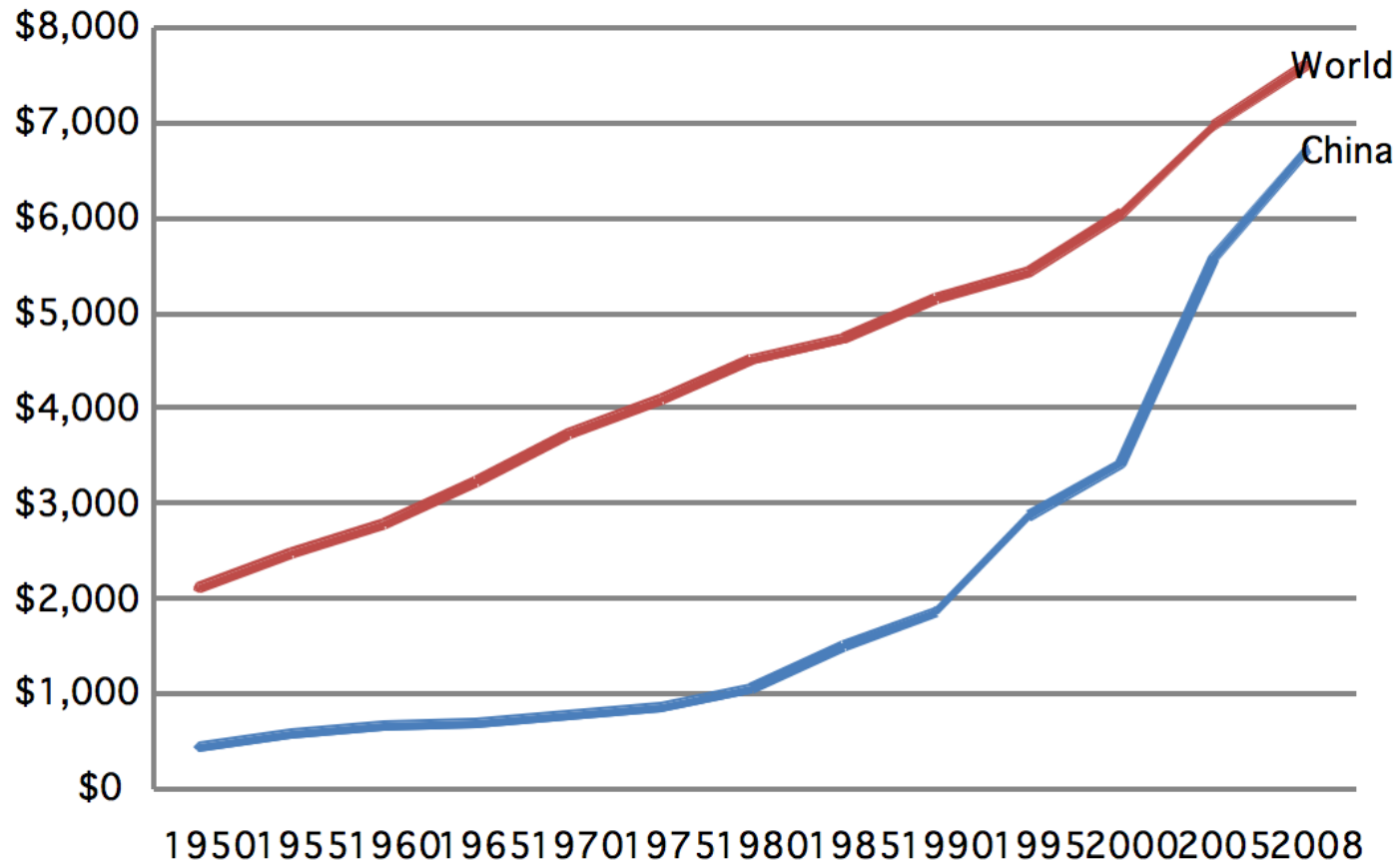
# China Yesterday (1980)

- Population: 981 million (22% global share)
- GDP PPP 1990: \$1.1 trillion (5.2% global share)
- Per capita income (PPP 1990): \$1,061 (24% of global average)
- Exports:\$21 billion (0.9% global share)and trade-GDP ratio of 13%
- Life expectancy: 67 yrs
- Widespread poverty, with 75% of labor force dependent on low productivity agriculture

# The China Miracle (1980 – Present)

- Per capita income (PPP 1990) increased by more than 6-fold
- Share in global GDP (PPP) increased by more than 3-fold
- Share in global exports increased by more than 8-fold (0.9% to 7.9%)
- Share in global merchandise exports increased 10-fold (0.9% to 8.9%)
- Poverty declined hugely
- The second largest economy in the world in PPP terms, after the US)
- FDI registered massive increase: China is the world's largest recipient of FDI today

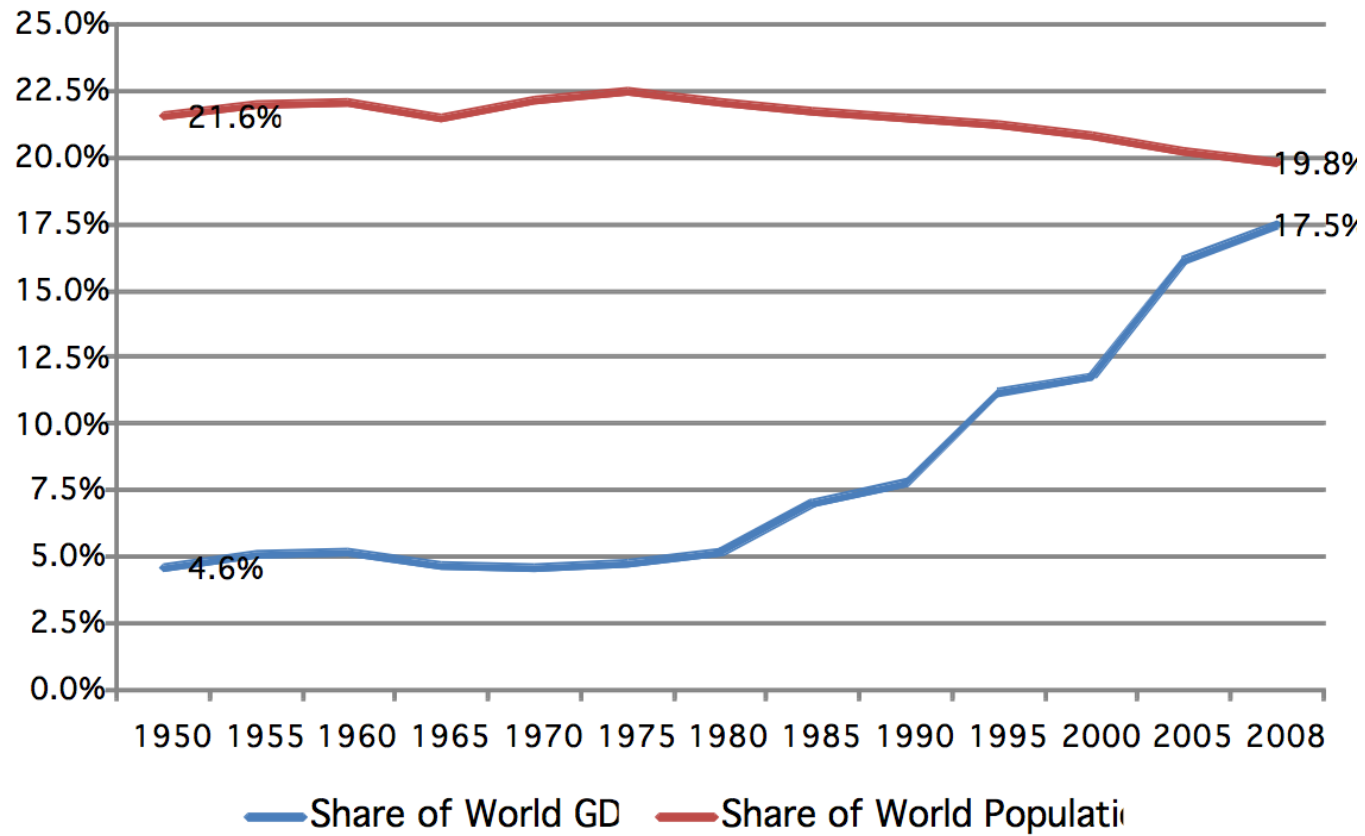
# China's Per Capita Income (1950-2008)



*PPP in 1990 terms*



# China's Share of World GDP and Population (1950-2008)



*PPP in 1990 terms*

# Before the Miracle: (1949-1958)

- Preparatory years after the establishment of PRC in October 1949
- Copied the USSR Stalinist model of central planning and institutions
- Massive land reforms during 1949-52
- The First Five Year Plan with Soviet-style heavy industrialization strategy
- The Plan: “Half in Moscow and half in Peking”
- 1956-57 – Hundred Flowers Bloom and the subsequent repression

# **Before the Miracle: The Great Leap Forward (1958-1966)**

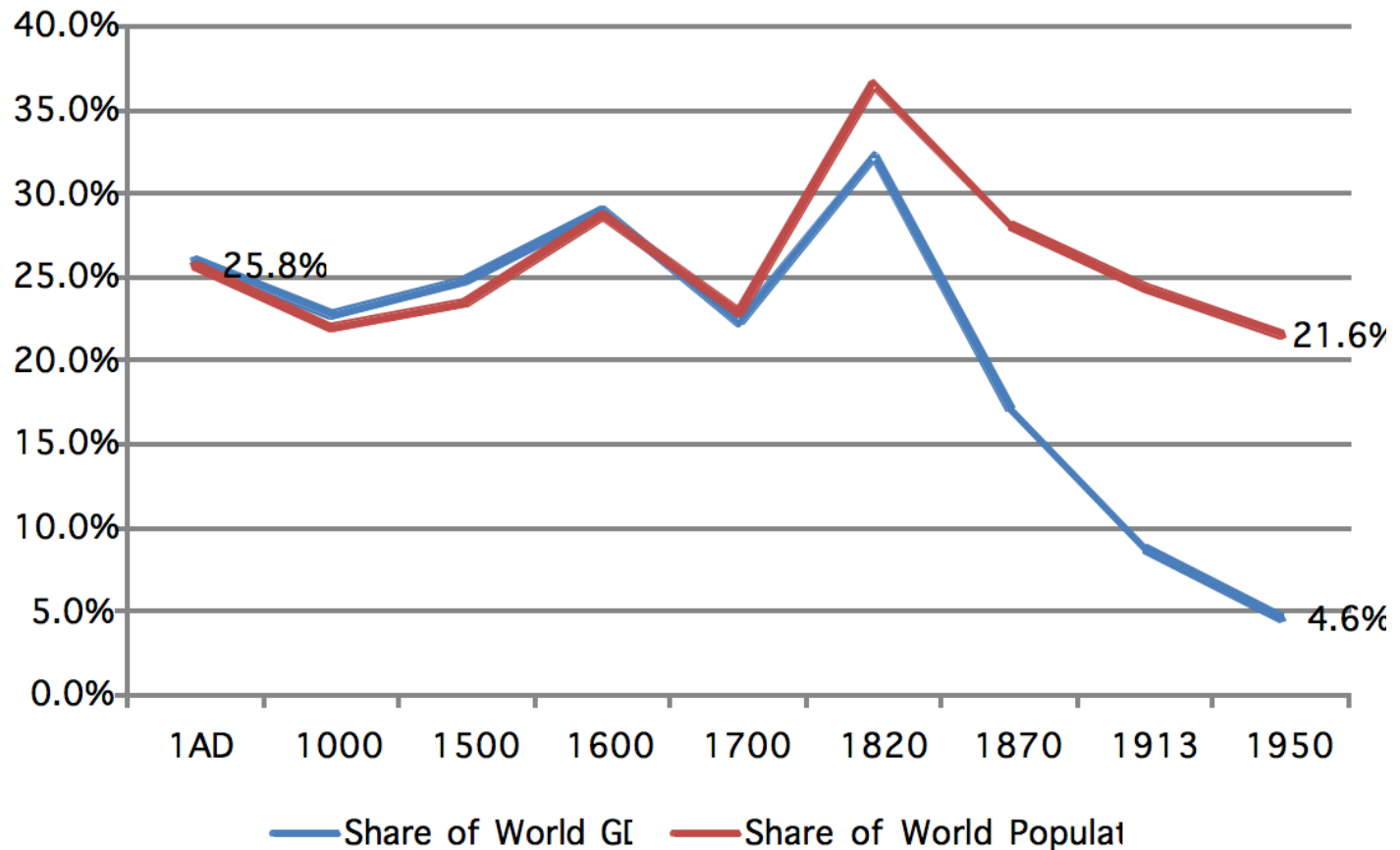
- A two-pronged effort: “walking on two legs”
- Continued massive investments in heavy industry
- Plus focus on commune-based agriculture
- Household backyard steel furnaces (60,000) melted existing tools to make new tools
- 26,000 communes with 14 hours a day work, and deeper sowing and closer planting)
- 1960 famine that killed about 30 million
- And another 30 million births were postponed due to food shortage and malnutrition

# Before the Miracle

## The Cultural Revolution Era (1966-1978)

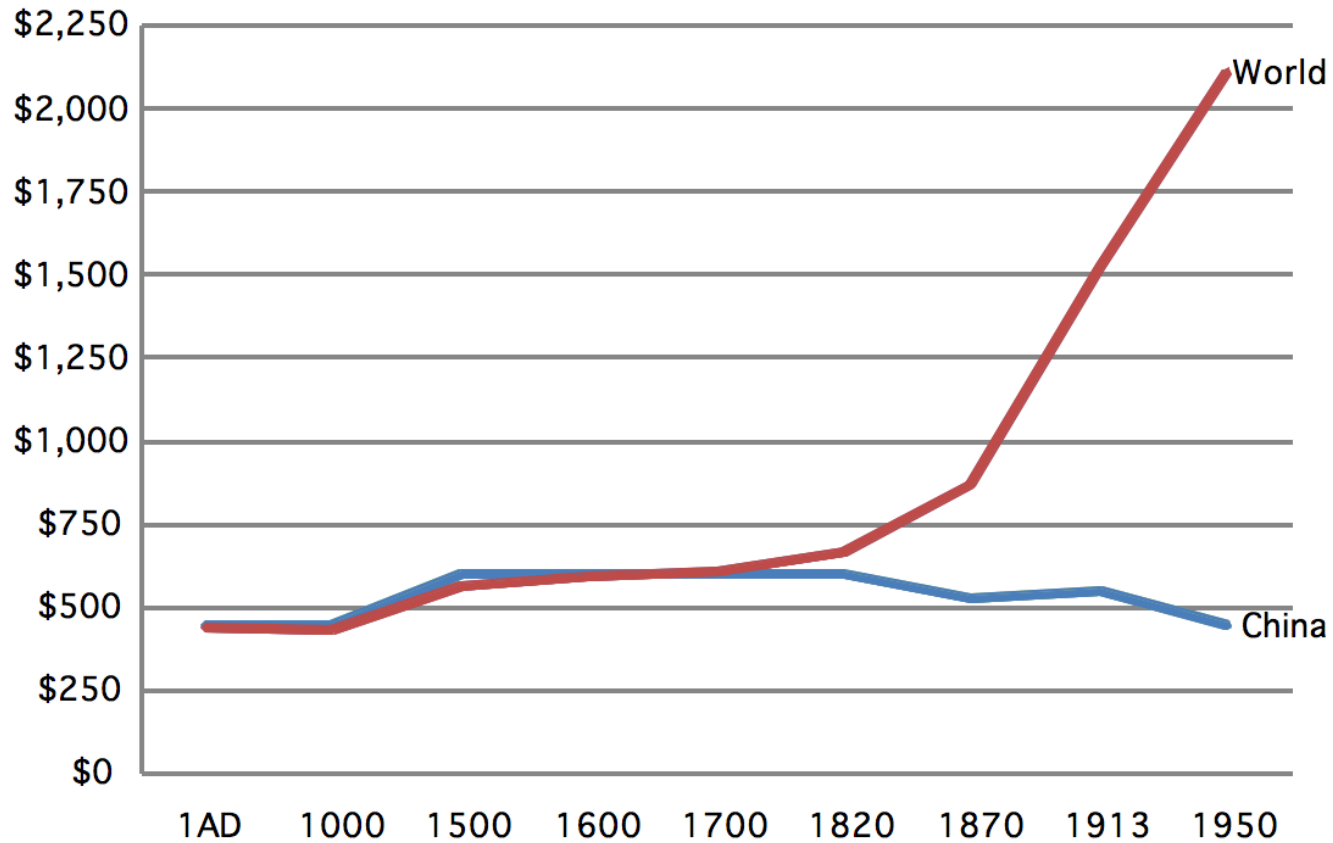
- Difficult to Define the core of CRE but always identified with "Red Guards"
- **Four Key Trends:**
  - Pervasive militarization of the economy
  - Complete suppression of markets and incentives
  - Ceasing of rural-urban labor mobility
  - Cutting China's links with the outside world
- The end of Maoism and the emergence of Deng Xiaoping as the Leader

# China Miracle: A Historical Reemergence (GDP and Pop. Shares: 1AD to 1950)



*PPP in 1990 terms*

# China's Per Capita Income (1AD to 1950)



*PPP in 1990 terms*

# **Initial Conditions for the China Miracle: Economic Consequences of the Socialist Era**

- Complete suppression of markets and incentives
- Isolation of China from the rest of the world
- Low employment growth and widespread poverty
- Huge but inefficient investments
- Neglect of services
- Rural-urban divide
  
- **Some silver linings however: high savings, hard working, literate people with basic skills for industry and manufacturing**

# China's Reforms and Opening Up

## Four Phases of Reforms

- 1978-1984
- 1984-1993
- 1993-1998
- 1998-Present



# First Phase of Reforms: Begin with the Farm Sector (1978-1984)

- A dual-track system of farming: getting price incentives to work
- Agricultural Collectives and the household contract system
- A certain amount of the farm produce by the households to be turned into Collectives at procurement target prices
- The households free to sell the excess output at market prices
- Introduced initially on a pilot basis, the contract system was extended to the entire rural China by 1983
- Grain output increased by 30% between 1978 and 1984, to 407 million tons
- Rural reforms produced quick results and instrumental in initial poverty reduction

# **Second Phase of Reforms: From Farming to Industry (1984-1993)**

- The basic tenets of what succeeded in the rural sector was introduced in the industry and manufacturing
- Again on a pilot basis first and then extended
- Dual pricing by the State-owned industrial enterprises
- Relaxation of entry barriers
- Setting up of special economic zones in coastal China to encourage production for exports
- Introduction of a dual exchange rate system

## **Third Phase of Reforms: From Planning to Market Economy (1993-1998)**

- By 1994, material balance planning was abolished and markets took over in allocating resources
- The two-tier exchange rate system was unified
- Central-local government responsibilities and authorities were clearly specified
- Market-based macroeconomic policy tools were increasingly relied upon
- PBOC, established in 1983, was given a workable organizational structure by 1998

# Fourth Phase of Reforms: Refining the Market Economy (1998-Present)

- China played a key role in not precipitating the 1997-98 AFC
- Became a WTO member in December 2001
- Regulatory reforms and Institution building for the financial sector
- Introduced corporate governance
- (Overall, developing the institutional set up for a market economy, even as the government continued to provide high quality infrastructure for economic development)

# The China Miracle: Investment, Infrastructure, and Institutions

- Investment, which was already high at 35% of GDP in 1980 increased further to 42% in 1995 and 44% in 2008
- Savings increased even more: from 35% in 1980 to 43% by 1995 to 54% in 2008
- China has also made progress in moving up the education ladder – from primary to secondary and even tertiary education (lecture 4 slides)
- By many indicators, China's infrastructure, funded largely by the State sector, is impressive, especially in the coastal areas
- The institutional underpinnings for development have also been significantly reformed and restructured in the past decades

# The China Miracle: Trade Reforms and External Opening Up

- Like in other areas, here too a gradual approach
- Mean statutory tariff rate has come down from 50% in 1980 to 16% by 2000 and to less than 10% by now
- NTBs have also been reduced substantially
- Today, exports account for 37% of GDP, up from 6% in 1980
- Manufacturing products now constitute 95% of China's merchandise exports
- China is at center stage in the rapidly evolving "Factory Asia"
- China's success in fostering FDI has been legendary

# The China Miracle: Institutional Development

- Building institutions for a market economy
- PBOC was established in 1983
- A set of regulatory institutions for financial sector established, especially since AFC
- For example: CBRC, CSRC, State Intellectual Property Office, State Administration of Technical and Quality Office
- China also became an integral part of several regional and global organizations/forums etc.
- Still an evolving process

# China's Future Challenges

- Still significant poverty – Sustaining high growth and ensuring inclusiveness
- Managing the environment and massive urbanization
- Rebalancing the sources of growth away from exports to domestic demand
- Playing a constructive role in regional and global governance



# Sustaining Growth and Fostering Inclusiveness

- Twin Challenges: avoiding the MIT and tackling development disparities
- At a time when population is ageing and slowing
- Higher education, R&D and innovation – key
- By 2005, China produced 3.4 million graduates (about half postgraduates)
- Yet, only 10% of these meet US standards (McKinsey Global Institute)
- Tackling intra-regional disparities and income inequalities

# Managing the Environment and Urbanization

- Only 20% of the population has access to safe drinking water
- 400 of the 660 major cities now face water shortage, 13 of them severe
- Half the major lakes are severely polluted, and only 38% of river water is drinkable
- By 2003, air pollution was causing more than 400,000 deaths a year (per capita car ownership is still very low)
- China currently contributes 17% of global carbon emissions
- Shanghai just about makes the 100th place in the worldwide ranking of 215 cities by livability (Beijing 116; Gaungzhou 131; Nanjing 135; Shenyong 145; Jilin 161)
- Share of urban population increased from 21% in 1981 to 43% by 2005

# Rebalancing the Sources of Growth

- China's more than \$2.6 trillion forex reserves – a global concern
- Accumulated current account surpluses – excess savings (over investment)
- Political economy of development and the limits to export-led growth
- Need for adjustment by saving less (consuming more)
- China's private consumption is only 34% of GDP in 2008 (down from already low of 51% in 1980 and 42% in 1995) – almost lowest in the world
- Government consumption also down from 15% of GDP in 1980 to 12% in 2008
- How to transform a producer-exporter economy to a consumer-importer at the margin? What role for exchange rate?

# **Playing a Constructive Role in Regional and Global Governance**

**As China's economic importance grows, so will its responsibilities in:**

- Asian regional forums (eg, ASEAN+3 and EAS)
- Regional Institutions (such as ADB and UNESCAP)
- Trans-regional forums such as the APEC
- Global forums such as the G20
- Global institutions such as the WTO, IMF, WB

# Conclusions

- China was the largest economy in the world for centuries (in 1820 accounted for 1/3rd of global GDP)
- Then declined in importance until around 1980 (Withdrew from the rest of the world)
- Has gained some of the lost ground since 1980 through re-integration with the world (now 17.5%)
- Has emerged as an economic powerhouse regionally and globally - really a miraculous performance
- China's challenges going ahead are formidable
- Will china be able to successfully address those challenges?

# Sources of Data

- The World Bank, World Development Indicators, 2010 and 1997
- UNDP, Human Development Report, 2009
- Angus Maddison, Historical Statistics of the World Economy: 1950-2008, OECD, 2010
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- Alan Winters and Shahid Yusuf, 2007, Dancing with the Giants: China, India, and the Global Economy, The World Bank and Institute of Policy Studies

***India's Late Entry to the Miracle Club***  
***Lecture 6***

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

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# India Past and Present (Economic Indicators)

*Note: Figures in brackets are % global share, except for urbanization which is global average*

	1980	1990	2008
Population	679 mil (15%)	839 mil (16%)	1.15 bil (17%)
Urban Population	23% (...)	26% (43%)	30% (50%)
GDP (Current FX)	\$162 bil (...)	\$317 bil (1.5%)	\$1.2 tril (2.1%)
GDP (PPP, 1990)	\$637 bil (3.2%)	\$1.1 tril (4.0%)	\$3.4 tril (6.7%)
Per Capita Income (Current FX)	\$240 (...)	\$390 (...)	\$1,040 (12%)
Per Capita Income (PPP, 1990)	\$938 (21%)	\$1,309 (25%)	\$2,975 (38%)
Exports	\$11.6 bil (0.5%)	\$22.5 bil (0.5%)	\$282 bil (1.4%)
Service Exports	\$3 bil (0.8%)	\$4.6 bil (0.6%)	\$103 bil (2.7%)



# India Past and Present (Social Indicators)

	1980	1990	2008
<b>Life Expectancy</b>	<b>55 yrs</b>	<b>58 yrs</b>	<b>64 yrs</b>
Under-5 Mortality	(...)	116	69
<b>Access-to-Sanitation</b>			
Urban	(...)	44%	52%
Rural	(...)	4%	18%
<b>Youth Literacy Rate</b>			
Male	(...)	74%	88%
Female	(...)	49%	74%
<b>Enrollment Rates</b>			
Primary	83%	97%	113%
Secondary	30%	44%	57%
Tertiary	5%	6%	13%
<b>Poverty (1)</b>			
\$1-a-day	(...)	49.4%	41.6%
\$2-a-day	(...)	81.7%	75.6%
Human Development Index (HDI)	(...)	(...)	0.612 (M)

Notes:

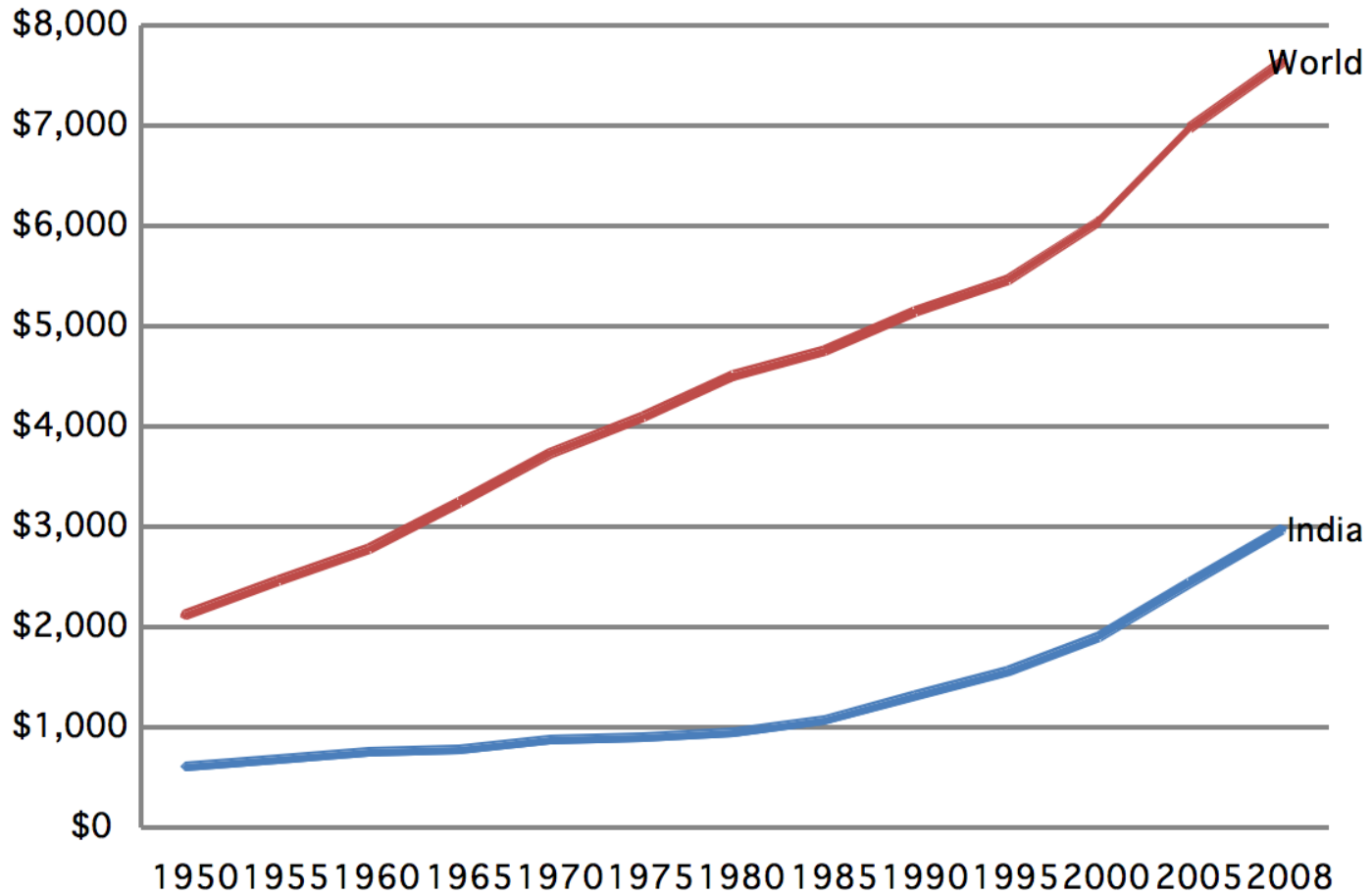
(1) 1990 figures from 1993-94

2008 figures from 2004-05

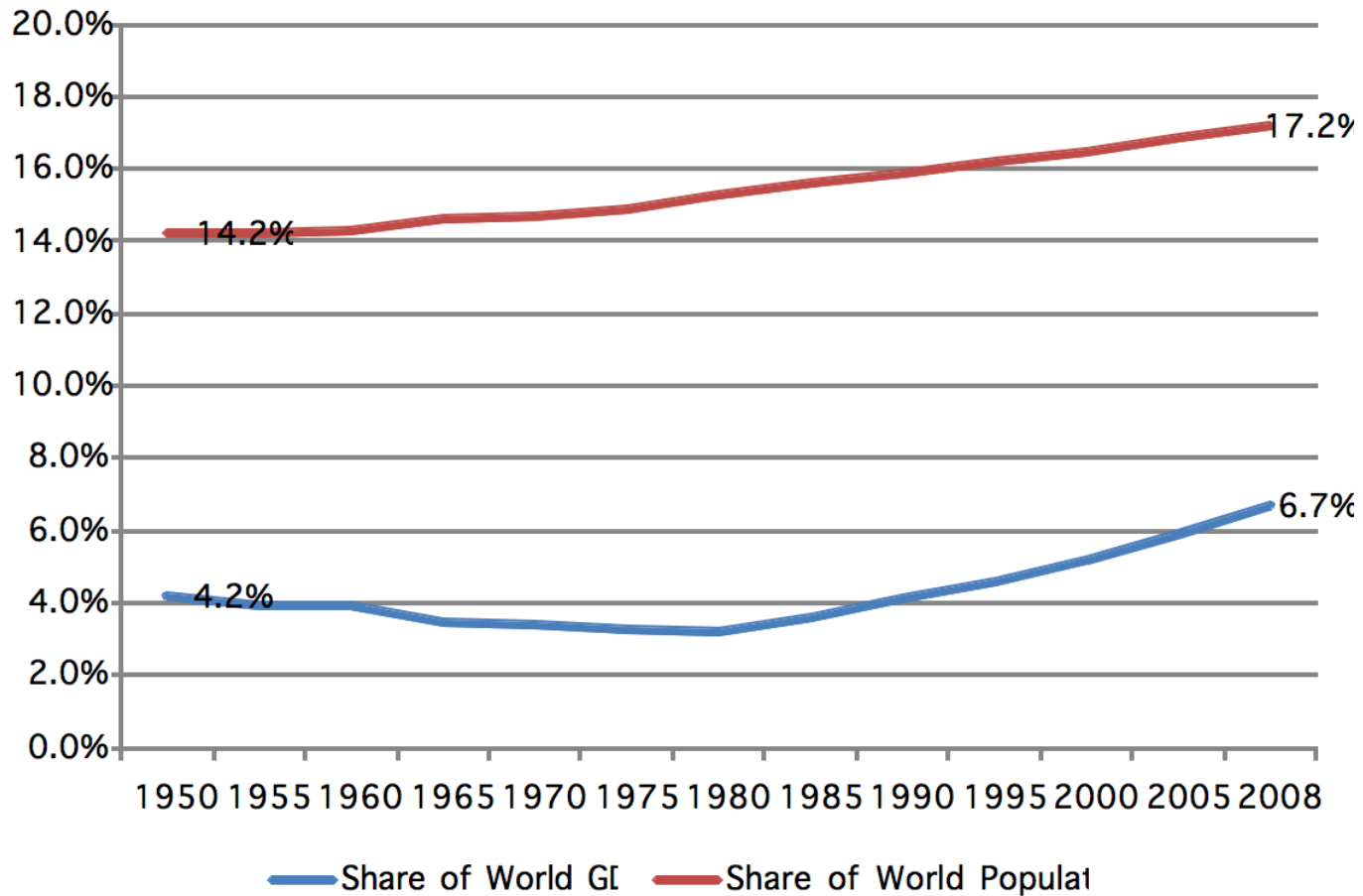
# Deciphering the Indian Miracle

- Between 1990 and 2008, GDP (in PPP terms) grew at an annual rate of 6.3% and per capita income at a rate of 4.6%
- Not many countries, large ones anyway, grew at such a pace during that period
- Except, say, China (8% and 7.1%, resp.) and Viet Nam (7.3% and 5.9% resp.)
- Growth since 1990 also much faster than its own “Hindu rate” during most of the four decade since 1950 (slide 5)
- Per capita income (PPP 1990) thus more than doubled since 1990; almost tripled since 1985 (slide 5)
- Share in global economy has increased, although much less dramatically than China’s (slide 6)
- Acceleration in the economy followed by modest improvements in social indicators too
- Has India finally joined the Asian miracle club?

# India's Per Capita Income (1950-2008)



# India's Share of World GDP and Population (1950-2008)



# **India's Miracle in a Regional Perspective: Wasted Years?**

**In terms of per capita income (PPP 1990), India in 2008 was where:**

- Japan in 1958 (50 yrs gap)
- Singapore in 1966/67 (40 yrs gap)
- Korea in 1973/74 (35 yrs gap)
- Malaysia in 1976/77 (32 yrs gap)
- Thailand in 1984/85 (25 yrs gap)
- Indonesia in 1993 (15 yrs gap)
- China in 1996/97 (12 yrs gap, see also figure 7, page 19 of the India 2039 book)
- Viet Nam and the Philippines in 2008 (at par)

# Before the Miracle: (1947-1957)

- Post-independent India, general aversion to Western capitalism
- The first five year plan (1951-56) and two competing models of development for the future
- The “Bombay Plan” with focus on markets and private sector-led growth
- The “Mahalanobis Model” with central planning, state controls, and import substitution
- Prime Minister Nehru, with his Fabian socialism and fascination for the Soviet model, favors the latter
- India becomes the first non-communist country to follow the Soviet model, but with private sector side by side
- Socialist economy with a democratic polity
- “Mixed economy” or a “Mixed-up economy”?

# **Before the Miracle (1957-66): Industrial Policy and Import Substitution**

- Heavy industry – the lynchpin of industrialization
- Leading role for the public sector (reservation for public sector and commanding heights)
- State controls on private sector too (industrial licensing)
- Import-substitution and technological self-reliance (import licensing, forex controls, and ban on FDI)
- Employment generation by small and cottage industries (reservation for small scale industries)

**What, who, how, how much, and at what price to produce was all determined by the State**

# **Before the Miracle (1966 -1980): After Controls, More Controls**

- A failed 1966 devaluation (WB-led) and a hardening of State controls
- Major private commercial banks nationalized in 1969 (commercial banks to be non-commercial)
- The 1969 anti-monopoly legislation (MRTP) capped company size (big is bad)
- Selective exemption from licensing to smaller industrial units (small is beautiful)
- NTBs were tightened, tariffs and income taxes raised sky high (earning income only to pay taxes)
- Political unrest, "state of emergency", and political musical chairs

**The heydays of License Raj: Producing more than the license was punishable by law; perhaps the only country where one got punished for being more productive**

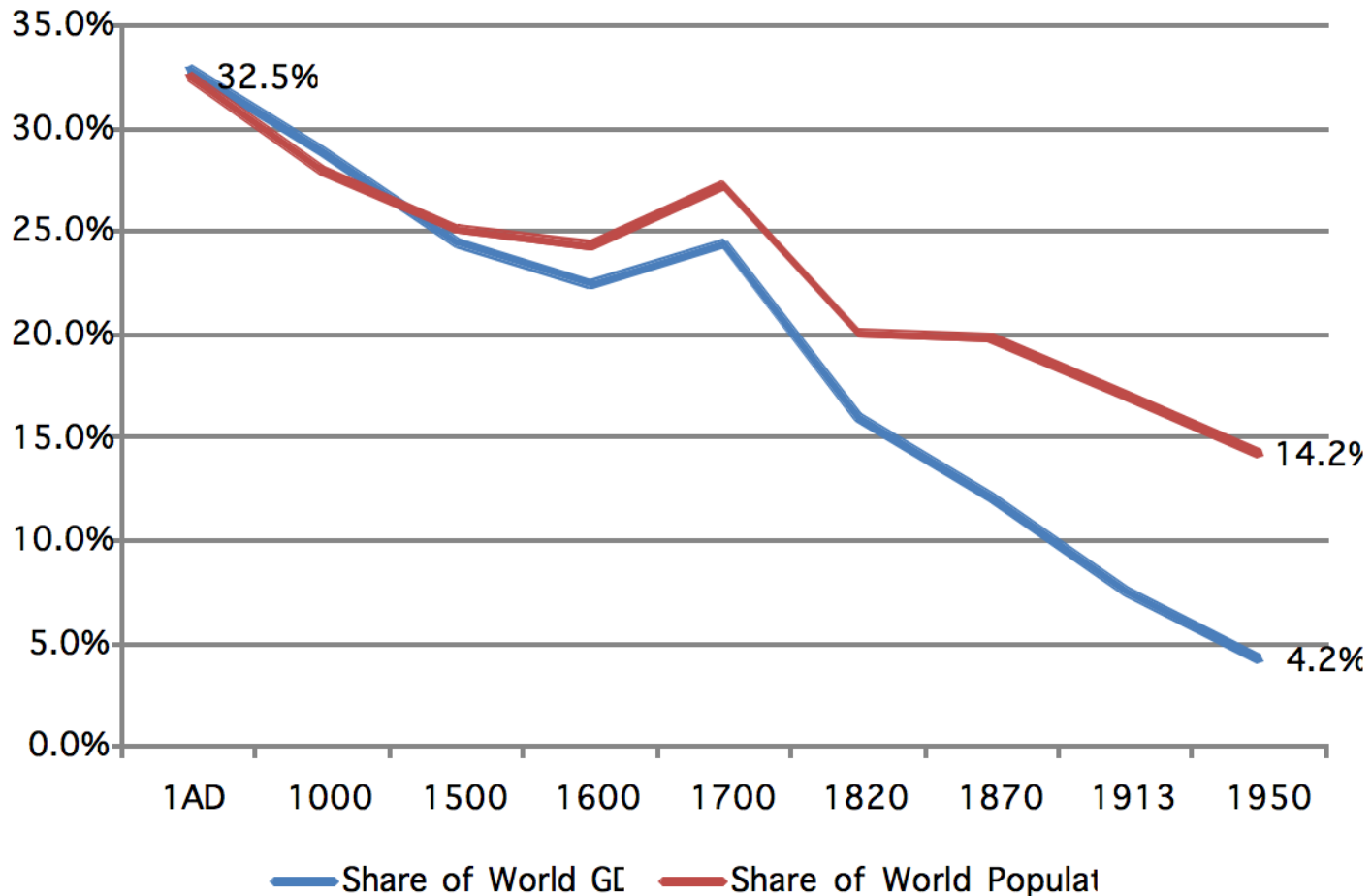


## **Before the Miracle (1980-1990/91): A Period of Contemplation and Some Action**

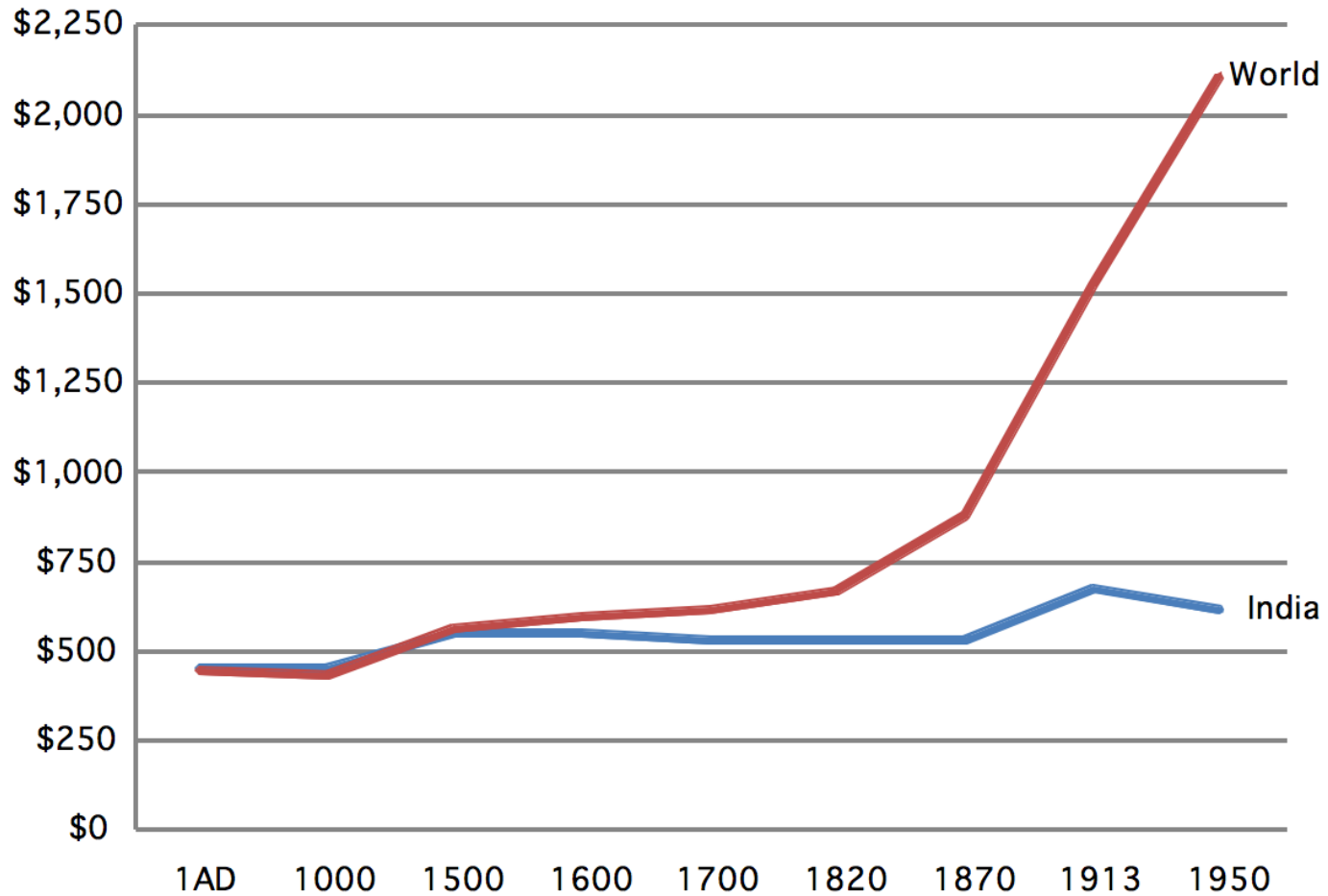
- Growing consensus – the development strategy needs change
- Some 31 sectors freed from Industrial licensing
- Import licensing liberalized (OGL expansion, which accounted for 30% of imports by 1990)
- Some NTBs replaced by tariffs
- Public enterprises given more autonomy from govt.
- Indo-Japanese automobile joint venture – symbolic of the slowly changing mindset

**Even these small changes – “God of small things” – gave a boost to the economy: growth started picking up in the second half of 1980s**

# India Miracle: A Historical Reemergence? (GDP and Pop. Shares: 1AD to 1950)



# India's Per Capita Income (1 AD to 1950)



# Initial Conditions for the Miracle: Consequences of 4 Decades of Dirigisme

- Suppressed markets, distorted incentives
- Barriers to entry contrived domestic competition
- Barriers to exit blocked creative destruction
- Draconian import controls limited foreign competition
- Reservation for small and cottage industries stifled scale economies
- Red tape, rent seeking, and populist policies of various State subsidies
- Result: "Socialism for the rich and capitalism for the poor"?
- **Some silver linings? Affordable higher education in science and technology, and small entrepreneurial class who could survive even under the worst business environment?**

# India's Reforms and Opening Up in Early 1990s

- A fiscal and balance of payments crisis by 1990-91
- In response to the crisis, wide-ranging deregulation and liberalization measures followed
- Most industries freed from industrial licensing
- Import licensing abolished for all but consumer goods and a handful of capital and intermediate products
- Export restrictions abolished for all but a few products
- Tariffs gradually reduced – the top rate fell from 355% in 1990-91 to 85% in 1993-94 and to 50% by 1995-96
- A dual exchange rate system introduced in 1992 and unified within a year
- By 1994, many current account transactions freed up and the rupee made convertible on the current account

# India's Reforms and Opening Up Since the 1990s

- Reforms initiated in the 1990s broadened and deepened subsequently
- Many public enterprises privatized
- Consumer goods freed from import licensing
- Tariffs reduced gradually – India's mean tariff rate of 9.7% (2008) compared well with China's 8.6%
- FDI liberalized for several sectors including infrastructure
- Services, such as banking, insurance, telecoms now open for foreign participation to varying degrees
- Foreign portfolio investment allowed in the Indian stock market, although rupee is not fully convertible on the capital account
- **Overall, the economy now much more market-oriented and private-sector-led than just about two decades ago**

# Miracle and Structural Change

## India and China (% of GDP)

*Note: China figures in parenthesis. Figures on agriculture, industry, and services for 1990 are for 1995.*

	1980	1990	2008
Investment	21 (35)	24 (35)	40 (44)
Savings	17 (35)	23 (38)	38 (54)
Private Consumption	73 (51)	66 (50)	54 (34)
Government Consumption	10 (15)	12 (12)	12 (14)
Exports	7.2 (7.3)	7.1 (19)	24 (41)
Agriculture	37 (31)	26 (20)	17 (11)
Industry	26 (47)	28 (47)	29 (49)
Services	37 (22)	46 (33)	54 (40)

# India's Imperatives

- Sustaining the growth momentum and ensuring inclusiveness
- Developing infrastructure
- Refining the business environment
- Managing the environment and urbanization
- Improving governance
- Integrating regionally, even as continuing to integrate globally



# Sustaining the Growth Momentum

- Has India just entered MIT? (in 2007, WB placed it in the lower middle income group)
- Learn from successful transformers (eg., Korea)
- Exploit the demographic dividend (expected labor force growth of 1.7-2.7%), though demography is not destiny
- By 2005, India produced 2.4 million graduates (10% engineers), slightly less than China's 3.4 million figure
- Yet, like China, only 10% of these meet US standards, % for engineers higher at 25% (McKinsey Global Institute)
- Need for focusing on the quality of education (pricing an issue)
- Safely nets for the poor (better public health care and access to education)

# Developing Infrastructure

- India's infrastructure deficiencies well known (slide 21)
- Investment in infrastructure at around 5-6% of GDP pales in comparison to China's 20%
- Studies say: need to raise it to 10-11% of GDP
- Need for private sector investment to complement public investment (lessons from other countries?)
- Need for competitive markets and independent and stronger regulatory bodies (public-private partnerships)

# Infrastructure Indicators: (2005-2008)

## India and China

	India	China
Electricity Consumption (kWh per capita)	503	2,041
Value lost due to poor power (% of sales)	6.6	1.3
Air freight per capita (million ton km)	0.8	8.5
Passengers carried by air (1,000 per capita)	44	139
Container port (TEU units per capita)	6,283	79,149
Internet bandwidth (bits per capita)	32	280
Mobile subscribers (per 100 persons)	21	42
Bandwidth subscribers (per 100 persons)	0.3	5.0
Quality of overall infrastructure [1-worst, 7-best]	3.4	4.2
Global infrastructure ranking	72	47

# Refining the Business Environment

- Business environment improved significantly since 1990s, as the License Raj was dismantled, but much scope for further enhancement
- The time required for beginning a business, registering property, and completing construction work, and hiring workers etc are now comparable to, say, China (Lecture 4 slides), but much behind countries like, say, Korea
- However, it takes almost 4 years (as compared to a little more than a year in China) for enforcing business contracts
- Similarly, because of the complicated procedures and an overburdened judiciary, it takes 7 yrs to close a business (China: 1.7 yrs)
- Clarity and predictability of procedures and paper work - large scope for improvement

# Managing the Environment and Urbanization

- Water and air pollution emerging as serious environmental and health issue
- As much as 70% of rural population lacks safe drinking water
- Almost no big Indian city has 24/7 water supply, irrespective of safety standards
- About 1/4 the of urban dwellers have no toilet facilities
- Traffic congestion in major cities worsening rapidly, even with very low levels of private car ownership
- In terms of livability, New Delhi ranks 148 out of 215 cities worldwide (Mumbai:151, Bangalore: 153, and Chennai: 159)
- Urban population now constitutes only about 30% of the total, and India has a long way to go in urbanization

# Improving Governance

- Red tape and corruption
- Multiple clearances and lack of accountability of Govt. Ministries
- Overstretched and nontransparent bureaucracy
- Politicized police and clogged courts
- **Overall, a need for redefining the role of the government, retooling the bureaucracy and the law enforcement authorities for a modern economy**

# Integrating Regionally

- Today, India is the weakest link in “Factory Asia”
- But, already China has become India’s largest trading partner
- And India is actively engaging in the regional FTAs, and a member of the EAS
- As India’s economic footprint expands, need for integrate itself within the Asia
- A three-pronged role for India ?: take leadership in SAARC, take South Asia to the rest of Asia (only South Asian member in EAS), and to the rest of the world (only South Asian country in G20)

# Conclusions

- India was the largest economy in the world for thousands of years: from 1AD to almost 1700
- Then lost its global share in the next two and half centuries (1700 until independence in 1947)
- Lost another precious 4 decades after independence through a policy regime of dirigisme
- Was treated with such a high dose of socialist medicine that the patient nearly died
- Has recovered some of the lost ground in the last two decades or so
- Huge potential to achieve prosperity in one generation, but formidable challenges remain
- Will the “incredible India” live up to the potential?



# Sources of Data

- The World Bank, World Development Indicators, 2010 and 1997, 1982
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# **Regionalization of Production – The Evolution of “Factory Asia” Lecture 7**

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor

# Asia's Regionalization of Production and Trade: The Context

- Six decades of remarkable economic development (successive economic miracles:(covered in lectures 1-6)
- Decades of unilateral trade and investment liberalization – Asia's global integration (covered in lectures 1-6)
- While globalizing, production and trade got regionalized too (Factory Asia - largely covering ASEAN+3+Hong Kong+Taiwan)
- For most part, regionalization was a product of economic interactions - market-led and private sector-driven
- Largely remained so until after the 1997-98 AFC
- Since the AFC, State-led trade and investment integration measures (especially FTAs) – a helping hand to regionalization
- European integration – State-led with markets and private sector following? (to be covered in student group presentation)

# Japan's Relocation of Manufacturing: The First Driver of Regionalization

- By mid-sixties, Japan's rapid growth in the previous decade and half already putting pressure on wages and the labor market.
- The Nixon shock adds further pressure: Japanese Yen maintained at 360/\$ for 22 years until December 1971 appreciated to 308/\$
- By Feb.1973, Japan adopts a floating exchange rate system; by 1985 Yen appreciates to 240/\$
- The Plaza Accord and Yen appreciates to 120/\$ within a year of the Plaza Accord
- Coupled with tightening labor market, continuous Yen appreciation induced Japanese companies to relocate production
- First to the NIEs, then to the ASEAN, and subsequently to China and Viet Nam
- The stability of the ASEAN exchange rates (vis-à-vis the \$) initially and that of the Yuan subsequently - provided an added boost

# **NIEs Join Japan in Industrial Relocation: Flying in Sequence**

- As the NIEs moved up the economic ladder, so did their wages
- Industrial relocation from the NIEs to rest of Asia followed
- First to ASEAN4, and subsequently to China (since late 70s and early 80s) and Viet Nam (since early 90s)
- Continuous trade liberalization under the WTO provided a further boost to production regionalization
- Quality transport infrastructure and the IT revolution further induced regionalization, as it cut logistics and other related costs
- The regionalization of production – a result of multinational companies continuously moving production from one low-cost economy to another
- Equally importantly, globalization and regionalization of Asian economies went hand-in-hand

# Regionalization through FTAs: ASEAN the Asian Pioneer

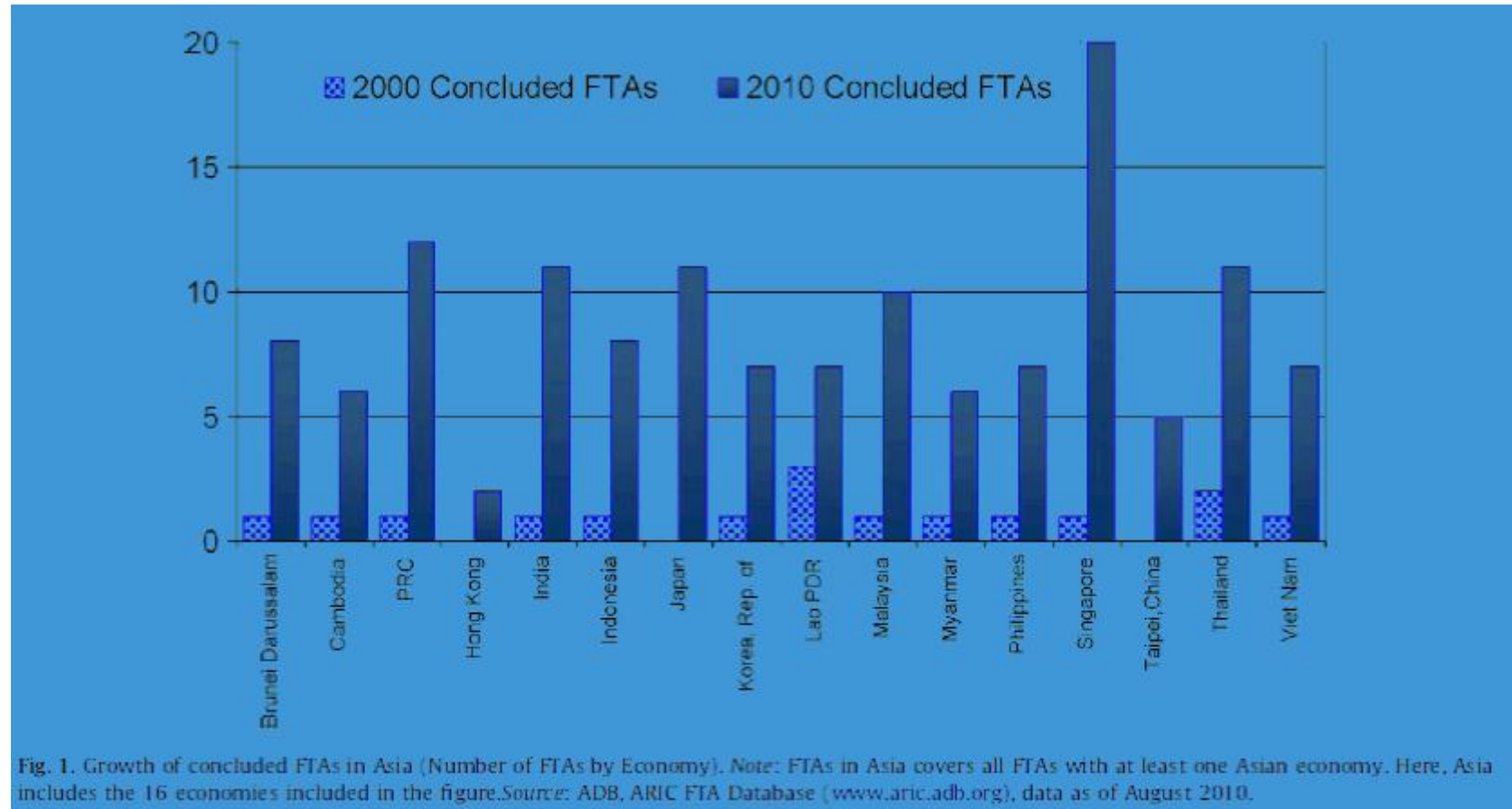
- For a long time, Asian production and trade integration was largely driven by markets and the private sector
- In recent years, Asian governments have vigorously pushed trade and investment integration through preferential trading arrangements (both within and outside Asia)
- The earliest efforts at FTAs in Asia was by the original ASEAN6 to form AFTA
- In January 1992, the original members of ASEAN (the ASEAN4 plus Singapore and Brunei) signed the AFTA
- AFTA to be achieved in a phased manner over 15 years (by 2008), subsequently advanced to 2003
- Other members joined the initiative subsequently -- Viet Nam in 1995, Laos and Myanmar in 1997, and Cambodia in 1999 -- making it a ten member multilateral FTA

# Since the AFTA: Many More FTAs

- There have been a spurt of FTAs in Asia (ASEAN+3+Hong Kong+ Taiwan+ India) between 2000 and now
- In 2000, there were only 3 concluded FTAs in Asia
- That number has shot up to 65 by now (2011)
- Another 50 are under negotiation and another 41 proposed
- Of the 65 FTAs signed, 56 are in effect
- Asia's 65 FTAs by 16 countries compares with the America's 98 FTAs by 34 countries
- More than 3/4th of Asia's FTAs are bilateral (the remaining plurilateral)

(Notes: These numbers are as of January 2011, while the numbers in slides 7 and 10 are as of August 2010, totaling 61 concluded FTAs and 49 in effect at that time)

# Asian FTAs (2000-2010)





# Leaders and Laggards in FTA Race

- Singapore by far has the largest number of concluded FTAs (21)
- Followed by China, Japan, and India (12 each), and Malaysia and Thailand (11 each)
- ASEAN - the pioneer in FTAs -- is emerging as the regional hub linking its 10 countries with the rest of the region
- Advantage Singapore -- small open economy, close to zero tariffs, world class infrastructure, excellent trade logistics
- China and India forming FTAs to ensure market access for goods
- Japan, a late comer to FTAs, has stepped up the efforts to give a boost to its large MNCs
- Malaysia and Thailand emerged as the production hubs for auto and electronics industries

# Indoor and Outdoor FTAs

- Japan, Thailand, Indonesia, Viet Nam and the Philippines have more than 50% of their FTAs within Asia (slide 10)
- More than 50% of the FTAs by India, China, Taiwan, Korea, and Singapore are cross-regional

# Intra-Regional and Cross-Regional FTAs

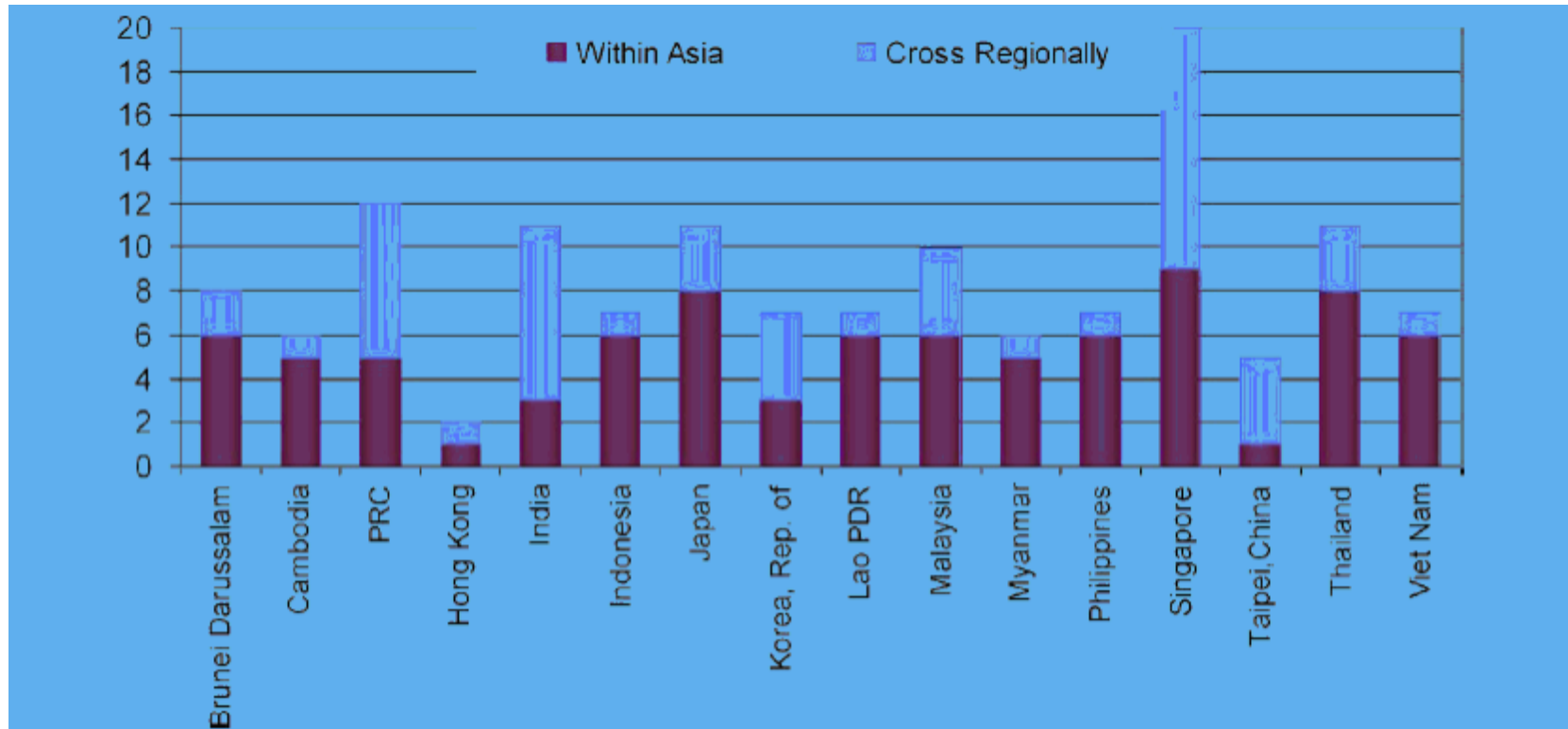


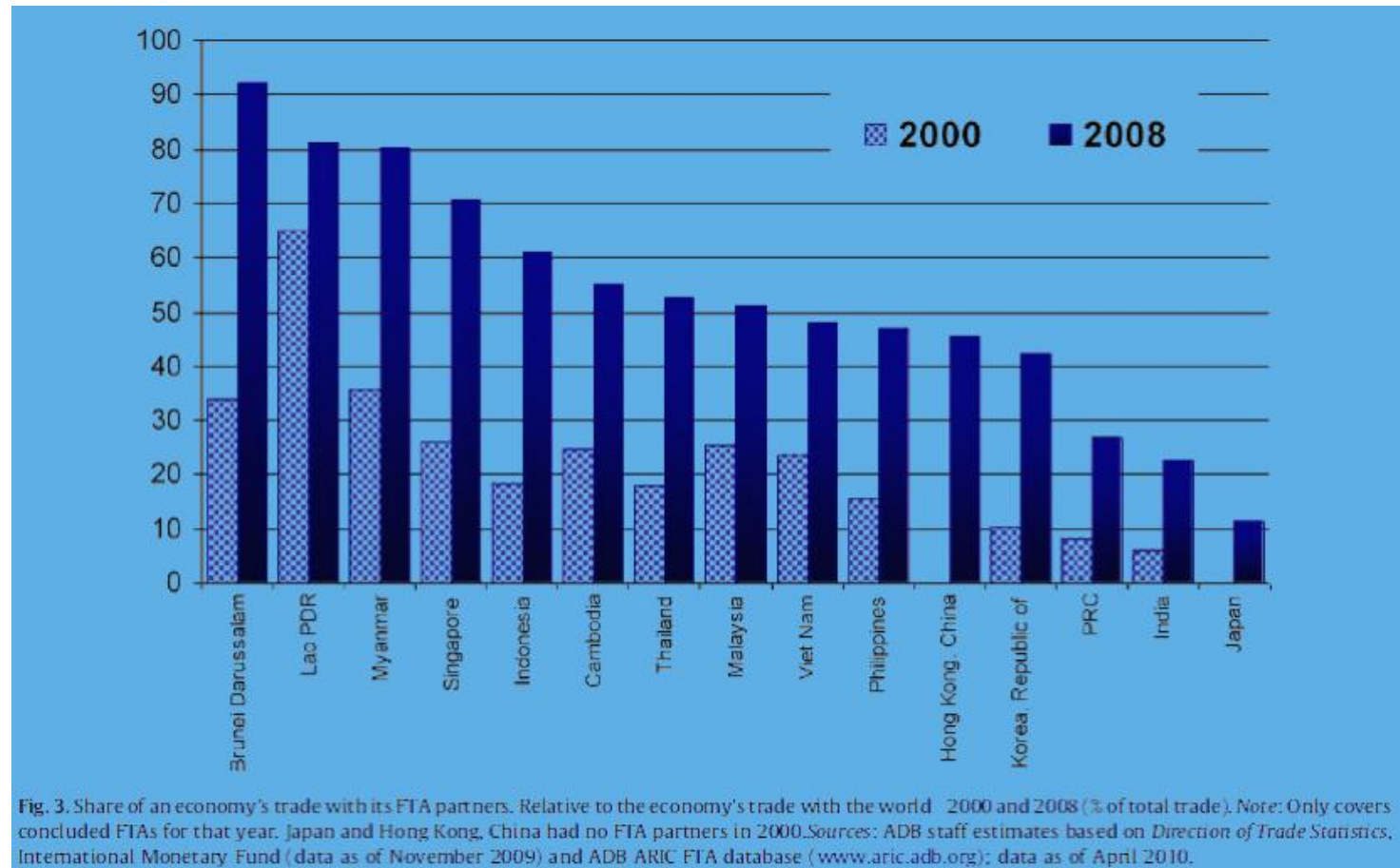
Fig. 2. Geographical orientation and share of concluded FTAs in Asia—FTAs within Asia and cross-regionally (number of FTAs by economy). Note: FTAs within Asia cover FTAs where all partners are in Asia. Here Asia includes the 16 economies listed in the figure. Source: ADB ARIC FTA Database ([www.aric.adb.org](http://www.aric.adb.org)), data as of August 2010.

# Trading through FTAs

(Source: Kawai & Wignaraja, 2011)

- Difficult to measure – the share of a country's bilateral trade with its FTA partners in the country's total global trade
- Bold assumption: all goods trade is covered by the concluded FTAs
- Between 2000 and 2010, trade coverage by FTAs has increased across the board, simply reflecting the spurt in FTAs
- As of now, the larger economies have smaller FTA trade shares than the ASEAN members (reflecting AFTA)
- Korea (42%); China (27%); India (23%), and Japan (11%)
- Among the ASEAN - Brunei, Myanmar, and Lao (over 80%); Singapore and Indonesia (over 60%); others in the range of 45-55%
- Taiwan has the lowest share of 1%

# Trade Coverage by Asian FTAs



# What Drives the FTA Spurt in Asia?

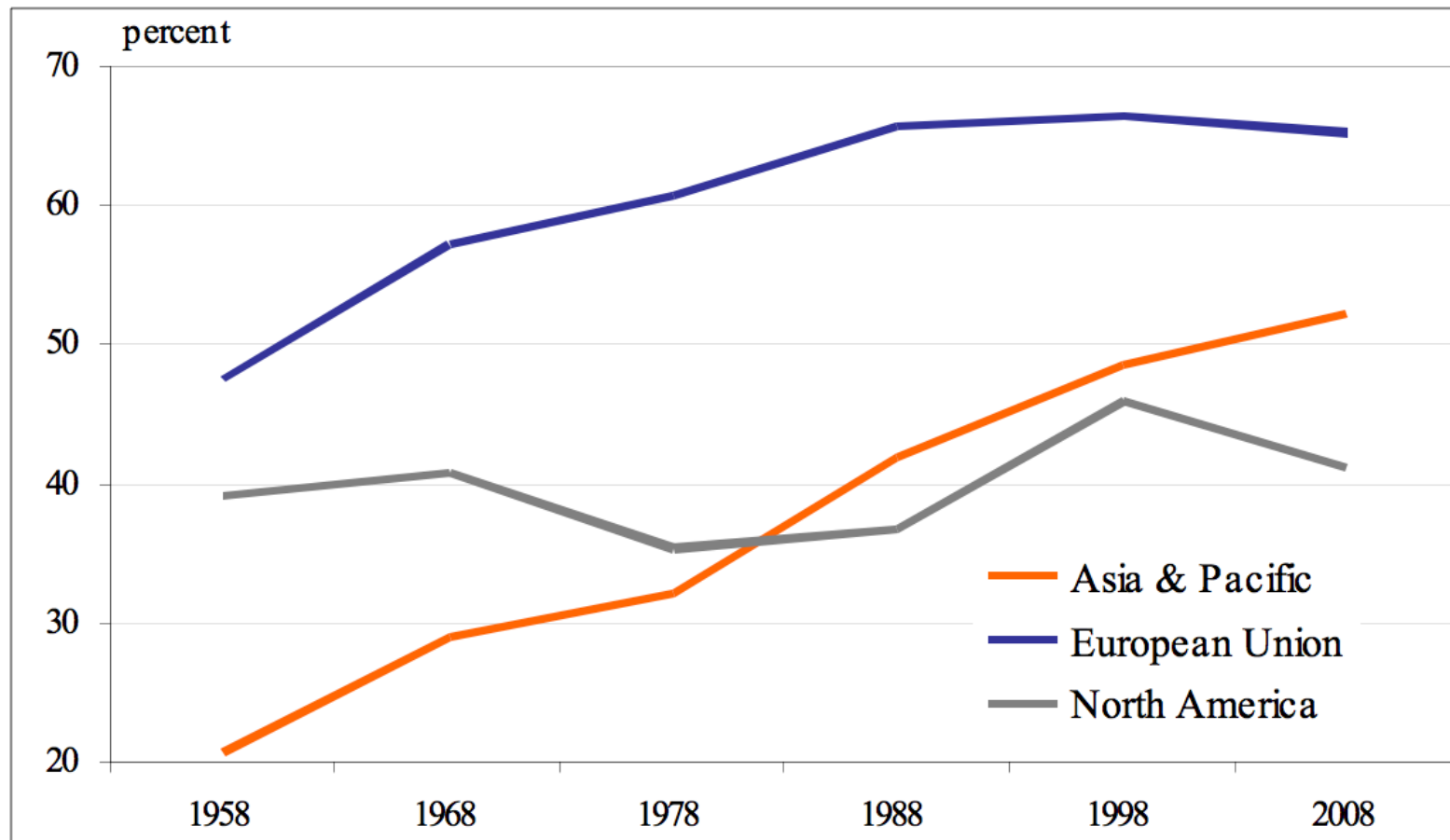
- Cement gains from the market-driven and private sector-led trade and production integration (helping hand from the governments)
- Preferential trading arrangements and other regional arrangements in other parts of the world (Fear of being left behind)
- Post-AFC imperative to cooperate regionally, even as Asian countries compete globally (co-opetition)
- Find a parallel track to the WTO track – given the stalling of the Doha Round (go regional and bilateral if the global multilateral track is blocked)

# Production Regionalization and Intraregional Trade

- As trade and production regionalization increased, through markets and private sector and then complemented by government measures, so did intraregional trade (slide 15)
- The share of intraregional trade in Asia's total trade increased from about 20% in late 1950s to about 28% by mid-60s (once the NIEs took-off)
- Then to about 32% by mid-70s (once the ASEAN3 took-off)
- And then to about 45% by mid-90s (China's opening up and global integration)
- By 2008, stood at about 52% -- lower than the EU's 65% but higher than North America's 40%
- A big difference across sub-regions though, East Asia has the highest intraregional trade share (52%) while South Asia the lowest (6%) (slide 16)

# Evolution of Asia's Intraregional Trade (1958-2008)

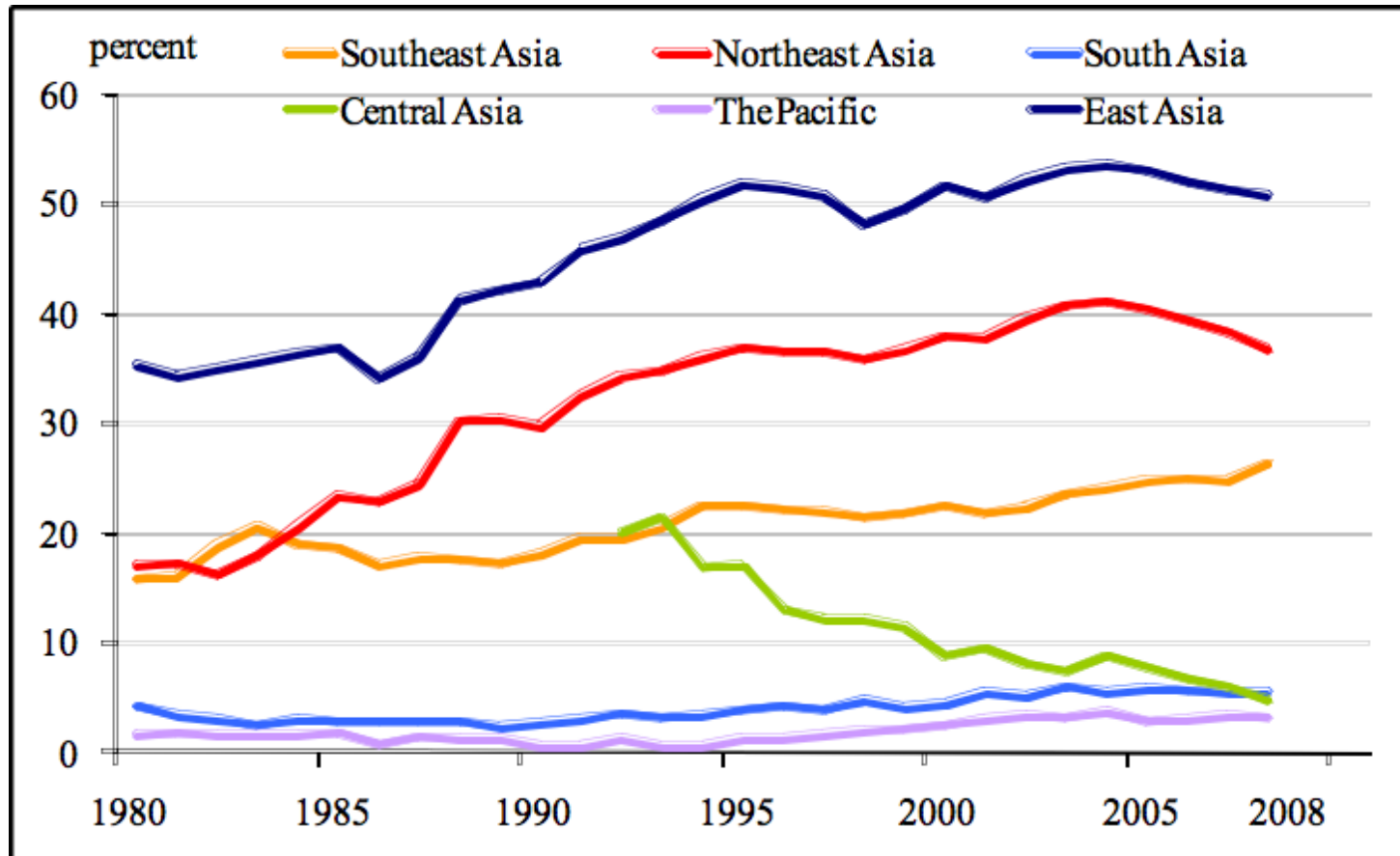
(Source: ADB, 2011)





# Intraregional Trade Across Sub-regions

(Source: ADB, 2011)



# Intraregional Trade and “Factory Asia”?

- Close to 60% of East Asia’s intraregional trade is in parts and components (intermediate products), remaining in final goods
- Similar share of parts and components trade in other sub-regions in Asia is much lower, indeed miniscule in South Asia.
- Factory Asia is now limited to East Asia, although it has the potential to extend to the rest of Asia with new FTAs that connect these subregions, albeit gradually
- Factory Asia relies heavily on the rest of the world for demand for its final goods

## **Within Factory Asia**

- China the key final assembly hub
- Japan and the NIEs major sources of capital goods and innovative intermediate products
- ASEAN a key link in the production of parts and components

# Understanding “Factory Asia” through the New Trade and Growth Theory?

(Source: Gill and Kharas, 2007)

- **Industrial organization:** Scale economies and imperfect competition - crucial elements in several industries; hence in industrialization (conventional model - constant returns to scale and perfect competition)
- **International trade:** Intraindustry trade reflects scale economies (conventional model – interindustry trade reflecting relative factor endowments)
- **Economic geography:** increasing returns to scale and imperfect competition leads to agglomeration and geographical coalescing (conventional model – no role for geography and neighborhood effects)
- **Endogenous growth:** Innovation – a key source of external economies and investment in R&D and human capital a driver of innovation and its absorption (conventional model - exogenous technical progress)

# **Sustaining Factory Asia: Challenges Ahead**

- Better regional monetary and financial cooperation (Lecture 8)
- Improved regional infrastructure (Lecture 9)
- Stronger regional institutions and working towards an Asian Economic Community (Lectures 10 & 11)
- Refining and consolidating the FTAs – making the best out of the second best

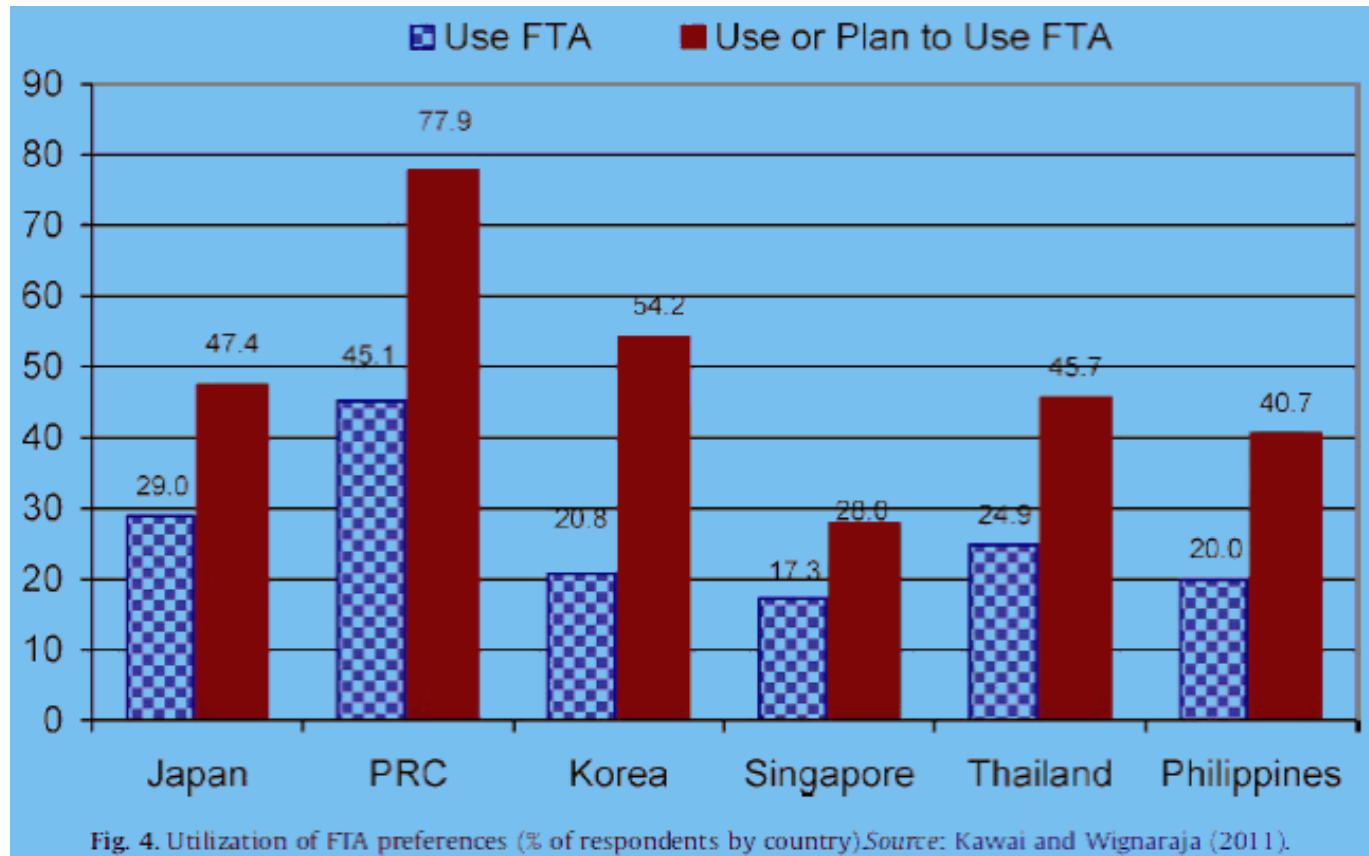
# **Making the Best out of the Second Best**

- Making FTAs user-friendly
- Bringing in WTO-plus elements
- Working towards a region-wide FTA
- AN FTA by the Trilateral Summit countries - China-Japan-Korea - A major building block for a region-wide FTA?

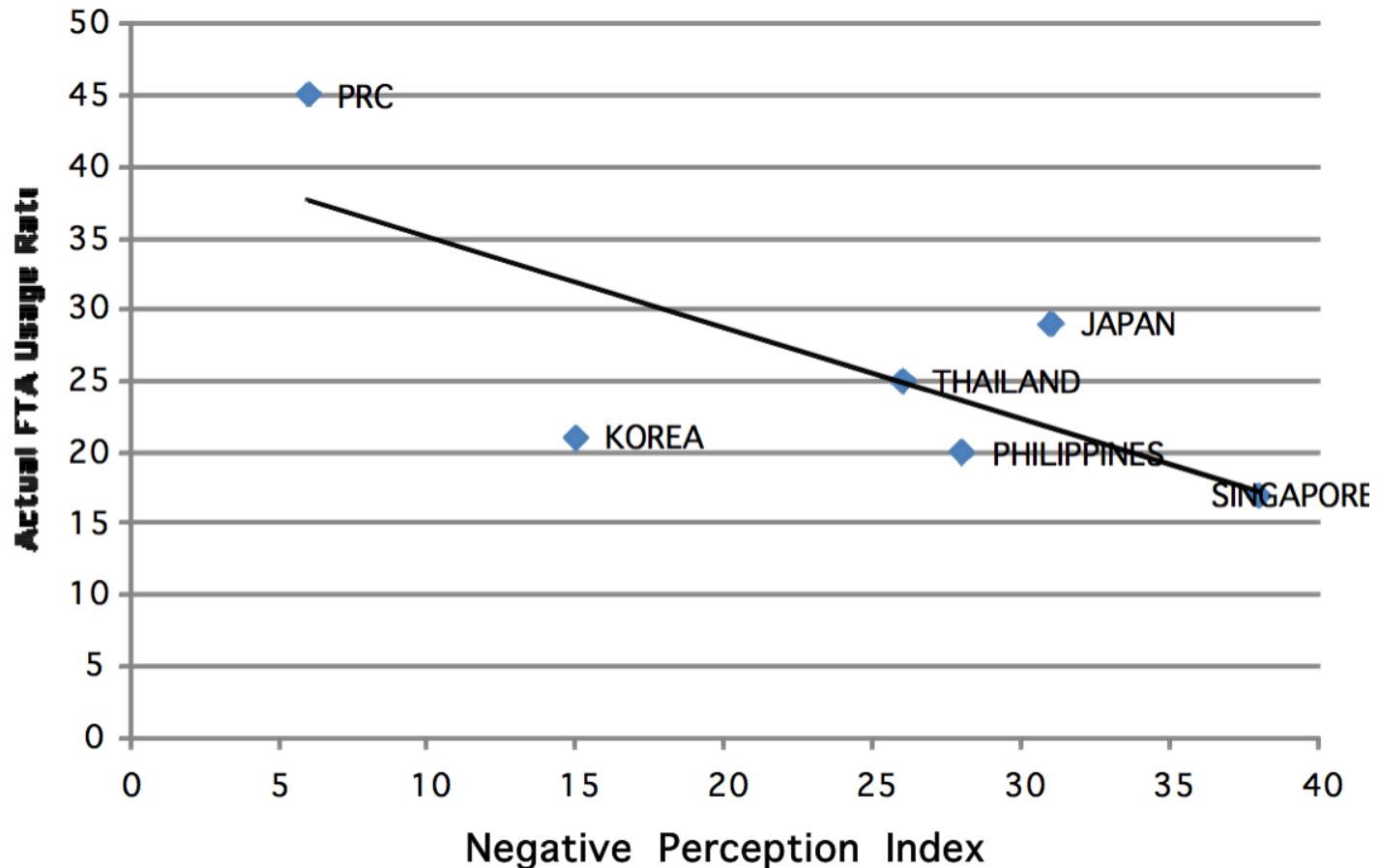
# Making FTAs User-friendly

- Asian FTA usage by businesses generally much less than in North America; recent evidence from firm-level surveys – usage rate may be better
- Of the 841 firms surveyed in six countries, 28% reported they use FTAs and another 25% plan to use (slide 22)
- Key reasons for non-usage – high administrative costs of usage (cumbersome ROO), lack of information, low margins of preferences
- Singaporean firms have the most negative perception of ROO (38%), Chinese firms the least (6%); Japan (31%), Philippines (28%), Thailand (26%), Korea (15%)
- Negative ROO perception and FTA usage seems to be inversely related (slides 23 and 24 - Source: Kawai and Wignaraja, 2011)

# FTA Usage by Firms

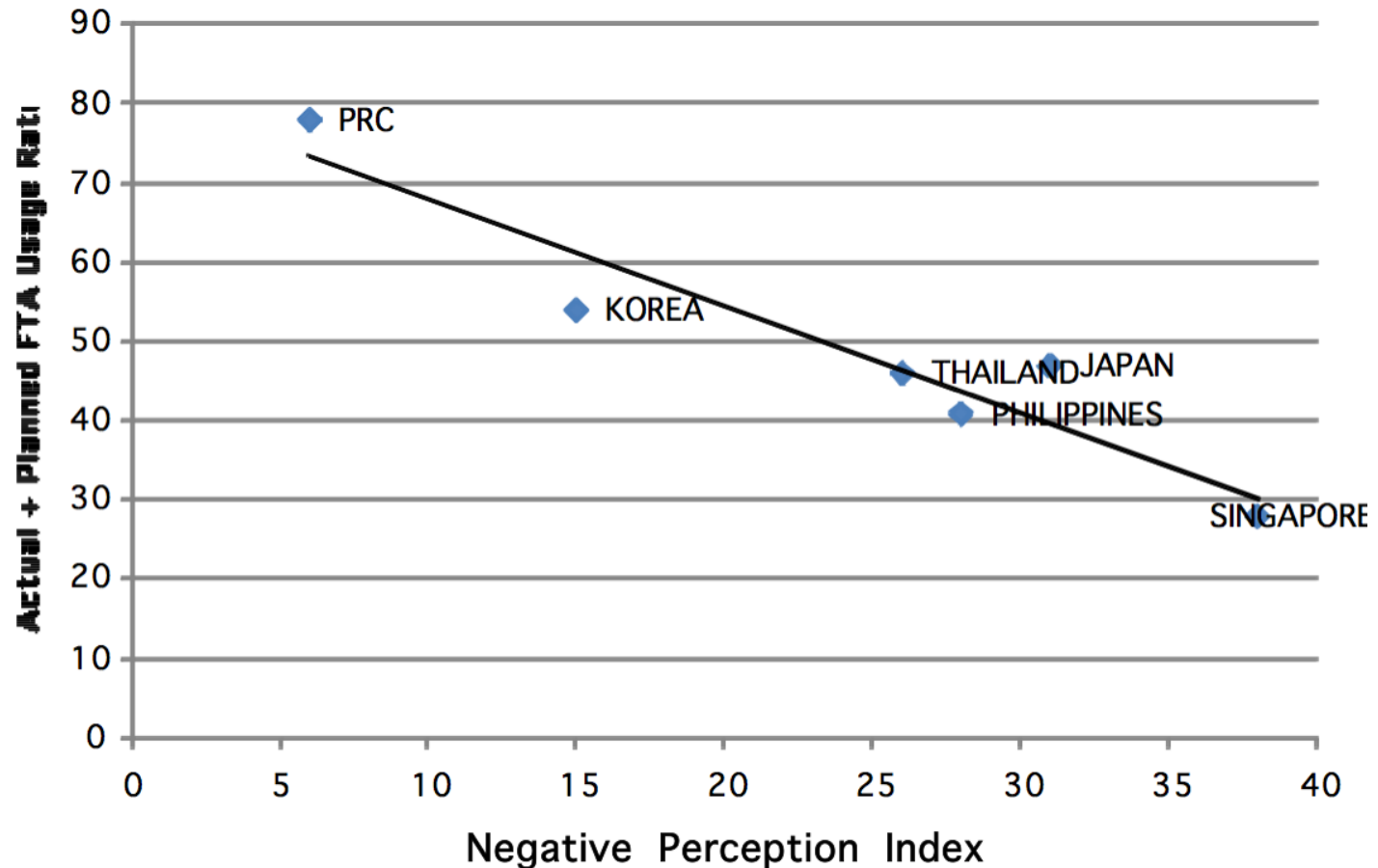


# Actual FTA Usage Rate vs. Negative ROO Perception





# Actual + Planned FTA Usage Rate vs. Negative ROO Perception



# Bringing in WTO – Plus Elements: Making FTAs Freer

- Asian FTAs vary widely in scope (slide 24)
- Japan, Singapore, Korea, Malaysia FTAs tend to be broader in scope
- China and India limit FTA scope; other countries fall in between,
- Better coverage crucial?
- Singapore issues: trade and investment, competition policy, government procurement, trade facilitation?
- Inclusion of these desirable: i.e., investment provisions and competition policy could facilitate FDI (technology transfer, and production network)
- Trade facilitation could lower transaction costs
- Overall, WTO-plus could be a major plus for broadening and deepening “Factory Asia”

# Free and Not-So-Free FTAs

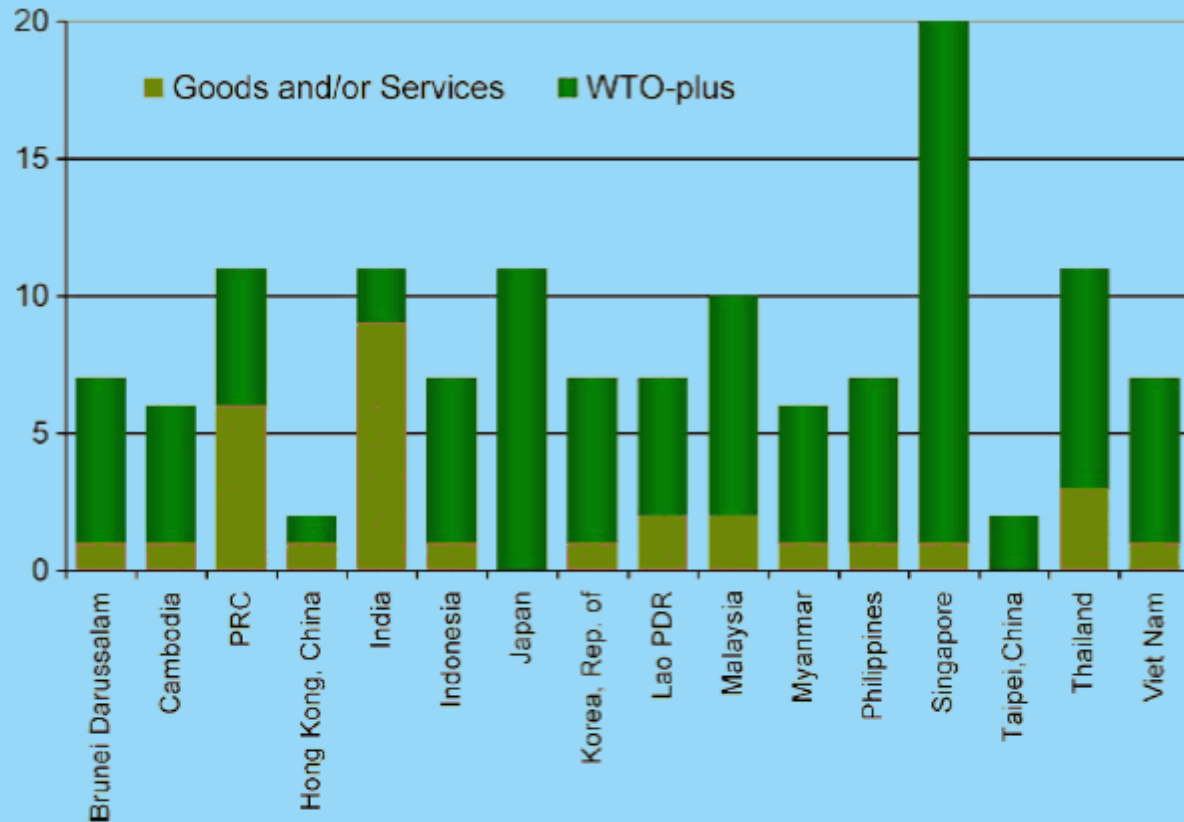


Fig. 7. Scope of Concluded FTAs in Asia (number of FTAs with Narrow and WTO-plus coverage by economy). Note: Data do not include Taipei, China-Nicaragua and Taipei, China-El Salvador-Honduras FTAs due to difficulty in accessing official English translation of the FTAs. Source: ADB ARIC FTA Database ([www.aric.adb.org](http://www.aric.adb.org)); data as of June 2010.

# Working Towards a Region-wide FTA (Broadening FTAs)

- Need for gradually consolidating the large number of FTAs
- Consolidation could:
  - Simplify the Noodle-bowl and ROOs
  - Improve market access to goods, services, skills, and technology
  - Increase market size and permit specialization and realization of scale economies
  - Facilitate FDI and technology transfer
  - Permit simplification of tariff schedules, rules, and standards

**Overall, consolidate the FTAs into a region-wide FTA in an open regionalism framework.**

***"Globalize while Regionalizing"***

# Trilateral FTA (China, Japan, and Korea) – A Key Building Block?

- A building block for an ASEAN+3 FTA , could attract other countries like India over time?
- Sequencing a Trilateral FTA – Bilaterals first and trilateral next?
- Bilaterals first: who goes first? China-Korea, China-Japan, Japan-Korea?
- China seems to be keen but:
  - Japan's concerns: China's rising competitiveness? China-market economy or a non-market economy? Option to use safeguards?
  - Korea's concerns: China – a large country FTA partner? Will be swamped by imports from China?
  - Japan-Korea: Interested but Japan concerned about agriculture? Korea about Japan's manufactures and intermediates, already has trade deficit with Japan?

# Conclusions

- Regionalization of Asian trade and production – initially market-driven and private-sector led
- Asia, especially East Asia, regionalized while globalizing
- More recently, complemented by State-led FTA spurt
- Emerging “Factory Asia” – China assembly hub, Japan and the NIEs supply capital goods and innovative intermediates, ASEAN parts and components
- Sustaining Factory Asia requires making FTAs user-friendly, broadening their scope, consolidating in to a region-wide FTA
- Can a Trilateral FTA (China-Japan-Korea) FTA be the building for a region-wide FTA over time? Probably yes
- Asia needs to continue to globalize while regionalizing - Asian regionalism as a building block for global multilateralism

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# **Monetary and Financial Cooperation for Asian Integration Lecture 8**

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor



# Why Monetary and Financial Cooperation in Asia?

- Complement trade and investment integration (sustain and nourish Factory Asia)
- Manage regional macroeconomic interdependence
- Develop efficient financial sectors/markets, and promote regional financial stability
- The 1997-98 Asian financial crisis – a major historical impetus

# Complement Trade Integration (Trade-Money-Finance Nexus)

- Money and finance – key for facilitating trade and investment
- Minimizing currency risk and credit risk – key to help broaden and deepen “Factory Asia
- Efficient and well regulated financial markets that provide low-cost local currency finance and stable exchange rates help minimize both the risks
- Low-cost finance for “Factory Asia’s”:
  - Working capital requirements
  - Capital investment and expansion
  - Innovation and research

# Manage Macroeconomic Interdependence (Macro-Money-Finance Nexus)

- Trade integration increases macro-interdependence (more synchronized business cycles)
- The cross-country contagion during the 1997-98 AFC partly a reflection of the macro-interdependence
- Recent studies show that macro-interdependence among East Asian countries has increased since the AFC
- For East Asia, the ADB (2008) study find that the average correlation coefficient (before and after AFC) of:
  - GDP increased from 0.07 to and 0.54
  - Consumer prices increased from 0.10 to .39
- Increased macro-interdependence implies significant cross-country spillovers of national monetary (and fiscal) policies
- *Hence, the need for regional monetary cooperation*

# Deepen and Broaden Financial Markets (Money-Finance-Regional Nexus)

## **In East Asia, pre-AFC:**

- Financial sector development lagged behind the miraculous performance of the real economy
- Financial sectors dominated by banks and capital markets less developed  
Within the capital market, bond markets far less developed than equity markets (lack of spare tire)
- Overall, regulation and supervision somewhat lax

## **Post-AFC emphasis on developing:**

- more balanced,
- well-regulated,
- and better supervised financial sectors
- Hence, the need for monetary and financial cooperation

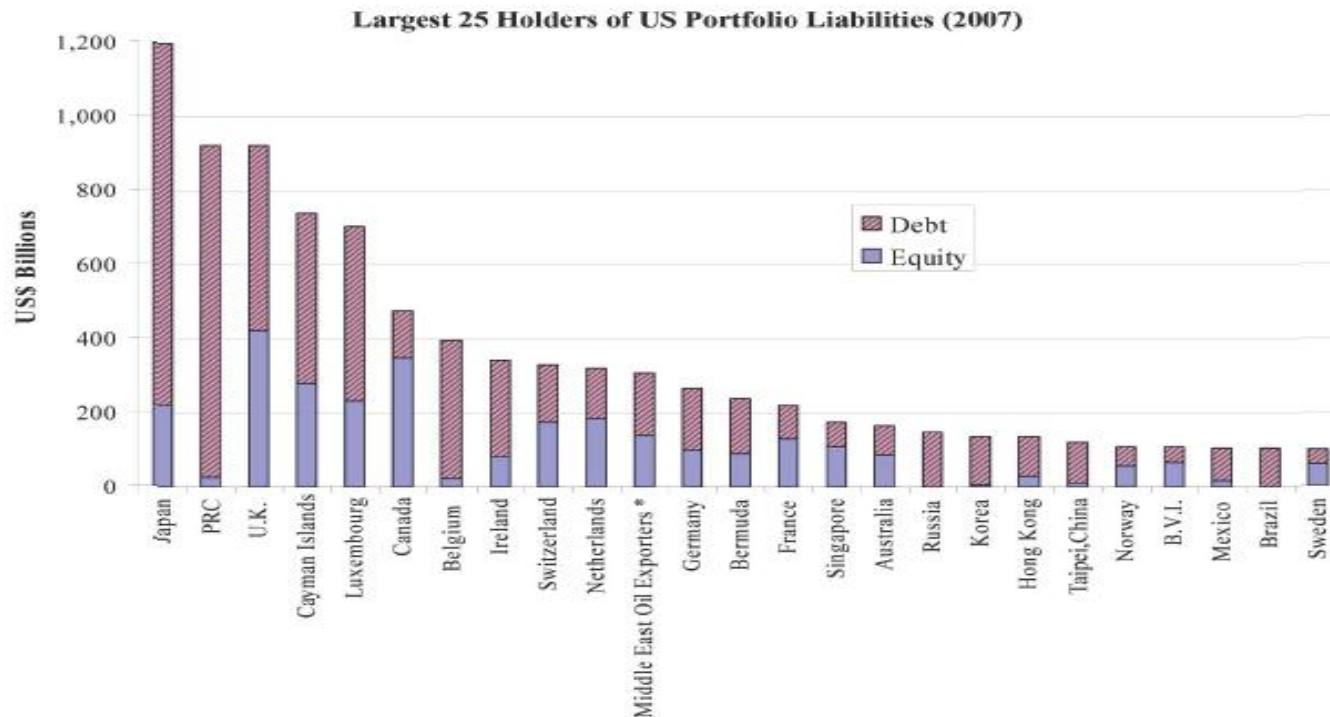
# Financial Broadening and Deepening (Stylized Stages & Sequencing)

- **Emergence of banks** – good at dealing with asymmetric information through relationship lending and maturity transformation
- **Emergence of stock markets** – provides an instrument banks are not good at: long-term commitment of risk capital while still giving investors a liquid form of investment
- **Emergence of fixed income markets (bond market)** – bond markets provide suitable instruments for long-term investors, e.g., pension funds and insurance companies
- **Final stage – derivatives markets and securitization** – derivatives help hedge risks and securitization allows risks to be redistributed across investors (the so-called originate-to-distribute model)
- **Post-GFC rethinking?**

# Why Regional Integration for Financial Market Development?

- **Size matters** – bigger markets tend to be more liquid, stable, and efficient (lower cost of capital)
- **Geographical proximity helps:**
  - countries closer to each other tend to trade more,
  - the larger the trade flows, the larger are the financial flows
  - proximity reduces information asymmetry
- **Could help reduce global payments imbalance by**
  - promoting consumption and investment in Asia

# Inadequate Financial Development Drives Asia to Export Capital to the U.S?



Notes: Based on USG data released on 4/30/2008. Includes official and non-official sector holdings.

\* Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia & United Arab Emirates.

# **1997-98 AFC: A Catalyst for Asian Monetary and Financial Cooperation**

- The realization that the region needs to develop regional self-help mechanisms
- ASEAN+3 spearheaded such initiatives to:
  - Maintain macroeconomic stability
  - Prevent the recurrence of financial crisis
  - Manage crises when they occur
  - Promote balanced, well regulated and supervised financial sectors



# Major Post-AFC Initiatives

- The ASEAN+3 Finance Ministers Forum:
  - The Chiang Mai Initiative (CMI) - May 2000
  - Economic Review and Policy Dialogue (ERPD) – May 2000
  - ASEAN+3 Macroeconomic Research Office (AMRO) - May 2010
  - The Asian Bond Markets Initiative (ABMI) – May 2003
  - Credit Guarantee and Investment Facility (CGIF) - April 2010
- The Asian Bond Funds (ABF) by Executives' Meeting of East Asia and Pacific Central Banks (EMEAP) – 2003

# CMI, ERPD, and AMRO

- Japan's \$100 bil AMF proposal did not get much support
- CMI – a bilateral currency swap initiative was thus launched in May 2000 - 90% tied to IMF program; ERPD established
- May 2005 – collective decision-making for activating BSAs, doubling the BSA size from 36.5 bil, lowering the IMF-tied portion to 80%
- Between May 2007 and May 2009 – multilateralized the BSAs and established a CMIM – a regional fund amounting to \$120 bil
- March 2010 – the CMIM became effective, with country-wise shares, borrowing limits, voting power and decision-making modality (see ADB 2011 for details)
- May 2010 – decision to set up an independent regional surveillance body – AMRO – to strengthen ERPD and support the CMIM

# ABMI and CGIF

- Promote issuance of local currency bonds (creation of new securitized debt instruments)
- Improve the regulatory framework (harmonization of standards, practices, and policies)
- Improve infrastructure for bond markets (establishment of a regional settlement and clearing system)
- Facilitate demand for local currency bonds (credit guarantee and enhancing the capacities of Asian credit rating agencies)
- April 2010 – CGIF established as an ADB Trust Fund with initial capital of \$700 mil to provide guarantee for eligible local currency bonds
- Japan and PRC (\$200 mil each); Korea (\$100 mil); ASEAN10 (70 mil); ADB (\$130 mil)

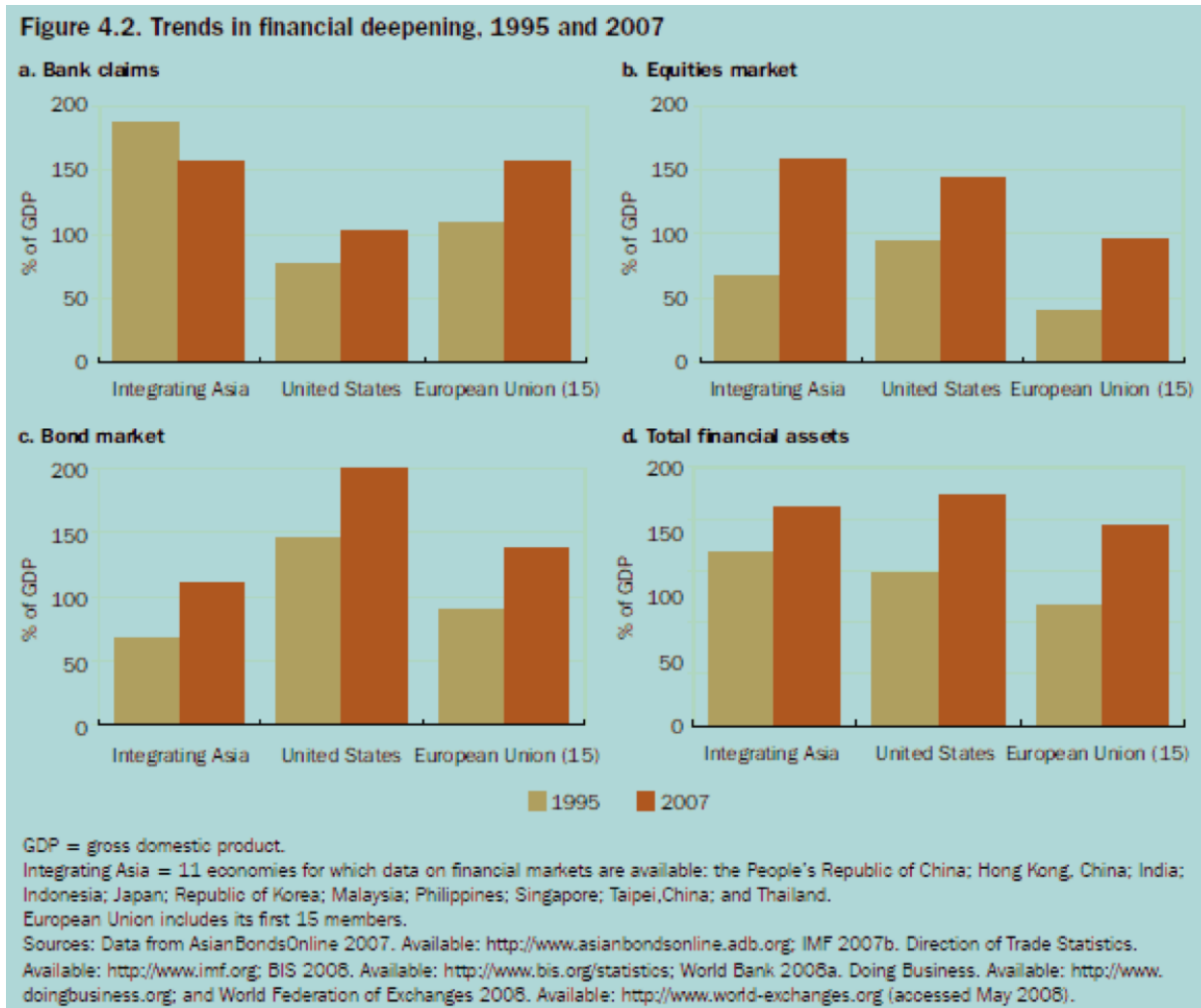
# EMEAP and ABFs

- EMEAP – consists of central banks of 11 economies (China, Japan, Korea, Hong Kong, Singapore, Indonesia, Malaysia, Philippines, Thailand, Australia, New Zealand)
- June 2003 – ABF I (\$1 bill) invested in dollar-denominated Asian sovereign bonds
- December 2004 – ABF II (2 bill):
  - Part of which was invested in high quality local currency bonds of member economies
  - Another part in local currency bonds with rating below investment grade ratings

# Trends in Regional Financial Development and Integration

- Financial systems have deepened and broadened (slide 15)
  - Have diversified too (slide 16)
  - Bond markets have grown (slide 17)
  - Price indicators converging (slide 18)
  - Stock price correlations increasing (slide 19)
- (Note that cross-border macroeconomic interdependence has also increased since the AFC slide 4 )

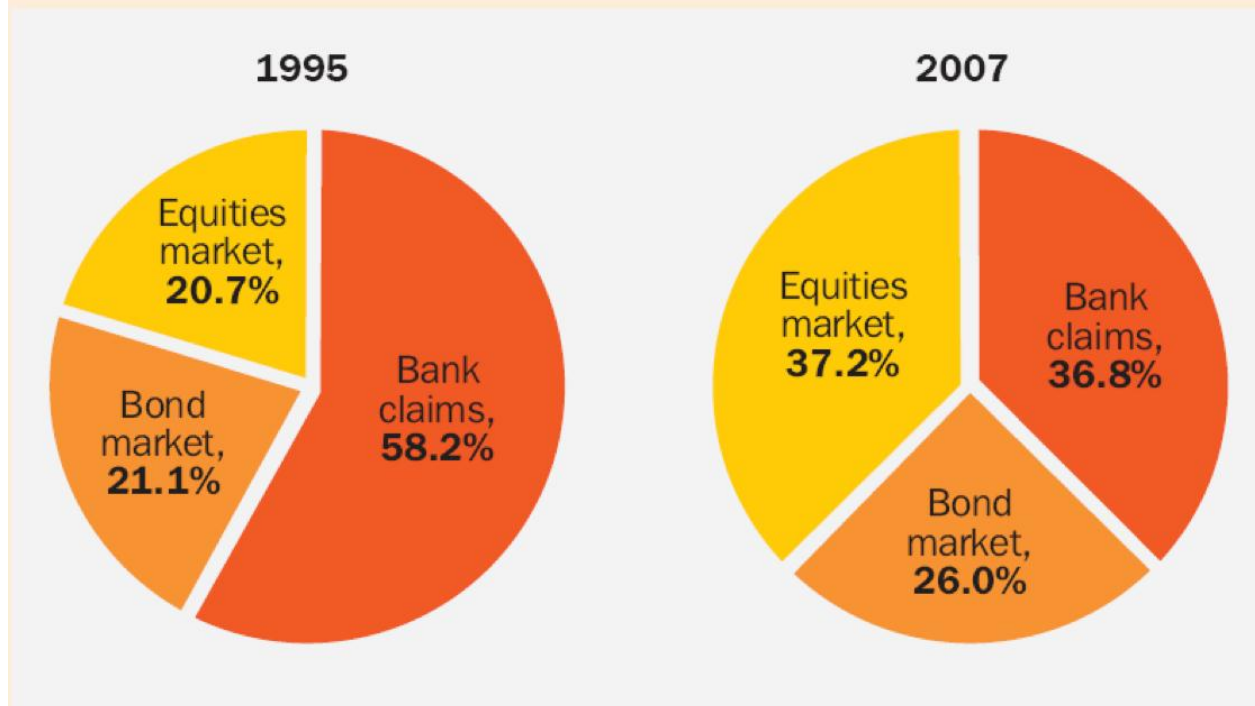
# Financial Broadening and Deepening



# Financial Diversification

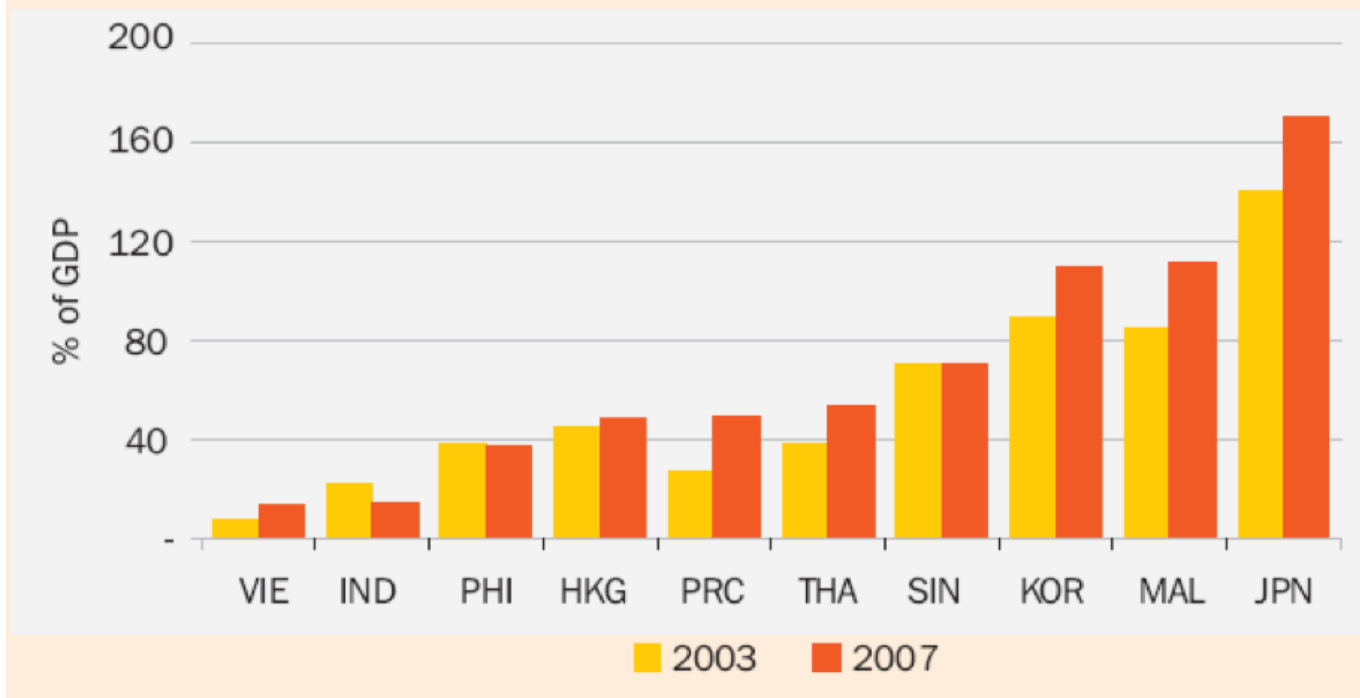
**Figure 4.1. Increasing share of capital markets**

Share in total financial assets in Integrating Asia



# Growth in Bond Markets

**Figure B4.3. Growing local-currency denominated bond markets**  
Share of total issuances in GDP, 2003 and 2007

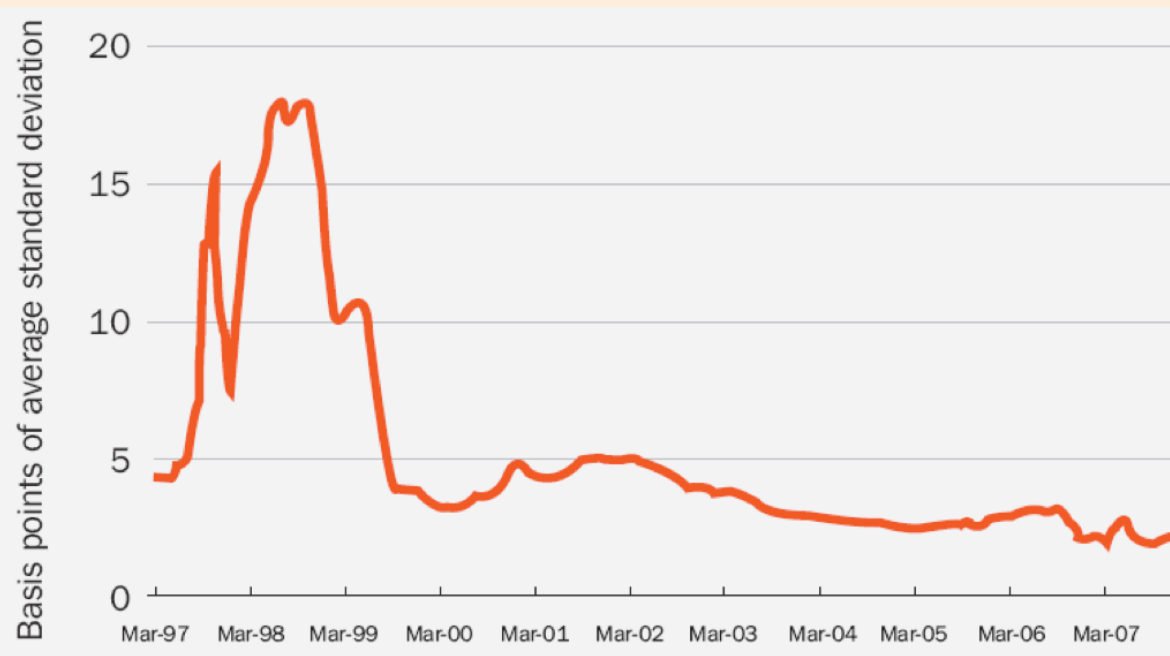




# Converging Price Indicators

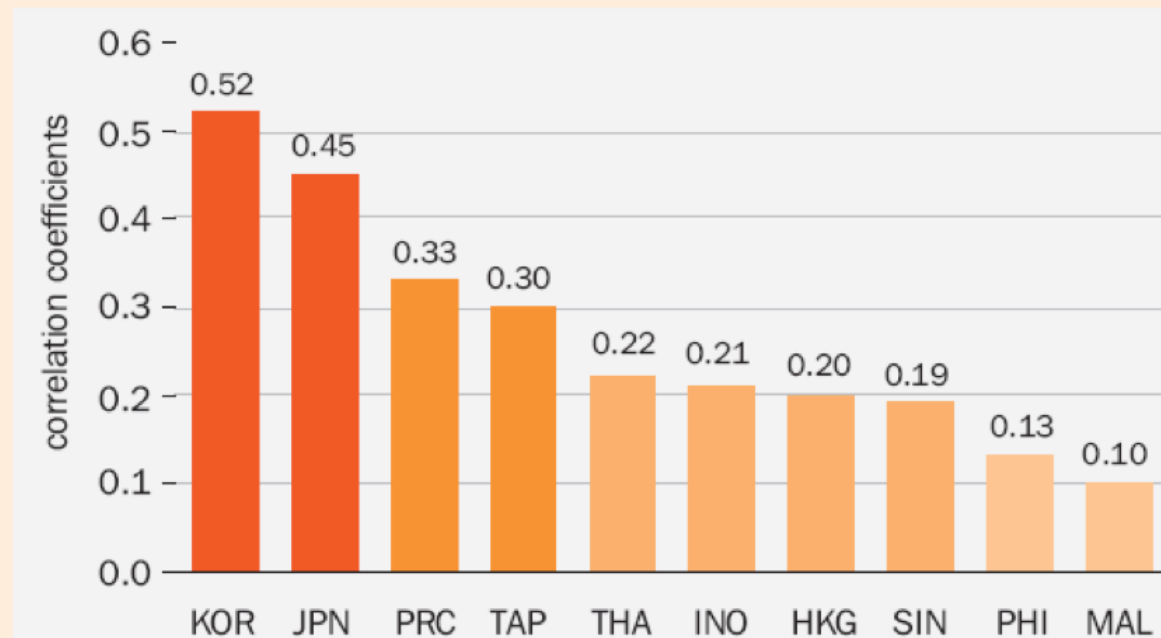
**Figure 4.7. Declining interbank rate differentials**

(Standard deviation of cross-market overnight interbank rate differentials)



# Increasing Stock Price Correlations

**Figure 4.9. Correlation of stock price indexes in Integrating Asia**  
Absolute changes in the average of bilateral correlation coefficients  
precrisis (1990:Q2–1996:Q4); postcrisis (2000:Q1–2006:Q2)



# Monetary and Financial Cooperation: What Next?

- Much less consensus here than in the case of regional trade (and investment) integration
- Strengthen regional surveillance?
- Coordinate exchange rate policies regionally?
- What next in financial regionalism?
- Should and how can other countries in Asia be brought into the fold of the many ASEAN+3 initiatives? Any role for EAS, APEC, any other forum? (Lectures 10 and 11)
- Strengthen institutions for monetary and financial cooperation? (Lectures 10 and 11)

# Strengthening Regional Surveillance

- Until now ERPD has primarily been a mutual information exchange exercise – good beginning
- Need to move to more rigorous “peer review and peer pressure stage”, and eventually to “due diligence stage”
- Objective assessment of economic and financial situations in the member economies crucial
- Can AMRO accomplish this? Will it have the mandate and independence? Adequate funding and human resources?
- Should the ASEAN+3 Finance Ministers Forum be extended to include Central Bank Governors too?

# Coordinating Exchange Rate Policies Regionally

- How to anchor regional coordination?
- Basket pegging to external trading partners?
- Use a regional currency unit?
- Any other options?
- A common currency for the region?
- What lessons from European integration?
- And what lessons from the recent crisis in the Euro-zone?

# What Next for Financial Regionalism?

- Mutual recognition, or harmonization of financial sector policies and practices?
- An Asian Clearing and Settlement Mechanism?
- Does ASEAN financial integration hold promise?
- Would the large inter-country heterogeneity a hindrance for financial integration?
- What lessons from European integration?
- How to promote financial regionalism in the changing global financial landscape?
- What lessons from the current global financial crisis for Asian financial integration?

# Conclusions

- The 1997-98 AFC - a major impetus for Asian (East Asian) monetary and financial cooperation and integration, to:
  - Support "Factory Asia"
  - Manage growing macro-interdependence,
  - Broaden and deepen financial markets
- ASEAN+3 has been spearheading major monetary and financial cooperation initiatives
- Many worthwhile ideas for taking these initiatives forward, but less consensus (progress will anyway be very gradual?)

# Sources

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# **Regional Infrastructure for a Seamless Asia Lecture 9**

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor

# What is Infrastructure?

- **Transportation** – roads, railways, ports, waterways, and airports
- **Energy** – power plants, hydroelectric dams, dams, electricity grids, and gas and oil pipelines
- **Telecommunications** – telephone and internet systems
- **“Hard” component** – physical structures, equipment and facilities, as well as
- **“Soft” component** – policy, regulatory, and institutional framework that facilitates the operation of the hard component

# What is Regional Infrastructure?

- **Cross-border Infrastructure:**
  - Projects that involve physical construction work and/or coordinated policies and procedures that involve two or more neighboring countries
- **National Infrastructure with significant cross-border impact; projects that:**
  - Connect to the network of a neighboring country
  - Stimulate significant cross-border trade and income
  - Require cooperation and coordination across countries

# Why Regional Infrastructure?

- Reduces cost of cross-border trade and enhances the competitiveness of “Factory Asia”
- Regional infrastructure – a public good that has network externalities and agglomeration effects (a key element of “Factory Asia”)
- Makes it easier for goods, people, and ideas to move across borders and narrows the development gap across Asia
- Overall helps regional integration and helps people to move from deprivation to development
- Asia still home to huge number of poor – 900 mil, who live on less than \$1-a-day and 1.8 bil who live on less than \$2-a-day

***Infrastructure - one of the four "I"s of development (along with institutions, investment, and innovation)***

# Advantage Infrastructure: National as well as Regional (Empirical Evidence)

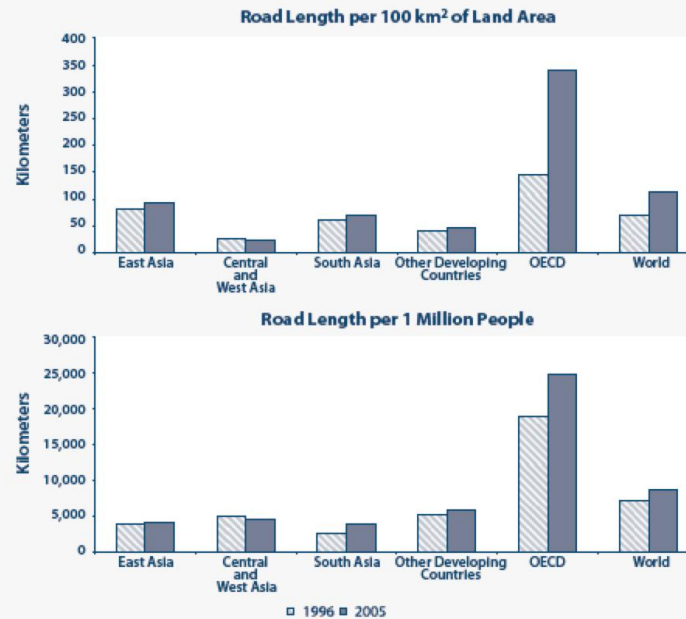
- Infrastructure explains 1/3 of the differences in labor productivity between East Asia and Latin America
- 40% of the growth difference between low and high growth economies explained by infrastructure (a study of 100 countries)
- Compared to a coastal country, a landlocked country has 50% higher transport costs and 60% less trade
- A 10% reduction in transport costs to boost Asia's trade by 3-4%
- A 20% reduction in logistics costs would increase trade-GDP ratio in the range of 10 to 20 for about 10 Asian countries
- Infrastructure also a good conduit for poverty reduction
- Decline in trade costs explain more than half of the pre-WW I (1870-1913) surge in global trade and around 1/3 of post-WW II global trade growth

# Asia's Infrastructure: An Overview

- Asia's seaports have rapidly expanded and air transport has soared in the last decade and half
- Road coverage has improved in East (including southeast) Asia but not elsewhere; even fallen in central and west Asia (slide 7)
- Railways is another weak link – except in East Asia, the region's rail network shrank since 1996 (slide 8)
- Asia's per capita consumption of electricity increased since the mid-1990s, but with huge intra-regional differences (slide 9)
- Despite much improvements, the ICT indicators are far below OCED; also exhibit huge intra-regional differences (slide 10)
- Soft component of infrastructure also better but with big intraregional differences (slides 11 and 12)
- Overall, quality of infrastructure better but again big intra-regional differences (slide 13)

# Asia's Road Network

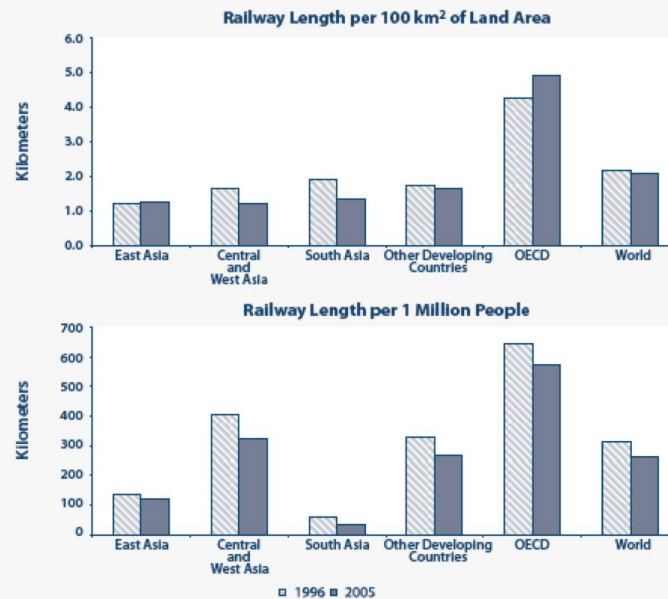
Figure 2.1. Road Network Indicators by Region, 1996 and 2005



km<sup>2</sup> = square kilometer; OECD = Organisation for Economic Co-operation and Development.  
 Notes: East Asia (15) includes: Brunei Darussalam; Cambodia; Hong Kong, China; Indonesia; Lao People's Democratic Republic; Malaysia; Mongolia; Myanmar; People's Republic of China; Philippines; Republic of Korea; Singapore; Taipei, China; Thailand; and Viet Nam. Central and West Asia (8) includes: Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. South Asia (8) includes: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. Other developing countries include 116 countries classified as developing by the International Monetary Fund.  
 Source: World Bank (2007a, 2008b, 2009b).

# Asia's Railway Network

Figure 2.2. Railway Indicators by Region, 1996 and 2005

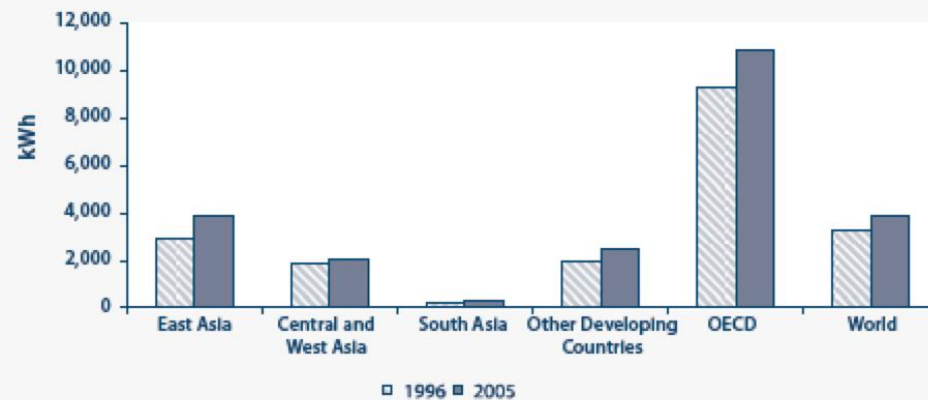


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 Source: World Bank (2007a).



# Asia's Electricity Consumption

Figure 2.4. Electricity Consumption Per Capita, kWh, 1996 and 2005



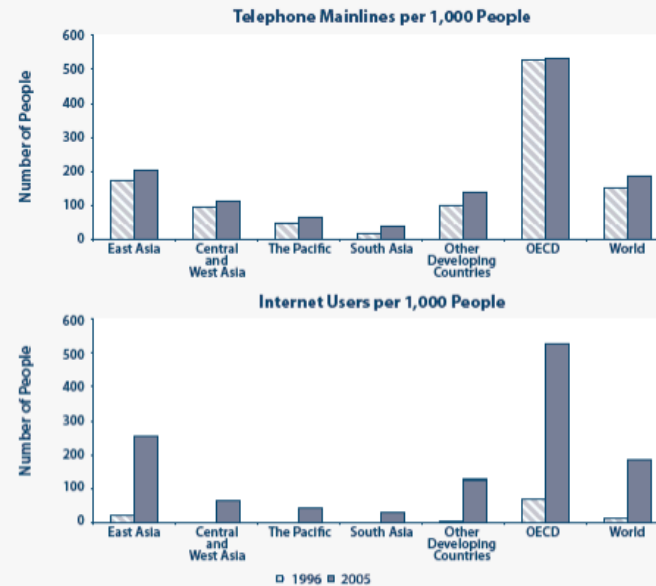
kWh = kilowatt-hour; OECD = Organisation for Economic Co-operation and Development.

Notes: East Asia (15) includes: Brunei Darussalam; Cambodia; Hong Kong, China; Indonesia; Lao People's Democratic Republic; Malaysia; Mongolia; Myanmar; People's Republic of China; Philippines; Republic of Korea; Singapore; Taipei, China; Thailand; and Viet Nam. Central and West Asia (8) includes: Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. South Asia (8) includes: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. Other developing countries include 116 countries classified as developing by the International Monetary Fund.

Source: World Bank (2007a, 2008b).

# Asia's ICT Indicators

Figure 2.3. ICT Indicators by Region, 1996 and 2005



ICT = Information and communication technology; OECD = Organisation for Economic Co-operation and Development.

Notes: East Asia (15) Includes: Brunei Darussalam; Cambodia; Hong Kong, China; Indonesia; Lao People's Democratic Republic; Malaysia; Mongolia; Myanmar; People's Republic of China; Philippines; Republic of Korea; Singapore; Taipei, China; Thailand; and Viet Nam. Central and West Asia (8) Includes: Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. The Pacific includes: Cook Islands, Democratic Republic of Timor-Leste, Federated States of Micronesia, Fiji Islands, Kiribati, Marshall Islands, Nauru, Papua New Guinea, Republic of Palau, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. South Asia (8) includes: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. Other developing countries include 116 countries classified as developing by the International Monetary Fund.

Source: World Bank (2007a, 2008b).

# Asia's Border Trade Costs

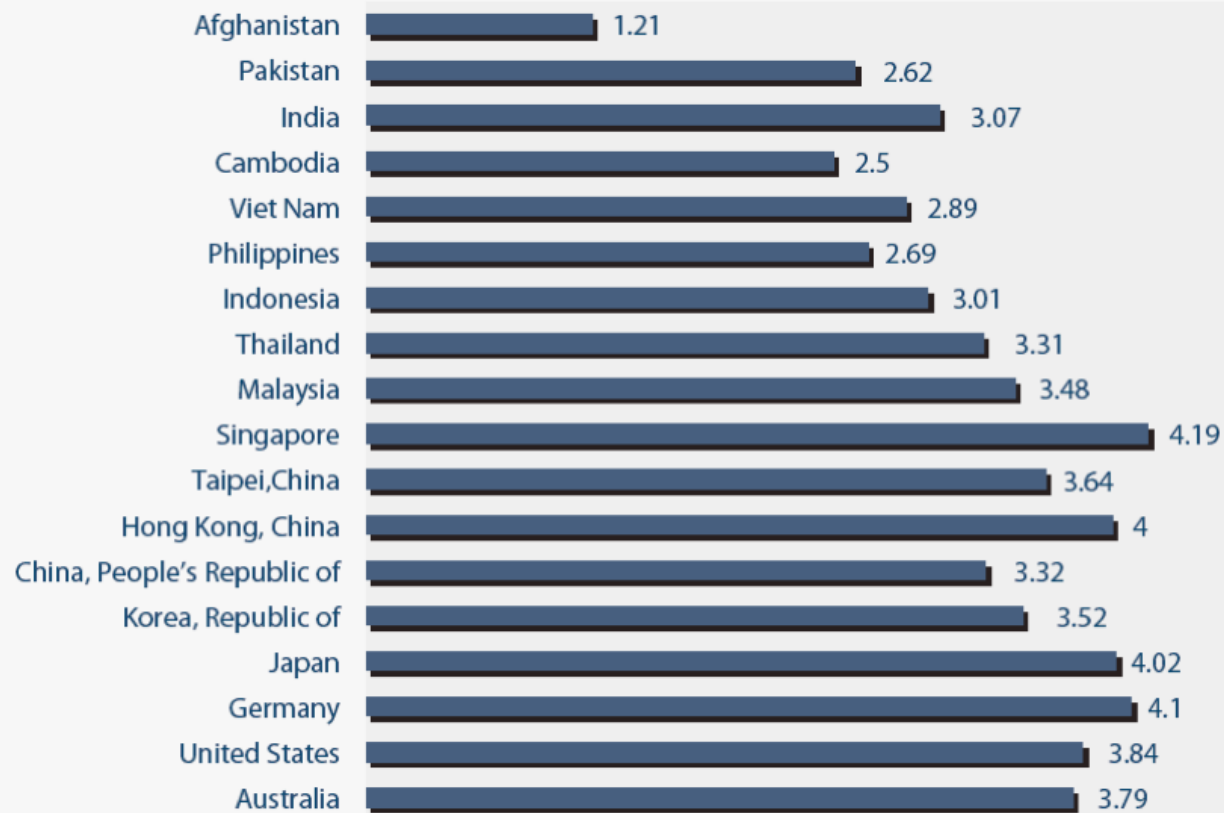
Table 2.4. Border Trade Costs, 2009

Subregion	Sub-Saharan Africa	East Asia and Pacific	South Asia	Central and West Asia	Latin America and Caribbean	OECD
<b>Exports</b>						
Documents needed (average number)	8	7	9	7	7	5
Time required (days)	34.7	23.3	33	29.7	19.7	10.7
Cost to (\$ per container)	1,878.8	902.3	1,339.1	1,649.1	1,229.8	1,069.1
<b>Imports</b>						
Documents needed (average number)	9	7	9	8	7	5
Time required (days)	41.1	24.5	32.5	31.7	22.3	11.4
Cost to (\$ per container)	2,278.7	948.5	1,487.3	1,822.2	1,384.3	1,132.7

\$ = United States dollar; OECD = Organisation for Economic Co-operation and Development.  
Source: World Bank (2009a).

# Asia's Logistics Facilities

Figure 2.6. International Logistics Performance Index



Notes: The international logistics performance index mainly reflects infrastructure, customs, international shipments, logistics competence, tracking and tracing, domestic logistics costs, timeliness, etc. Scores range from 1 to 5, 1 being the lowest.  
Source: World Bank (2007b).

# Asia's Infrastructure Quality

	All	Road	Rail	Port	Air	Elec
G7	5.7	5.7	5.4	5.4	5.8	6.4
World	3.8	3.8	3.0	4.0	4.7	4.6
Asia	3.8	3.7	3.6	3.9	4.6	4.9
East Asia	4.6	4.7	4.8	4.8	5.1	5.3
Southeast Asia	4.2	4.2	3.2	4.3	5.1	4.7
South Asia	2.9	3.1	2.8	3.4	4.2	2.8
Central Asia	3.5	3.1	3.6	3.2	4.2	3.6

***Note: score 1= underdeveloped; 7=extensive and efficient by international standards, data for 2008***

# Asia's Infrastructure Quality

	All	Road	Rail	Port	Air	Elec
Singapore	6.7	6.6	5.6	6.8	6.9	6.7
Hong Kong	6.3	6.4	6.2	6.6	6.7	6.7
Korea	5.6	5.8	5.8	5.2	5.9	6.2
Malaysia	5.6	5.7	5.0	5.7	6.0	5.8
Taiwan	5.5	5.6	5.7	5.5	5.7	5.9
Thailand	4.8	5.0	3.1	4.4	5.8	5.5
China	3.9	4.1	4.1	4.3	4.4	4.7
India	2.9	2.9	4.4	3.3	4.7	3.2
Philippines	2.9	2.8	1.8	3.2	4.1	4.2
Indonesia	2.8	2.5	2.8	3.0	4.4	3.9
Vietnam	2.7	2.6	2.4	2.8	3.9	3.2

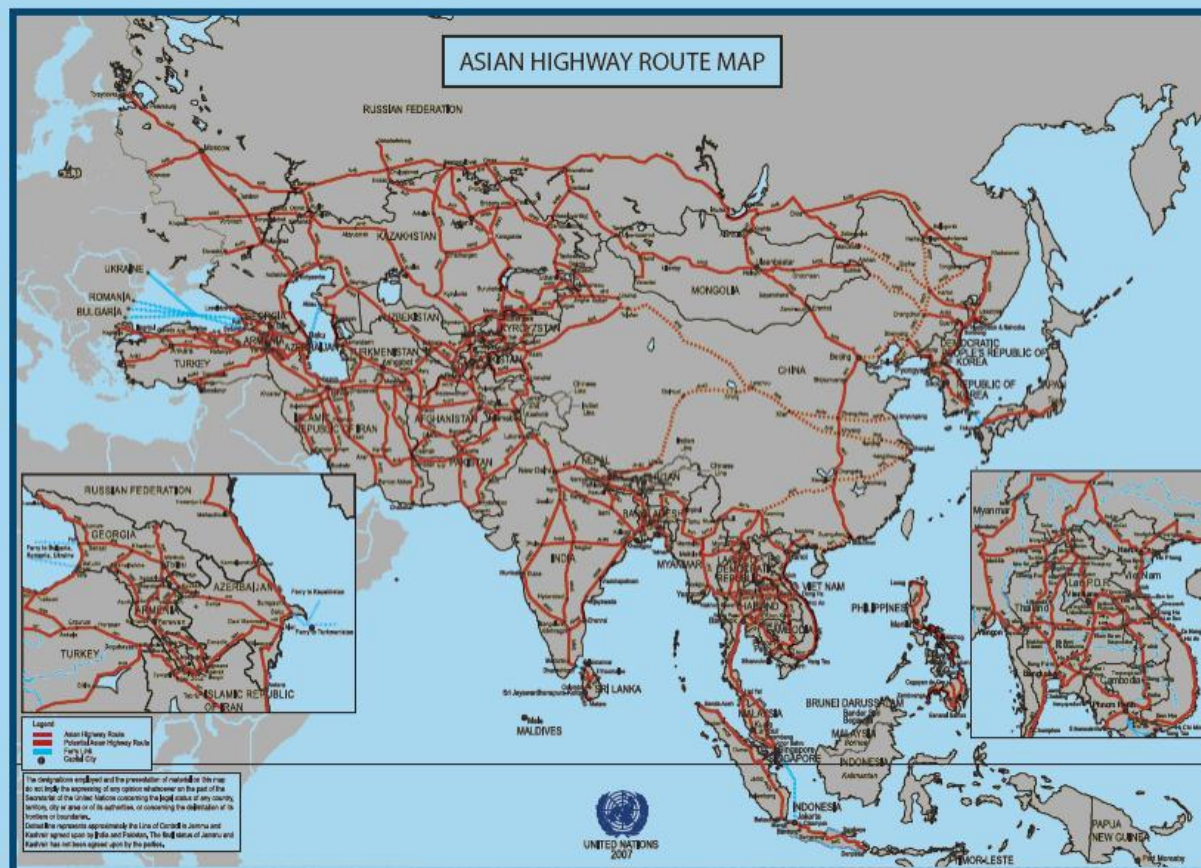
***Note: score 1= underdeveloped; 7=extensive and efficient by international standards, data for 2008***

# Asia's Infrastructure Investment Needs (2010-2020)

- Asia's total infrastructure investment needs estimated to be about \$8 tril, or about \$730 billion per year
  - 68% for new capacity and remaining for maintenance
  - Electricity (51%) and transport roads (31%); telecoms (13%)
  - East Asia, including Southeast (58%); South Asia (34%)
- Of the \$8 tril, about \$290 bil for financing more than 1,000 regional infrastructure projects
  - Transport (71%); Energy (29%)
  - (Pan-Asian (62%); subregional (38%))
  - Of the Pan-Asian- 29% for Asian ports; 24% for Trans-Asian highways, and 47% for Trans-Asian railways (slides 16 and 17); subregional cooperation programs (slides 18 and 19)

# Trans-Asian Highway

Figure 1.1. Asian Highway Network

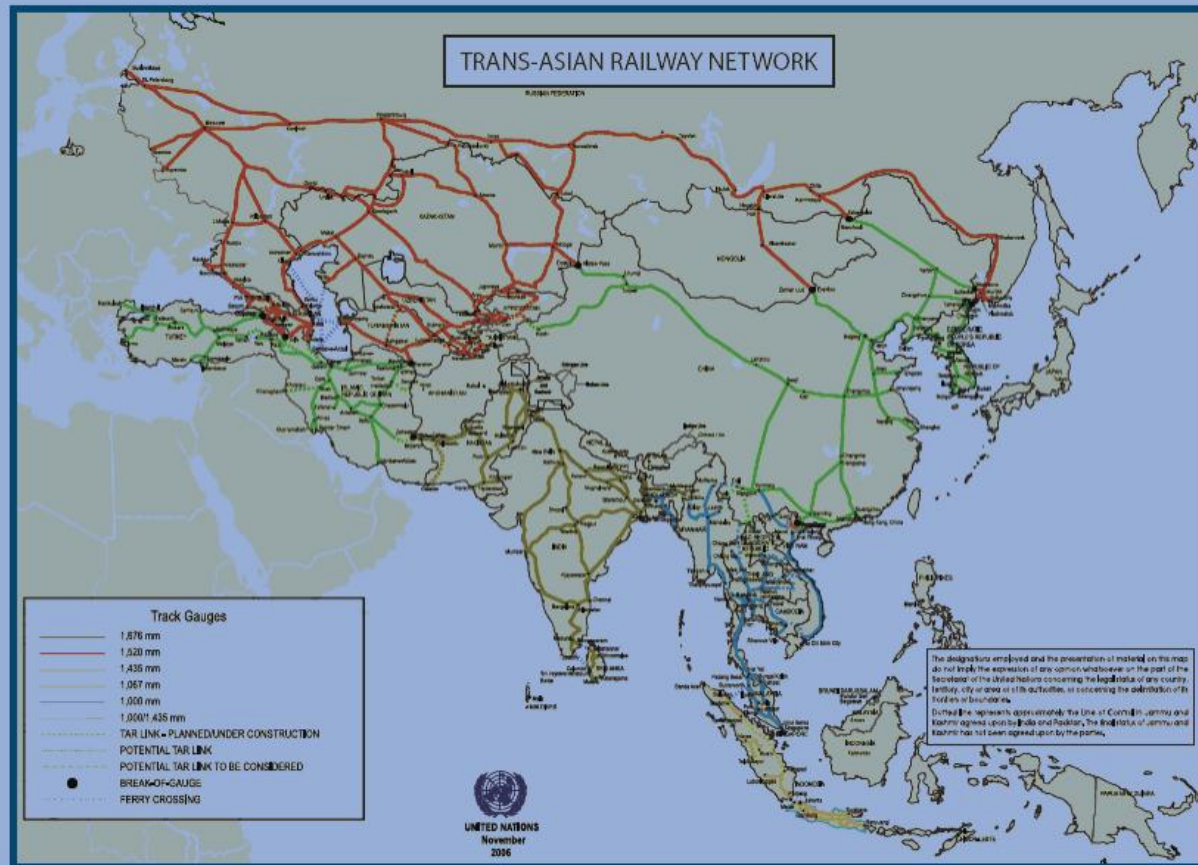


Source: UNESCAP (2009a).



# Trans-Asian Railway

Figure 1.2. Trans-Asian Railway Network



Source: UNESCAP (2009b).

# Asia's Subregional Economic Cooperation Programs

- Greater Mekong Subregion (GMS) Program – 1992
- Indonesia, Malaysia, Thailand Growth Triangle (IMT-GT) – 1993
- Brunei, Indonesia, Malaysia, Philippines East ASEAN Growth Area (BIMP-EAGA) – 1994
- Central Asian Regional Economic Cooperation (CAREC) – 1997
- South Asia Subregional Economic Cooperation (SASEC) – 2001
- Pacific Islands Forum (PIF)

# Subregional Cooperation Programs



# **Building Regional Infrastructure: Key Challenges**

- Identifying, prioritizing, and preparing viable projects
- Developing effective policies and regulatory frameworks
- Developing regional institutions for cross-border cooperation
- Financing regional infrastructure
- What lessons from Europe for Asia?

# Project Identification and Preparation

- **Involve greater uncertainty and risk:** the outcome — and hence the benefit — depends upon the performance of other partners
- **More complex than national projects:** they are more costly to design, and face greater uncertainty in terms of timing and expected benefits
- **More difficult to manage:** commitment, depending on perceived benefits and national priorities, may differ substantially
- **Deal with multiple governments:** more time consuming than national projects

# Developing Effective Policies and Regulatory Framework

## Designing policies and regulatory frameworks to to address:

- Rights of passage for goods, people, and vehicles
- Permits licenses, and other measures to facilitate transit rights
- Consultation and dispute settlement mechanisms
- Jurisdiction and responsibility over the title and offshore pipeline segment
- Managing the social and environmental issues
- Displacement of people
- Unintended migration
- Smuggling and human trafficking

# Developing Regional Institutional Arrangements

- Institutions at the subregional levels: need to strengthen the institutional bases of the subregional cooperative programs?
- The GMS - one of the most successful subregional cooperative programs in Asia - a role model for the other subregionals?
- GMS CBTA (Cross-border Transport Agreement) - a good model for subregional cross-border transportation?
- How about developing Pan-Asian forums?
- A Pan-Asian Infrastructure Forum - with representatives from governments, private sector, civil society, and multilateral institutions? (more on this in Lecture 11)
- What role for ADB?

# Financing Regional Infrastructure

- Infrastructure investment - relatively large and lumpy, long implementation periods, even longer time for yielding returns
- Thus mostly done by governments, although PPs increasing gradually (require government guarantees and other support)
- Regional infrastructure investment - more complex and difficult
  - Require more than one government - larger sovereign risk
  - Uneven spread of costs and benefits of projects
  - More free rider possibilities
  - Heightened politicization of projects
- An Asian Infrastructure Fund? How to structure it? Who can make a beginning?
- ADB and its role



# Lessons from Europe?

- TEN (Trans-European Network) - four components - TEN-T; TEN-E; eTEN
- Maastricht Treaty (1992) provides the basis:
  - Establishing guidelines for project identification
  - Implementing measures for cross-border network operations
  - Supporting through feasibility studies, loan guarantees and interest subsidy
  - Financing through the EU Structural and Cohesion Funds and the European Investment Bank (EIB)
  - Promoting coordination among member countries, including helping address burden sharing

## **What can Asia learn from European TEN?**

# Conclusions

- Regional Infrastructure development is crucial to support “Factory Asia” and better integrate Asia more generally
- Despite impressive achievements in infrastructure development, Asia’s infrastructure investment needs are huge
- Regional infrastructure development is especially challenging given the special problems associated with cross-border projects - from project identification to completion
- Designing policies, institutions, and financing modalities are crucial to foster regional infrastructure development
- A PIF and an AIF at the pan-Asian level? What role for subregional cooperation programs?
- What lessons for Asia from Europe and its TEN?

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# **Institutions for Asian Integration: A Stocktaking Lecture 10**

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor

# Key Issues in Asian Integration

- **Progress of integration:** How far has Asia come?
- **Future of Asian Integration:** Where to go from here? What should be Asia's ultimate objectives in integration?
- **Need for institution building:** What does Asia have and what are the gaps?
- **Regional comparisons:** What lessons from other regions, especially Europe?
- **The way forward:** What institutional architecture suits Asia? What can be done, when, and by whom? And how to move from goals to strategies?

# Progress of Asian Integration

- Market-driven production networks and spurt in government-led FTAs— “Factory Asia” (lecture 7)
- Initiatives at monetary and financial cooperation (lecture 8)
- Development of regional infrastructure (lecture 9)
- Emergence of regional and subregional forums: EAS, ASEAN+3, ASEAN, SAARC, PIF, GMS, CAREC, BIMSTEC, SASEC, etc

***Much has been achieved, but much remains to be done too***

# Asia and its Subregions

**Table 2.1. Country Classification of Asia and the Pacific by Subregion**

ASIA AND THE PACIFIC		
<b>Central Asia</b>	<b>East Asia</b>	<b>Northeast Asia</b>
Armenia		China, People's Republic of
Azerbaijan		Hong Kong, China
Georgia		Japan
Kazakhstan		Korea, Republic of
Kyrgyz Republic		Mongolia
Tajikistan		Taipei, China
Turkmenistan		<b>Southeast Asia</b>
Uzbekistan		Brunei Darussalam
<b>South Asia</b>		Cambodia
Afghanistan		Indonesia
Bangladesh		Lao People's Democratic Republic
Bhutan		Malaysia
India		Myanmar
Maldives		Philippines
Nepal		Singapore
Pakistan		Thailand
Sri Lanka		Viet Nam
		<b>Pacific Islands</b>
	Cook Islands	
	Federated States of Micronesia	
	Fiji Islands	
	Kiribati	
	Marshall Islands	
	Nauru	
	Palau	
	Papua New Guinea	
	Samoa	
	Solomon Islands	
	Timor-Leste	
	Tonga	
	Tuvalu	
	Vanuatu	
	<b>Oceania</b>	
	Australia	
	New Zealand	

Source: Asian Development Bank.

# Asia and its Subregions : Some Economic Indicators

Table 2.2. Basic Economic Indicators by Region and Subregion

	Population 2009 (million)	Gross Domestic Product (GDP)		Per Capita GDP	
		\$ billion (2009)	Average Growth Rate % (1980–2009)	\$ (2009)	Average Growth Rate % (1981–2009)
Asia and the Pacific	3,854	15,812	4.3	4,103	2.3
East Asia	2,135	12,883	4.2	6,034	2.6
Northeast Asia	1,544	11,403	4.1	7,386	2.6
Southeast Asia	591	1,480	5.3	2,503	3.3
Central Asia	77	232	4.4	2,995	3.1
South Asia	1,606	1,568	5.8	976	3.8
Pacific	36	1,130	3.1	31,476	1.4
European Union	498	16,447	2.0	33,052	1.6
North America	449	16,468	2.7	36,708	1.5
World	6,734	57,925	3.2	8,602	1.1

Notes: The list of countries in each subregion is shown in Table 2.1. The European Union (EU) refers to the aggregate of the 27 EU member countries. North America includes Canada, Mexico, and the United States. The Pacific includes Pacific Islands and Oceania. Population, GDP, GDP growth, per capita GDP, and per capita growth values for the Cook Islands, Marshall Islands, Federated States of Micronesia, Nauru, Palau, and Tuvalu are as of end-2008. Regional GDP growth rates are derived using gross national income values weighted using the Atlas method. Per capita GDP growth rates are computed using GDP in 2000 US\$ prices.

Source: Key Indicators 2009, Asian Development Bank; World Economic Outlook Database (April 2010), International Monetary Fund; World Development Indicators (WDI) Database, World Bank. [www.adb.org/Documents/Books/Key\\_Indicators/2009/default.asp](http://www.adb.org/Documents/Books/Key_Indicators/2009/default.asp); [www.imf.org](http://www.imf.org); [www.worldbank.org](http://www.worldbank.org) (accessed 12 July 2010).



# Twin Challenges of Asian Integration - Uneven Across the Subregions and Functional Areas

	Production integration	Final goods integration	Services integration	Labor integration	Monetary and financial integration
East Asia	<b>High</b>	Moderate	Moderate	Low	Low
Central Asia	Low	Low	Low	Moderate	Low
South Asia	Low	Low	Low	Low	Low
Pacific	Low	Low	Low	Low	Low

# Need for Institution Building

- Cement recent gains
- Broaden the process (subregions and sectors)
- Promote beyond-the-border liberalization
- Ensure compatibility of regional and global integration
- Regional integration initially involves deregulation and subsequently re-regulation
- Credible regional institutions crucial for both these phases of regional integration

***Stronger institutions needed to complement market-driven integration***

***Ultimate goal: an Asian Economic Community***

# What is a Regional Institution?

- Institutions defined in various ways; no one definition
- In its broadest meaning: durable rules that shape expectations, interests, and behavior: ranging from formal obligations to informal norms of what constitutes normal behavior
- A narrower definition in everyday use: arrangements and organizations involving national governments
  - ranging from *ad hoc* and informal forums to formal standing bodies
  - focused on economic integration and cooperation

# What is an AEC?

- An integrated market where goods and services flow freely across national borders
- Deep and liquid financial markets open to cross-border financial flows
- Effective frameworks for coordinating macroeconomic for coordinating and exchange rate policies
- Regional forums to dialogue on economic, environmental, and social issues
- A consistent voice to project regional concerns in global governance forums and institutions

**“A strong and prosperous economic community that is regionally integrated and globally connected”**

# Is AEC ....

- An FTA plus?
- A Customs Union?
- A Single (Common) Market?
- An Monetary Union?
- An Economic Union?
- A “Mongrel” - Bits of Everything?
- Variable Geometry (Multitrack, Multispeed)?
- Concentric Circles?

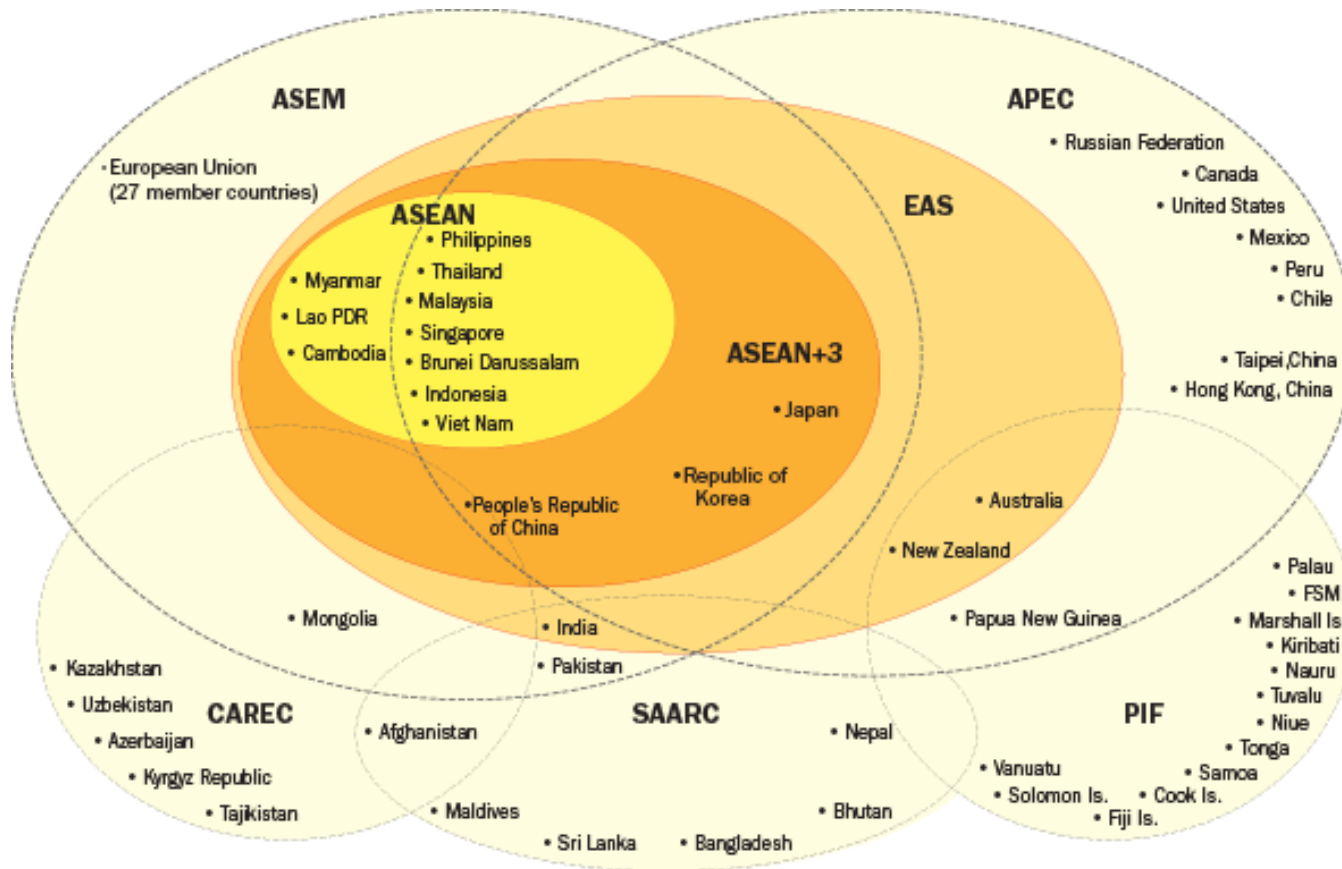
# Can AEC be Modeled on ASEAN Economic Community?

- Single market and production base
  - Free flow of goods, services, investment, capital, and skilled labor
- Competitive economic region
  - Competition policy
  - Consumer protection
  - Intellectual property rights
  - Infrastructure development
  - Taxation and E- Commerce
- Equitable economic development (bridging the development gap)
- Integration into the global economy (coherent external economic policy and participation in the global supply chain)

# Asia's Institutional Landscape "Dense"

	Trans-regional	Pan-Asian	Intra-regional	Subregional					Total
				Central Asia	South Asia	Southeast Asia	Northeast Asia	Pacific	
Overarching	4		2		1	1	1	1	10
Functional	3		8	3	3	5	1	5	28
Facilitating		2							2
<b>Total</b>	<b>7</b>	<b>2</b>	<b>10</b>	<b>3</b>	<b>4</b>	<b>6</b>	<b>2</b>	<b>6</b>	<b>40</b>

# And, Overlapping (Institutional Noodle Bowl?)





# At the Same Time, “Institution-Lite”

- Few Pan-Asian institutions
- Convoys rather than clubs
- Operate with few explicit procedural rules
- Not many have standing Secretariats
- Delegate few tasks to Secretariats even in cases where they exist
- Specify few obligations to its members
- Consensus approach to decision-making
- Nonbinding commitments (soft law)

**Regionalization without Legalization - a situation where rules are not precise and binding, and where the interpretation, monitoring, and implementation are not delegated to supranational bodies**

# Anatomy of Existing Institutions

- **Overarching (umbrella arrangements with comprehensive purview) - 10:**
  - Subregional - 4;
  - Intraregional - 2;
  - Transregional - 4;
- **Functional (Specialized arrangements with a narrow and often technical agenda) -28**
  - Subregional-17;
  - Intraregional - 8;
  - Transregional - 3;
- **Facilitating (organizations providing advisory, technical, and financial support) - 2**
  - Pan-Asian - 2

# Asia's 10 Overarching Institutions

- Only 3 have Secretariats - ASEAN, SAARC, PIF (Slide 19)
- Only 2 are based on Charter - ASEAN and SAARC
- Most have deliberative kind of mandate/modality
- All rely on consensus-based decision making
- Most have minimal delegation of powers from their members
- Most have weak dispute settlement mechanisms
- Except to some extent for ASEAN, no binding rules

# Asia's 28 Functional Institutions

- Close to 2/3 subregional, or even sub-subregional - mainly a bottom-up approach (slides 20 and 21)
- Most focus on developing cross-border infrastructure, promoting trade, and investment, and managing environment
- Among these, the GMS, CAREC, and SASEC are generally considered as the more successful ones in achieving their objectives
- Two of them - AMRO and CGIF - are very new and just about to start functioning
- In terms of organizational form, mandate setting modality, delegation of authority, decision-making process, commitments to rules, and dispute settlement mechanism, they are similar to the overarching institutions

# Asia's 2 Facilitating Institutions

- **ESCAP and ADB:** both are Pan-Asian, and service providers and hence facilitate regional integration
- **ESCAP** provides technical assistance and capacity building and advisory services to countries in regional integration, especially on Asian Highway and Railway Networks
- **ADB** plays a somewhat broader role as:
  - Financier: provides loans and grants for integration projects
  - Honest Broker: acts as catalyst and coordinator for member countries and regional forums
  - Knowledge Provider: creates, consolidates, and disseminates knowledge and information on regional integration
  - Capacity Builder: helps countries and regional and/or sub-regional forums build their institutional capacity to manage regional integration

# Overarching Institutions

Table 4.1. Features of Overarching IRIs in Asia and the Pacific

		Form	Level	Mandate/ Modality	Rules	Decision- Making	Delegation	Secretariat	Dispute Settlement	Feedback	
Transregional	Asia-Europe Meeting (ASEM)	Framework	Summit	Deliberative	Non-binding	Consensus	Minimal	Limited	None	None	
	Asia-Pacific Economic Cooperation (APEC)	Declaration	Summit, ministerial	Deliberative	Non-binding	Consensus	Minimal	Limited	None	Yes	
	Eurasian Economic Community (EurAsEC)	Treaty	Summit, ministerial	Deliberative	Non-binding	Flexible consensus	Minimal	Limited	Yes (Community Court)	Yes	
	Forum for East Asia-Latin America Cooperation (FEALAC)	Declaration	Summit	Deliberative	Non-binding	Consensus	Minimal	None	None	None	
Intraregional	Association of Southeast Asian Nations Plus Three (ASEAN+3)	Declaration	Summit, ministerial, officials	Deliberative, process-oriented	Non-binding	Flexible consensus	Minimal	Limited	None	None	
	East Asia Summit (EAS)	Declaration	Summit	Deliberative	Non-binding	Consensus	Minimal	Limited	None	None	
Subregional	South Asia	South Asian Association for Regional Cooperation (SAARC)	Charter	Summit, ministerial, officials	Deliberative	Non-binding	Consensus	Limited	Limited	Yes (in the South Asia Free Trade Agreement)	Yes
	Southeast Asia	Association of Southeast Asian Nations (ASEAN)	Charter	Summit, ministerial, officials	Deliberative, but developing distributive capacity	Binding (AEC Blueprint)	Flexible consensus	Minimal	Yes	Yes	Yes
	Northeast Asia	Trilateral Summit (TS)	Declaration	Summit, ministerial, officials	Deliberative (distributive potential)	Non-binding	Consensus	Minimal	Yes	None	None
	Pacific	Pacific Islands Forum (PIF)	Treaty	Summit, ministerial, officials	Deliberative	Non-binding	Consensus	Limited (better than minimal)	Yes	Yes, informal	Yes

AEC = ASEAN Economic Community, IRI = institution for regional integration.

Source: ADB staff estimates, based in part on fieldwork interviews.

# Functional Institutions (Part 1)

Table 4.2. Features of Functional IRIs in Asia and the Pacific

		Form	Level	Mandate/ Modality	Rules	Decision- making	Delegation	Secretariat	Dispute Settlement	Feedback	
Transregional	ASEAN Regional Forum (ARF)	Declaration	Summit, officials	Advisory	Non-binding	Consensus	Weak	Yes	None	None	
	Indian Ocean Rim Association for Regional Cooperation (IORARC)	Charter	Ministerial	Deliberative	Non-binding	Consensus	Minimal	Limited	Yes, informal	None	
	Shanghai Cooperation Organisation (SCO)	Charter	Summit, ministerial	Deliberative	Non-binding	Consensus	Minimal	Limited	None	None	
Intraregional	ASEAN + 3 Macroeconomic Research Office (AMRO)	Declaration	Officials	Deliberative/ Advisory	Non-binding	Qualified majority and consensus	Strong	Yes	None	Yes	
	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)	Treaty	Ministerial, officials	Deliberative	Non-binding	Consensus	Minimal	Limited	Yes	None	
	Central Banks of Southeast Asia, New Zealand, and Australia (SEANZA)	Meeting of governors of central banks	Governors' Symposium and Meeting	Deliberative	Non-binding	Consensus	Minimal	Limited	None	None	
	Coral Triangle Initiative (CTI)	Declaration	Ministerial, officials	Deliberative	Non-binding	Consensus	Minimal	Yes	None	None	
	Credit Guarantee and Investment Facility (CGIF)	Charter	Officials	Deliberative	Non-binding	Qualified majority and consensus	Strong	Yes	Yes	Yes	
	Economic Cooperation Organization (ECO)	Charter	Summit, ministerial, officials	Deliberative	Non-binding	Consensus	Minimal	Yes	Yes	None	
	Executives' Meeting of East Asia Pacific Central Banks (EMEAP)	Meeting of governors of central banks	Governors' Meeting	Deliberative	Non-binding	Consensus	Minimal	Limited	None	Yes	
	Network of Asian River Basin Organizations (NARBO)	Charter	Government, private sector	Deliberative	Non-binding	Consensus	Minimal	Limited	None	None	
Subregional	Central Asia	Central Asia Regional Economic Cooperation (CAREC)	Program	Summit, officials	Deliberative	Non-binding	Consensus	Weak	Yes	None	Yes
		International Fund for Saving the Aral Sea (IFAS)	Agreement	Summit, officials, private sector	Deliberative	Non-binding	Qualified majority and consensus	Strong	Yes	None	None
		United Nations Special Programme for the Economies of Central Asia (SPECA)	Program	Summit, officials	Deliberative	Non-binding	Consensus	Minimal	Yes	None	None

# Functional Institutions (Part 2)

Table 4.2 continued

South Asia	Bay of Bengal Programme Inter-Governmental Organisation (BOBP-IGO)	Agreement	Officials	Deliberative	Non-binding	Consensus	Minimal	Limited	None	None
	South Asia Co-operative Environment Programme (SACEP)	Declaration	Ministerial, officials	Deliberative	Non-binding	Consensus	Minimal	Limited	None	None
	South Asia Subregional Economic Cooperation (SASEC)	Program	Summit, officials	Deliberative	Non-binding	Qualified majority and consensus	Minimal	Yes	None	Yes
Southeast Asia	Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA)	Declaration	Summit, officials, private sector	Deliberative	Non-binding	Consensus	Minimal	Limited	None	None
	Greater Mekong Subregion Economic Cooperation Program (GMS)	Program	Summit, officials, private sector	Deliberative	Non-binding	Qualified majority and consensus	Weak	Yes	None	Yes
	Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT)	Declaration	Summit, officials, private sector	Deliberative	Non-binding	Qualified majority and consensus	Weak	Yes	None	Yes
	Mekong River Commission (MRC)	Agreement	Ministerial	Deliberative	Non-binding	Consensus	Minimal	Yes	None	None
	South East Asian Water Utilities Network (SEAWUN)	Declaration	Government, private sector	Deliberative	Non-binding	Consensus	Minimal	Limited	None	None
Northeast Asia	Greater Tumen Initiative (GTI)	Framework	Officials	Deliberative	Non-binding	Consensus	Minimal	Limited	None	None
Pacific	Forum Fisheries Agency (FFA)	Convention	Officials	Deliberative	Non-binding	Consensus	Minimal	Yes	None	None
	Pacific Islands Applied Geoscience Commission (SOPAC)	Constitution	Governing Council (officials)	Deliberative	Non-binding	Consensus	Minimal	Yes	None	None
	Secretariat of the Pacific Community (SPC)	Agreement	Summit (nonpolitical)	Deliberative	Non-binding	Consensus	Minimal	Yes	None	None
	Pacific Regional Environment Programme (SPREP)	Convention	Summit, ministerial, officials	Deliberative	Non-binding	Consensus	Minimal	Yes	None	None
	South Pacific Tourism Organisation (SPTO)	Agreement	Ministerial, officials	Deliberative	Non-binding	Consensus	Minimal	Yes	None	None

Source: ADB staff estimates, based in part on fieldwork interviews.



# Asia's Economic Heterogeneity a Constraint for Institution Building?

Table 2.11. Income (GDP per Capita) Gaps

Regions	Ratio of Highest:Lowest			Ratio of 3 Highest:3 Lowest		
	1990	1999	2008	1990	1999	2008
Asia and the Pacific	362.5	199.8	93.7	190.4	139.3	87.6
East Asia	362.5	199.8	87.5	190.4	108.1	53.8
Northeast Asia	72.6	78.2	19.5	5.8	6.4	4.0
Southeast Asia	200.4	120.8	87.5	103.6	52.6	39.5
Central Asia	n.a.	6.5	11.0	n.a.	2.7	6.9
South Asia	4.1	9.4	8.8	2.2	3.7	5.6
Pacific	9.6	17.5	21.2	3.9	7.0	7.6
Across Asia's subregions	8.2	10.1	7.3	2.3	3.1	2.6
Africa	74.4	105.1	108.3	45.4	59.3	73.2
Americas	224.0	59.6	60.0	74.7	32.9	34.5
Europe	53.9	152.9	66.8	24.7	58.3	28.5
Middle East	19.5	48.7	79.6	15.5	18.4	28.0

n.a. = not available.

Note: East Asia includes Northeast Asia and Southeast Asia. Africa includes North Africa and sub-Saharan African countries. Americas include North, Central, and South American countries. Europe includes the 27 member countries of the European Union and countries from Eastern and Southeast Europe. Middle East includes Bahrain, Iran, Israel, Jordan, Kuwait, Oman, Qatar, Saudi Arabia, Syria, United Arab Emirates, and Yemen.

Source: World Economic Outlook Database (October 2009), International Monetary Fund. [www.imf.org](http://www.imf.org) (accessed 15 October 2009).

# What about Other (Mostly Non-Economic) Factors?

- The environment: two world wars and the destruction it caused to Europe, the fragmented global economy, plus the US attitude for European integration then and Asian integration now?
- Asian preference for consensus and aversion to majority-rule based decision making (Asian way)?
- Aversion to legalization of cross-border disputes (another Asian way)?
- Cultural heterogeneity, unlike Europe?
- Political Heterogeneity - unlike Europe, not all countries in Asia have democracies -- a constraint?
- "Asia is not Europe"? And there is no "Asian Germany" either?

# Conclusions

- Progress in Asian economic integration has been significant in recent decades - Asia today is extensively integrated
- Yet, integration has been uneven both across subregions and functional areas
- To address this twin imbalances, strengthening the institutional base of integration crucial
- Asia's existing institutional base is dense and overlapping, yet light
- Economic heterogeneity as well as non-economic factors may pose constraints on strengthening the institutional base
- What should and can be done under these circumstances?  
(Lecture 11)

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# **Institutions For Asian Integration: What Next? Lecture 11**

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor

# Institution-Building for Asian Integration: An Agenda For Collective Action

Table 6.1. Enhancing Asian Regionalism: An Agenda for Collective Action

Themes	Building an Asian Economic Community: The Way Forward	
	Priorities	Policy Solutions
Integrating production	<ul style="list-style-type: none"> <li>Enhance investment in, and the productivity of, regional economies</li> <li>Strengthen comparative advantage derived from regional production chains</li> <li>Promote technological upgrading and development of a knowledge economy</li> </ul>	<ul style="list-style-type: none"> <li>Pursue trade and investment cooperation as widely and deeply as possible</li> <li>Develop guidelines for best practices in regional trade agreements</li> <li>Enhance regional infrastructure and connectivity via transport and energy links</li> <li>Support the global trading system</li> </ul>
Integrating financial markets	<ul style="list-style-type: none"> <li>Increase resilience against financial crises</li> <li>Develop larger, deeper regional financial markets</li> <li>Improve returns for investors and reduce capital costs to firms by strengthening the regional intermediation of savings</li> </ul>	<ul style="list-style-type: none"> <li>Improve financial market surveillance</li> <li>Promote the harmonization of standards and mutual recognition of regulations</li> <li>Strengthen local-currency bond markets and their infrastructure</li> <li>Liberalize capital accounts and cross-border financial services in a prudent manner</li> </ul>
Managing macroeconomic interdependence	<ul style="list-style-type: none"> <li>Ensure macroeconomic stability</li> <li>Smooth global economic adjustments, including reallocation of the region's external savings to regional demand</li> <li>Facilitate rebalancing of the sources of economic growth from exports to domestic demand</li> <li>Avoid excessive exchange-rate divergences across the region</li> <li>Increase investment and growth in slower-growing economies</li> </ul>	<ul style="list-style-type: none"> <li>Enhance the macroeconomic monitoring capacity of regional institutions</li> <li>Make macroeconomic consultation and surveillance more effective</li> <li>Build on efforts to strengthen regional financial initiatives to avoid the recurrence of financial crisis and respond to their challenges</li> <li>Cooperate in exchange-rate and macroeconomic policy management</li> </ul>
Making growth inclusive and sustainable	<ul style="list-style-type: none"> <li>Address climate change and other major environmental issues</li> <li>Provide opportunities for developing peripheral areas</li> <li>Reduce poverty and income disparities</li> <li>Fight epidemics and mitigate the impact of natural disasters</li> <li>Improve social safety nets and provide support for the aged</li> </ul>	<ul style="list-style-type: none"> <li>Provide regional public goods by creating forums and dialogues to increase awareness and protect the environment</li> <li>Connect the poor to the thriving regional economic centers by developing regional infrastructure</li> <li>Facilitate and manage labor migration</li> <li>Establish regional dialogues to prevent and manage epidemics and natural disasters</li> <li>Establish regional forums to promote the introduction of cost-effective social protection systems</li> </ul>

Source: Adapted from ADB 2008b.

# The Basic Approach to Institution-Building

- Asia's approach to be pragmatic and flexible
- A multi-track and multispeed process to accommodate the huge diversity
- Build on the existing institutions, especially those ones with potential but at the same time build newer ones
- Need to endow institutions with clearer mandates, stronger Secretariats, and larger delegation
- Decision-making to move away from consensus to some version of majority voting
- More objective, transparent dispute-settlement mechanisms
- Overall, less likely to be adopt a European-style approach with a large number of strong supranational institutions?

# Twin Principles for Reform: Openness and Transparency

- **Make the most of global institutions and conventions**
  - Continue to work constructively with global institutions such as the WTO, IMF, the world Bank, and the Financial Stability Board
  - The UN Convention on Contracts for the International Sale of Goods (CISG)
  - About 12 Conventions from the International Institute for the Unification of Private Law
- **Better transparency to promote greater accountability of institutions (establish Compliance Boards)**
  - Greater consultation with business and private sector
  - More participation of Civil society in regional institutions (EU's 2009 Lisbon Treaty and the European Citizens' Initiative)
  - Outreach seminars and consultation meetings



# Three Specific Recommendations

- Rationalize and strengthen the Existing overarching institutions
  - Develop institutions to exploit compelling functional opportunities
  - Establish new pan-Asian institutions and empower existing ones
  - Complement bottom-up with top-down approach
- “Preserve what you have and build those you need but don’t have”**

# Strengthen Existing Overarching Institutions

- Stronger Secretariats
- Adequate financial and human resources
- Greater Focus
- Clearer Mandates
- Better membership and compliance rules
- More effective decision-making modalities (not just consensus-based)
- Stronger links among the overarching institutions

# Strengthen/Develop Institutions for Functional Initiatives

- Rationale for smaller number of countries establishing specialized institutions for specific functional areas and then expanding the geographical coverage
- Case for institutionalizing the sub-regional economic corridor initiatives, especially GMS and CAREC
- Strengthen the institutional bases of ASEAN+3 CMIM and regional surveillance that could pave the way for the establishment of an AMF
- Building on the ASEAN+3 ABMI, establish a Regional Bond Markets Forum (to help standardize market practices and harmonize bond market regulations)
- Phase out redundant functional regional and sub-regional forums and institutions

# **Establish New and Stronger Pan-Asian Institutions**

## **Strengthen ADB and ESCAP and establish:**

- A Pan-Asian Infrastructure Forum
- An Asia-wide Free Trade Area (Asia-FTA)
- An Asian Monetary Fund (AMF)
- An Asian Financial Stability Dialogue
- An Asian Legal Advisory Council (ALAC)
- Several Regional Public Goods Forums (RPGFs)
- Council of Asian Economic Cooperation

# Complementarities with Global Institutions

**Table 6.2. Complementarities between Global and Asian Institutions**

Function	Global Institutions	Asian Institutions
Macroeconomic stability	<b>International Monetary Fund</b> <i>Global and national surveillance, crisis lending, systemic stability</i>	<b>Asian Monetary Fund</b> (to evolve from CMIM) <i>Regional surveillance, crisis lending, stability</i>
Development finance	<b>World Bank</b> <i>Global public goods: poverty, environment, food, and energy</i>	<b>Asian Development Bank</b> <i>Regional development priorities, regional infrastructure lending</i>
Trade liberalization	<b>World Trade Organization</b> <i>Global disciplines, dispute resolution, Article XXIV</i>	<b>Asia-Wide Free Trade Agreement</b> (to be forged by consolidating existing FTAs) <i>Deeper and wider regional trade agreement</i>
Financial system stability	<b>Financial Stability Board</b> <i>Standards of global financial markets, colleges of regulators</i>	<b>Asian Financial Stability Dialogue</b> (to be created) <i>Asian financial markets' regulatory initiatives</i>

Notes: CMIM = Chiang Mai Initiative Multilateralisation, FTA = free trade agreement.

Source: Adapted from Kawai, Petri, and Sisi-Ciamarra (2010).

# How to Move from Goals to Strategies?

- **Political leadership**
  - Lessons from Europe
  - Who takes the leadership?
- **Financial resources**
  - Lessons from Europe: EU's budget about \$200 billion; and EC's operating budget about \$3 billion
  - ASEAN Secretariat's operating budget:\$10 million; AMRO – a budget of \$3 million
  - ADB a benchmark with an operating budget of about \$400 million (with about 900 international staff and another 2500 national officers and administrative staff)?

# Who Takes the Lead?

- How to manage multispeed and multitrack integration and institution building?
- ASEAN - the pioneer - to be driving force for Asian integration and institution building?
- The Plus Three (China-Japan- Korea) countries to take the lead in an Asia-wide FTA formation?
- ASEAN+3 to lead in monetary and financial cooperation and institution building?
- What role for EAS?
- How to bridge the integration gap between East Asia and south and central Asia?
- Building stronger Pan-Asian Institutions - a dream or reality?

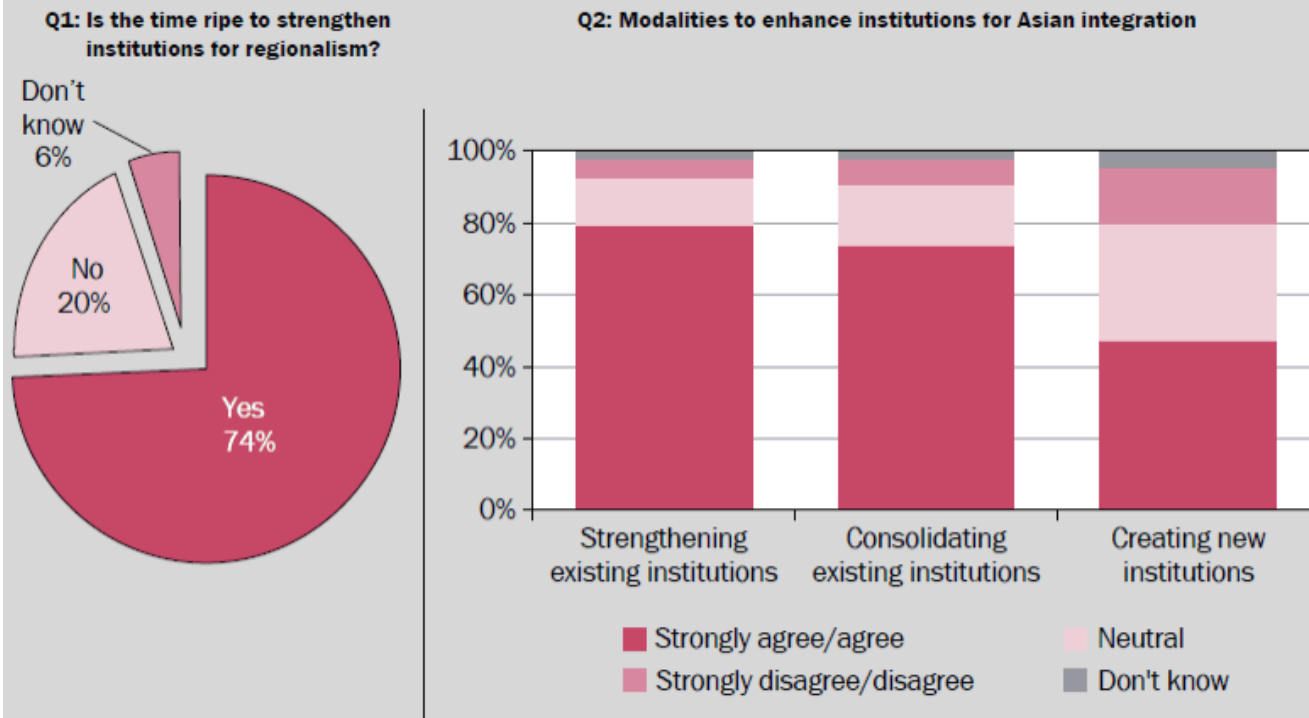
# **Will the Two-way Feedbacks from Economics to Politics Work for Asia?**

- European experience on sequencing integration and feedbacks:
- Coal and Steel integration – a political process – led to more demands for trade integration from export industries
- More trade integration led to more demands for exchange rate coordination
- Which, in turn, created greater need for supranational institutions
- Supranational institutions themselves induced more demand for economic integration, including standardization and harmonization of products and business practices
- Which in turn created demands for more political cooperation and coordination
- Will such dynamics be set in motion in Asia?



# What Asian Opinion Leaders Say?

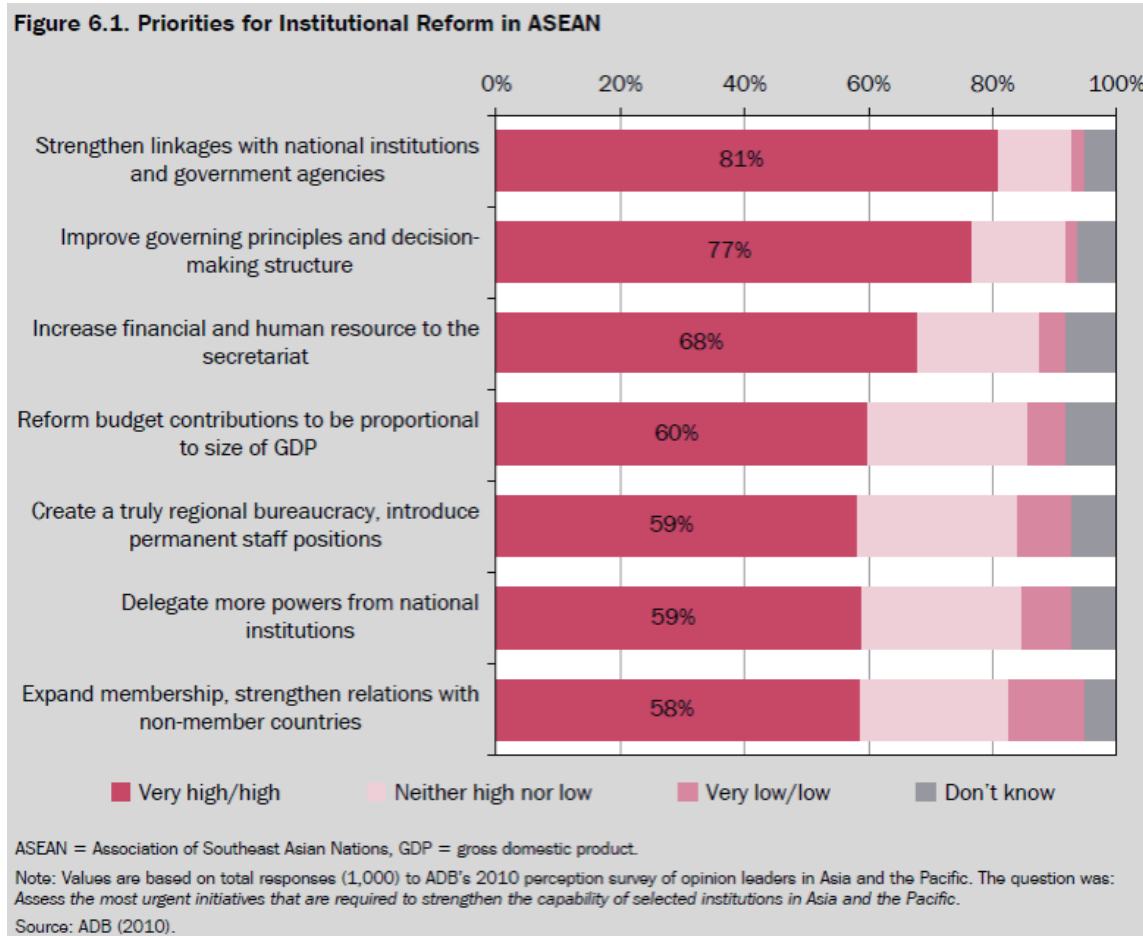
Figure A1.3. Readiness and Modalities for Asia's Institutions for Regional Integration



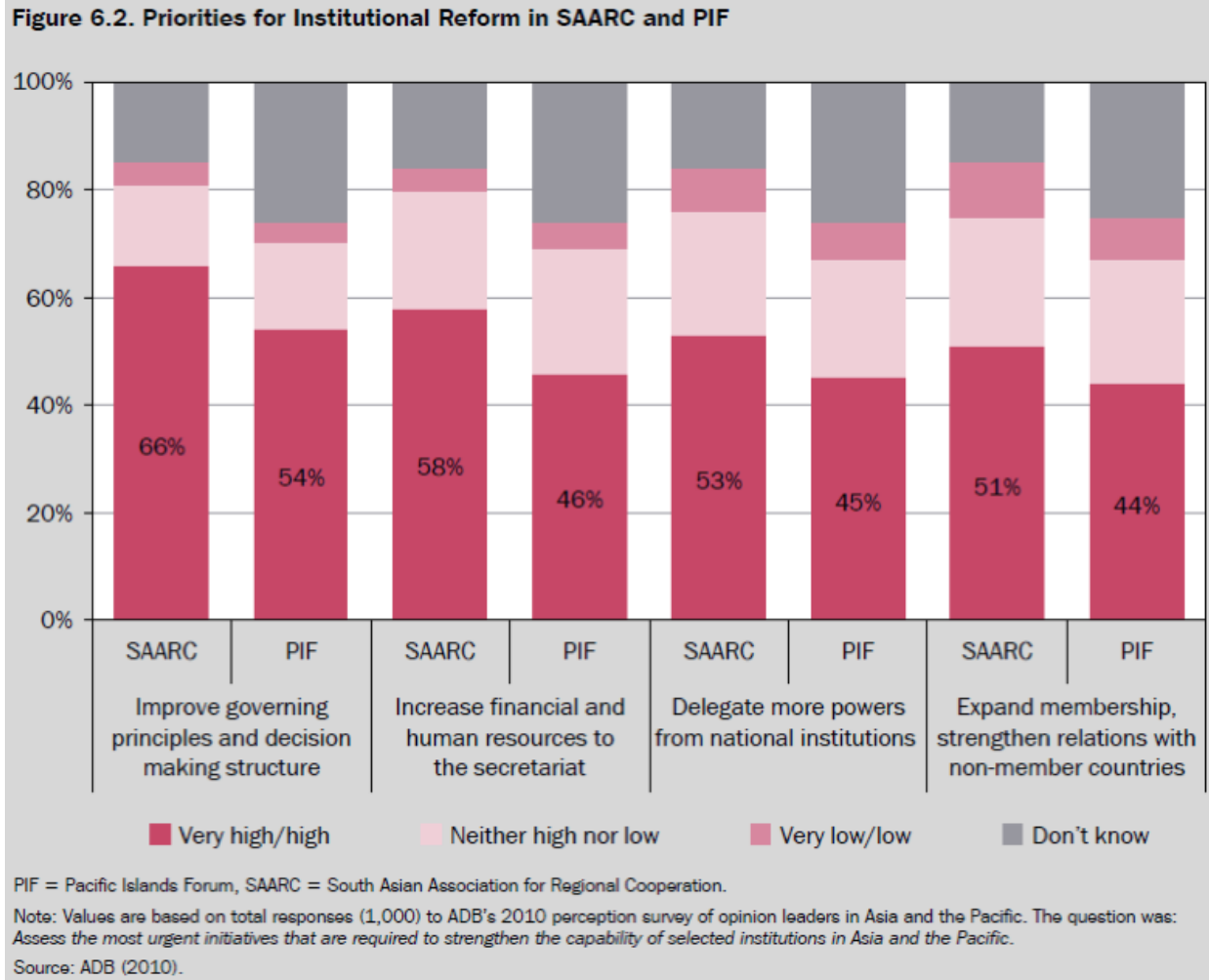
Note: Values are based on total response (1,000). The questions were: Q1 Do you share the view that the time is ripe for leaders in Asia and the Pacific to greatly strengthen the capabilities of institutions for regional integration? Q2 Indicate to what extent you agree (disagree) with the appropriateness of the different modalities to enhance institutions for regional integration in Asia and the Pacific.

Source: ADB (2010).

# What Priorities for ASEAN?

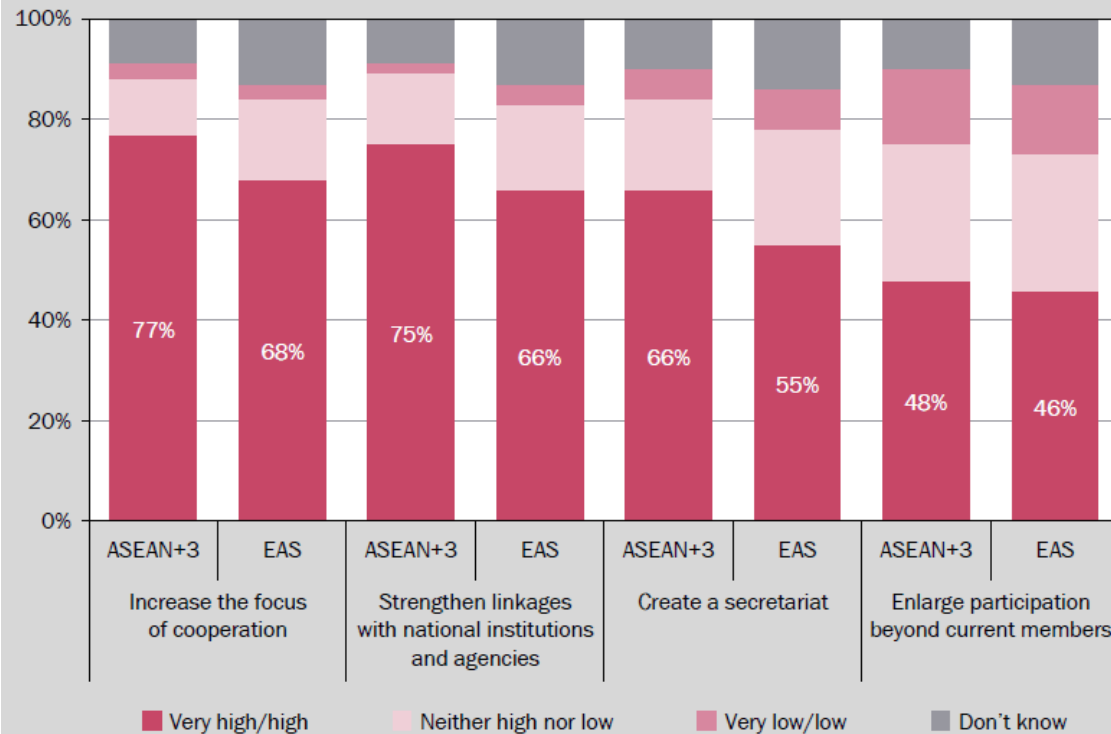


# What Priorities for SAARC and PIF?



# What Priorities for ASEAN+3 and the EAS?

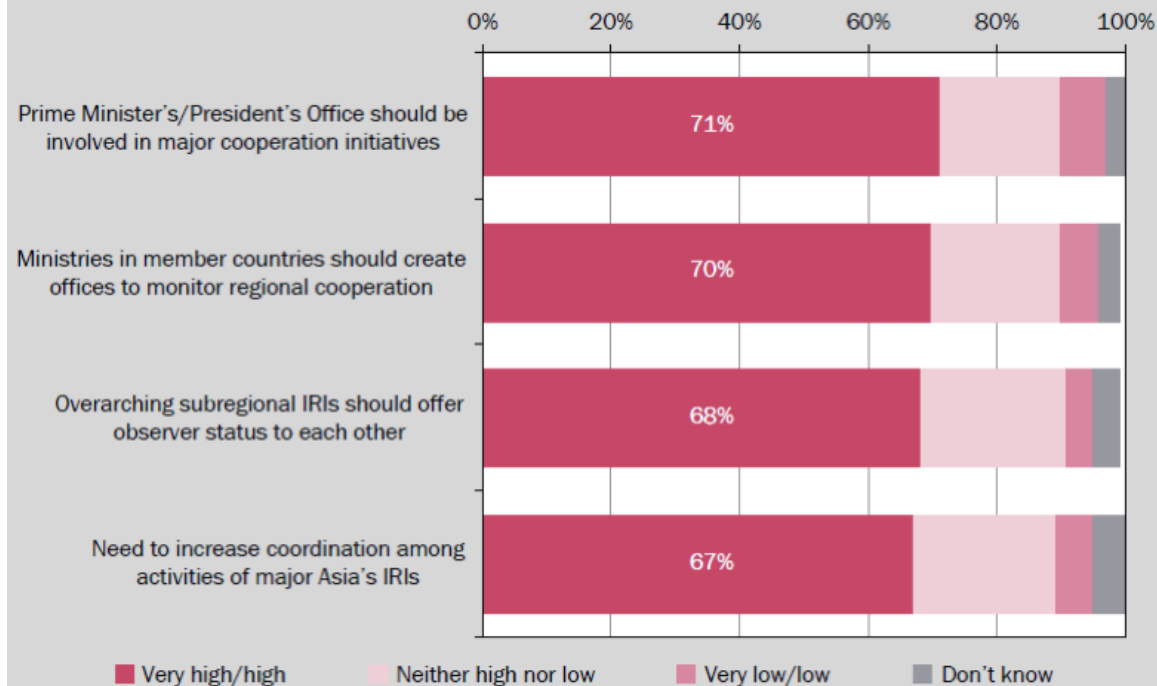
Figure 6.4. Priorities for Institutional Reform in ASEAN+3 and the EAS



ASEAN+3 = Association of Southeast Asian Nations + People's Republic of China, Japan, and Republic of Korea; EAS = East Asia Summit.  
 Note: Values are based on total responses (1,000) to ADB's 2010 perception survey of opinion leaders in Asia and the Pacific. The question was: Assess the most urgent initiatives that are required to strengthen the capability of selected institutions in Asia and the Pacific.  
 Source: ADB (2010).

# Stronger Inter-Institutional Linkages?

Figure 6.3. Suggestions for Strengthening Institutional Linkages



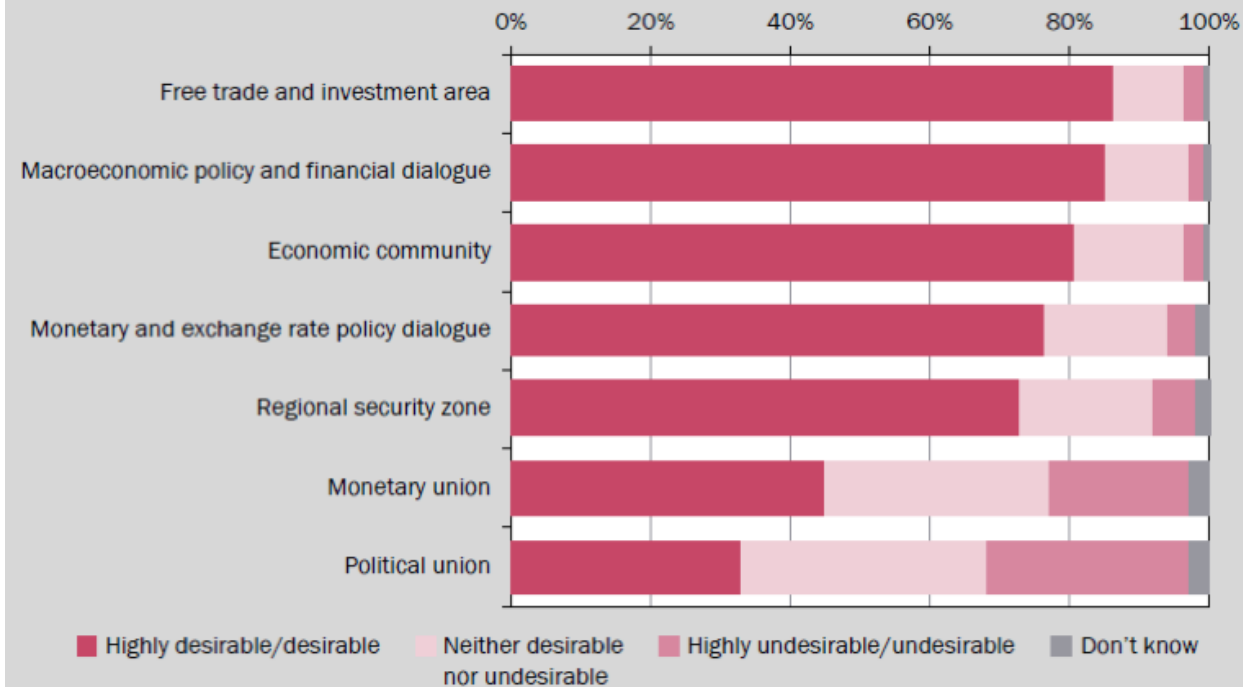
IRI = institution for regional integration.

Note: Values are based on total responses (1,000) to ADB's 2010 perception survey of opinion leaders in Asia and the Pacific. The question was: Rate the importance of the following initiatives which will eventually establish or create institutional linkages to support regional cooperation.

Source: ADB (2010).

# How Much Regional Integration is Desirable?

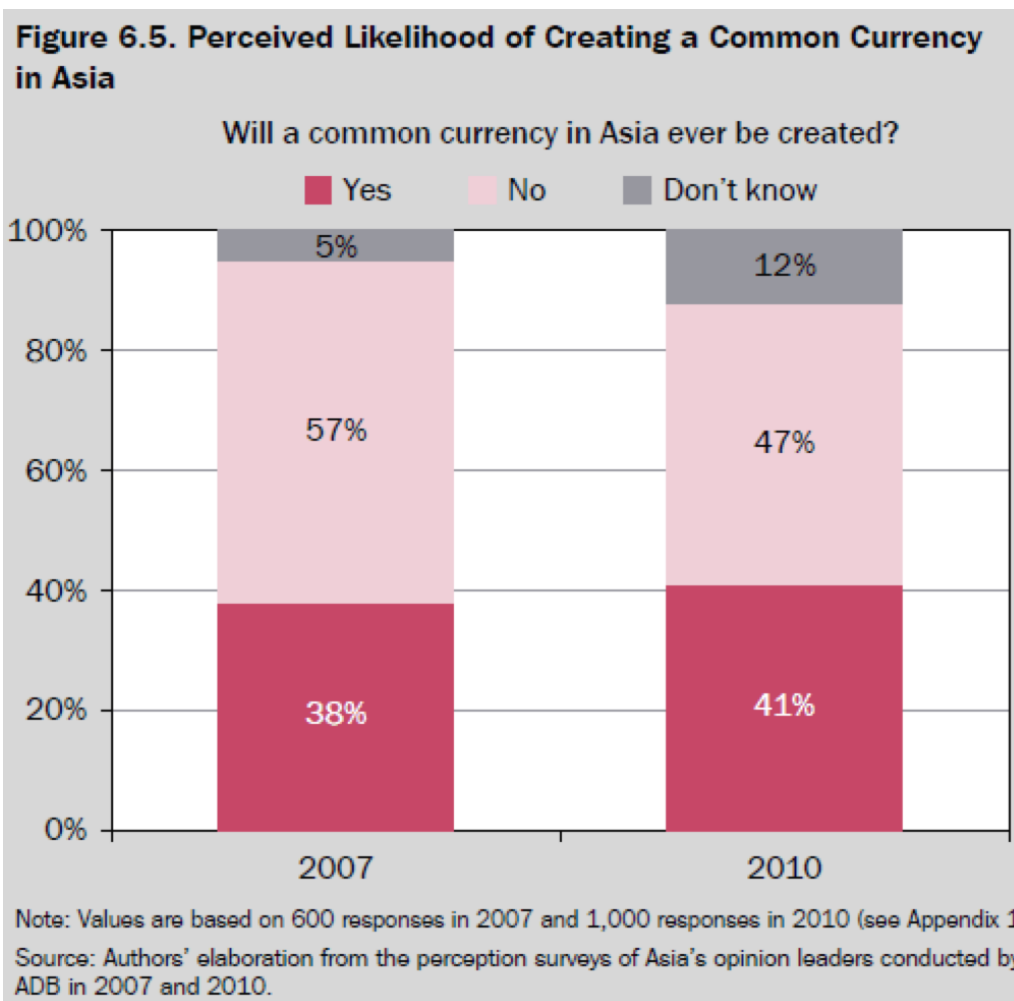
Figure A1.4. Desirability of Regional Integration Objectives



Note: Values are based on total response (1,000). The question was: *Thinking of your long-term vision for regionalism, rate the desirability of various integration objectives among countries in Asia and the Pacific.*

Source: ADB (2010).

# A Common Currency for Asia?



# Who are These Opinion Leaders?

Table A1.1. Breakdown of Perception Survey Responses

Subregion	Country	Category				Total
		Academia	Business	Government	Media/NGO	
Central Asia	Kazakhstan	2	4	4	2	12
	Kyrgyz Republic	1	2	2	1	6
	Uzbekistan	1	2	2	1	6
	<b>Total</b>	<b>4</b>	<b>8</b>	<b>8</b>	<b>4</b>	<b>24</b>
South Asia	India	16	36	36	16	104
	Pakistan	4	12	14	8	38
	Sri Lanka	3	10	10	3	26
	<b>Total</b>	<b>23</b>	<b>58</b>	<b>60</b>	<b>27</b>	<b>168</b>
Northeast Asia	PRC	36	70	43	8	157
	Japan	20	79	48	6	153
	Republic of Korea	11	43	12	2	68
	<b>Total</b>	<b>67</b>	<b>192</b>	<b>103</b>	<b>16</b>	<b>378</b>
Southeast Asia	Indonesia	7	42	23	10	82
	Malaysia	15	10	12	5	42
	Philippines	14	52	52	6	124
	Singapore	23	6	11	1	41
	Thailand	9	20	34	4	67
	Viet Nam	5	2	26	3	36
	<b>Total</b>	<b>73</b>	<b>132</b>	<b>158</b>	<b>29</b>	<b>392</b>
Pacific and Oceania	Australia	6	6	6	4	22
	Fiji Islands	1	2	2	1	6
	PNG	1	2	2	1	6
	Vanuatu	1	1	1	1	4
	<b>Total</b>	<b>9</b>	<b>11</b>	<b>11</b>	<b>7</b>	<b>38</b>
<b>Grand Total</b>		<b>176</b>	<b>401</b>	<b>340</b>	<b>83</b>	<b>1,000</b>

NGO = nongovernment organization; PNG = Papua New Guinea; PRC = People's Republic of China.

Source: ADB (2010).



# What Do Asian Political Leaders Say?

- Former Japanese Prime Minister Yukiko Hayatoma – An East Asian Community
- Chinese President Hu Jinto – A Harmonious Asia
- Korea's President Lee Myung-bak – New Asia Initiative
- Indian Prime Minister – An Asian Economic Community
- Former Australian Prime Minister Kevi Rudd – An Asia-Pacific Community
- Growing Commitment? Do they mean what they say?

# Will They Take the Next Steps?

- “We have created institutions for regional cooperation, but we have not empowered them adequately to enable them to be more proactive. The challenge before us is to translate institutions into activities, conventions into programs, official statements into popular sentiments” - Indian Prime Minister Manmohan Singh in his address to one of the SAARC Summits
- What he said about SAARC perhaps true for many other institutions for regional integration in Asia

# Conclusions

- Institution building for Asian integration to pragmatic and flexible to suit Asia's economic, social, and political realities
- Openness and transparency to be the core principles
- Three specific recommendations:
  - Strengthening existing overarching institutions
  - Strengthen/develop compelling functional institutions
  - Develop new Pan-Asian institutions
- Political leaders generally been supportive in their integration visions? Will they walk the talk?
- Who could take the lead? Shared leadership to reflect the political ground realities of Asia?

# Sources

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- Simon Cox, Institutional Design of Regional Integration: Balancing Delegation and Representation, Background Paper for ADB, December 2009
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- Kevin H. O'Rourke, Why the EU Won?, Background Paper for ADB, December 2009

# **Global Economic Governance: The Evolution of Institutions and Forums Lecture 12**

**Seoul National University**

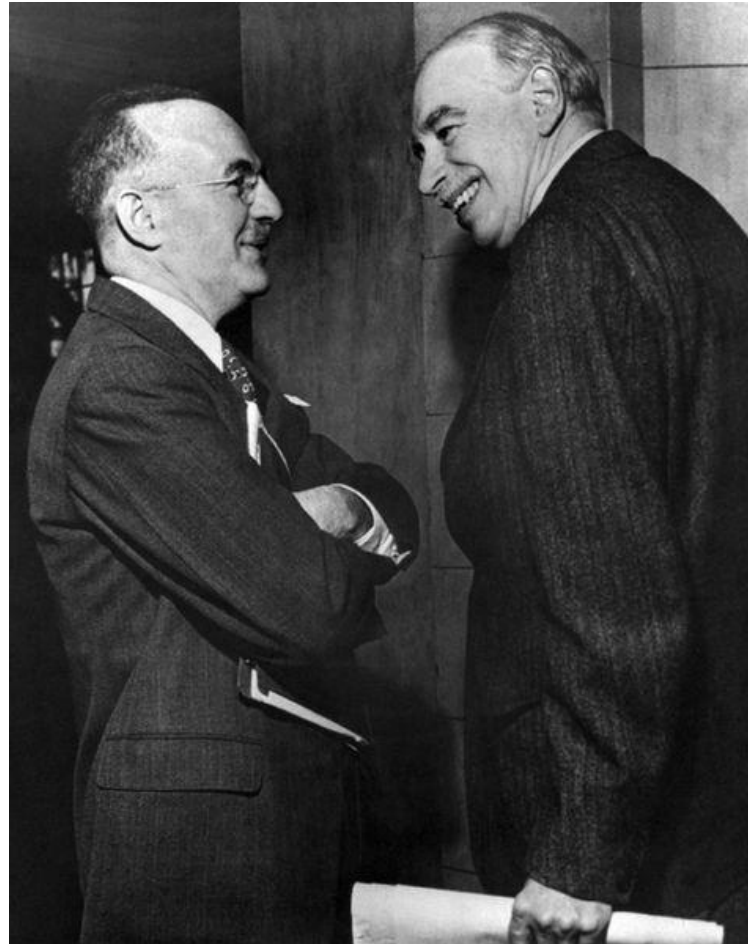
Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor

# Architects of Postwar Global Economic Governance?



# What is Global Economic Governance?

- Refers to norms, guidelines, standards, and practices, and the associated decision-making processes at the global level
- These norms etc are generally set by intergovernmental (international) institutions and forums
- Representation, decision-making processes, and voting rights of individual countries in these institutions and forums make a big difference to the quality and fairness of global governance
- While national governance aims at managing economic interdependence among citizens within a nation, global governance aims to manage economic interdependence across nations (and their citizens)
- Also very similar to the kinds of issues confronted in regional governance for managing economic interdependence across countries within a region (Lectures 7-11)

# Why Institutions for Global Economic Governance?

## **Economic**

- To manage spillovers of national economic policies across borders and the inherent conflict between global integration and independent sovereign states
- To maximize the gains from global integration – the more countries liberalize trade and investment, the larger the benefits accruing to the global economy as a whole
- To assist countries to cope with shocks created by markets in a globally integrated world

## **Historical**

- Rise of US with a highly articulated constitutional order and hence its inclination to establish formal institutions and forums rather than informal arrangements

## **Political**

- In the early 20th century, trend towards mercantilism (and protectionist) – hindering unilateral trade and investment liberalization



# Global Governance - Why a Postwar Preoccupation?

“What an extraordinary episode in the economic progress of man, that age was which came to an end in August 1914!”

“The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages; ...He could secure forthwith, if he wished it, cheap and comfortable means of transit to any country or climate without passport or other formality... he regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable”.

J M Keynes (1919), *The Economic Consequences of the Peace*, reprinted as *The Collected Writings of John Maynard Keynes*, Vol 2, London: Macmillan, 1971, pp.6-7.

# Global Governance Institutions/Forums Today

- World Trade Organization (WTO)
- International Monetary Fund (IMF)
- World Bank (WB) and its Affiliates Group – IFC, MIGA, ICSID
- BIS, the Basel Committee, and the Financial Stability Board (FSB)
- United Nations (UN) and its Institutions/Affiliates – UNCTAD, UNDP, UNEP, ILO
- The Group of Twenty (G20)

# World Trade Organization (WTO)

## Overview

- Established in 1995 after the Uruguay Round of Trade Negotiations (1986-94); 153 member countries; grew out of the 1947 General Agreement on Tariffs and Trade – GATT
- Based in Geneva, Switzerland; Secretariat Staff of over 600 with an annual budget of 194 million Swiss Francs

## Key Objectives/Functions

- Forum for multilateral trade negotiations
- Administer multilateral trade agreements
- Monitor national trade policies to ensure compatibility with multilateral trade agreements
- Settle trade disputes
- Provide technical assistance and training on trade-related issues to member countries

# International Monetary Fund (IMF)

## Overview

- A Bretton Woods institution established in December 1945; now has 187 member countries; based in Washington DC, US
- About 1,850 professional and managerial staff and another 560 other categories; annual budget of about \$1 billion

## Key Objectives/Functions

- Oversee the global monetary and financial system
- Conduct global economic and financial surveillance (crisis prevention)
- Help member countries in crisis management (especially to stabilize exchange rates and balance of payments) by providing loans and policy advice
- Conduct research on economic (mainly macroeconomic and financial) issues

# World Bank

## Overview

- The WB – grew out of IBRD – a Bretton Woods institution established in 1944 and also includes IDA established in 1960
- Based in Washington DC, US; More than 10,000 staff

## Key Objectives/Functions

*(in association with the other members of the World Bank Group)*

- Poverty reduction in poor countries and sustainable growth in middle income countries
- Provide finance (mainly loans for development projects and structural adjustment) to its member countries
- Conduct research and provide policy advice on development
- Address regional and global issues that cross national borders – climate change, infectious diseases, and trade

# World Bank Affiliates

## **International Finance Corporation (IFC) – est. in 1956**

- To promote sustainable private sector investment in developing countries – finances private sector projects, helps private companies to raise funds in the international financial markets, and provides advice to businesses and governments

## **Multilateral Investment Guarantee Agency (MIGA) – est. in 1988**

- To promote FDI to developing countries – insures investors against political risk, advises governments on attracting FDI, and mediates disputes between investors and governments

## **International Center for the Settlement of Investment Disputes (ICSID) – est. in 1966**

- To promote foreign investment in developing countries – facilitates conciliation and arbitration of investment disputes between member country governments and private investors

# Bank of International Settlements and the Basel Committee

## **Bank of International Settlements (BIS)**

- World's oldest international financial organization, established in May 1930; based in Basel, Switzerland
- 56 central banks are its members; about 600 staff
- A forum for discussion and policy analysis among member central banks and a center for monetary and financial research
- A prime counterparty for central banks in their financial transactions

## **Basel Committee on Banking Supervision**

- 36 member countries, has a Secretariat in BIS (but is a separate from), staffed mainly professional supervisors on secondment from members
- Develops international standards on banking , especially on capital adequacy and banking supervision

# Financial Stability Board (FSB)

## Overview

- Established in 2009 by the G20 Leaders; Secretariat located in Basel, Switzerland and hosted by the BIS
- Replaces and expands on the Financial Stability Forum (FSF) that was created in the aftermath of the 1997-98 Asian financial crisis
- Has a much expanded membership than the FSF – the G20, plus Hong Kong, Singapore, Netherlands, Spain, Switzerland, ECB, IMF, World Bank, OECD, IOSCO, IAIS, IASB, CGFS etc.

## Key Objectives/Functions

- Promote global financial stability through effective regulatory, supervisory, and other financial sector policies
- International coordination of the work of national financial authorities and international standard setting bodies



# United Nations Institutions

## **UN Conference on Trade and Development (UNCTAD)** – est. in 1964

- Focus on trade, investment and development – from developing country perspective; based in Geneva, Switzerland

## **UN Development Program (UNDP)** – est. in 1965

- Focus on development, especially its social and human dimensions; based in New York, US

## **UN Environment Program (UNEP)** – est. in 1972

- Focus on environmental management – developing international environmental conventions and working with governments and regional institutions; based in Nairobi, Kenya

## **International Labor Organization (ILO)** – est. in 1946

- Focus on developing and overseeing international labor standards; based in Geneva, Switzerland

# Group of Twenty (G-20) Forum

## Overview

- The Group of Twenty (G20) Finance Ministers and Central Bank Governors established in 1999, in the wake of the Asian financial crisis
- In the aftermath of the 2008 global financial crisis, the Group was upgraded to the Summit (Leaders) level since 2008
- Accounts for 90% of world GDP, 80% of world trade, and 2/3 of world population

## Key Objectives/Functions

- Initial focus was to bring together major advanced and emerging economies (non-G7 countries) to stabilize the global financial markets
- Premier international forum for constructive dialogue on:
  - Fostering international cooperation
  - Strengthening financial regulation and supervision
  - Reforming IMF and multilateral development banks
  - Maintaining open markets

# Anatomy of Institutions for Global Economic Governance

INSTITUTION \ AREAS		Trade and Investment	Monetary and Macroeconom	Financial Markets and Institutions	Development	Labour	Environment
G-20	WTO	●			●		●
	IMF		●	●			
	WB Group	●		●	●		●
	BIS		●	●			
	Basel Committee			●			
	FSB			●			
UN	UNCTAD	●			●		
	UNDP				●		
	UNEP						●
	ILO					●	

●	Primary Focus
●	Secondary Focus

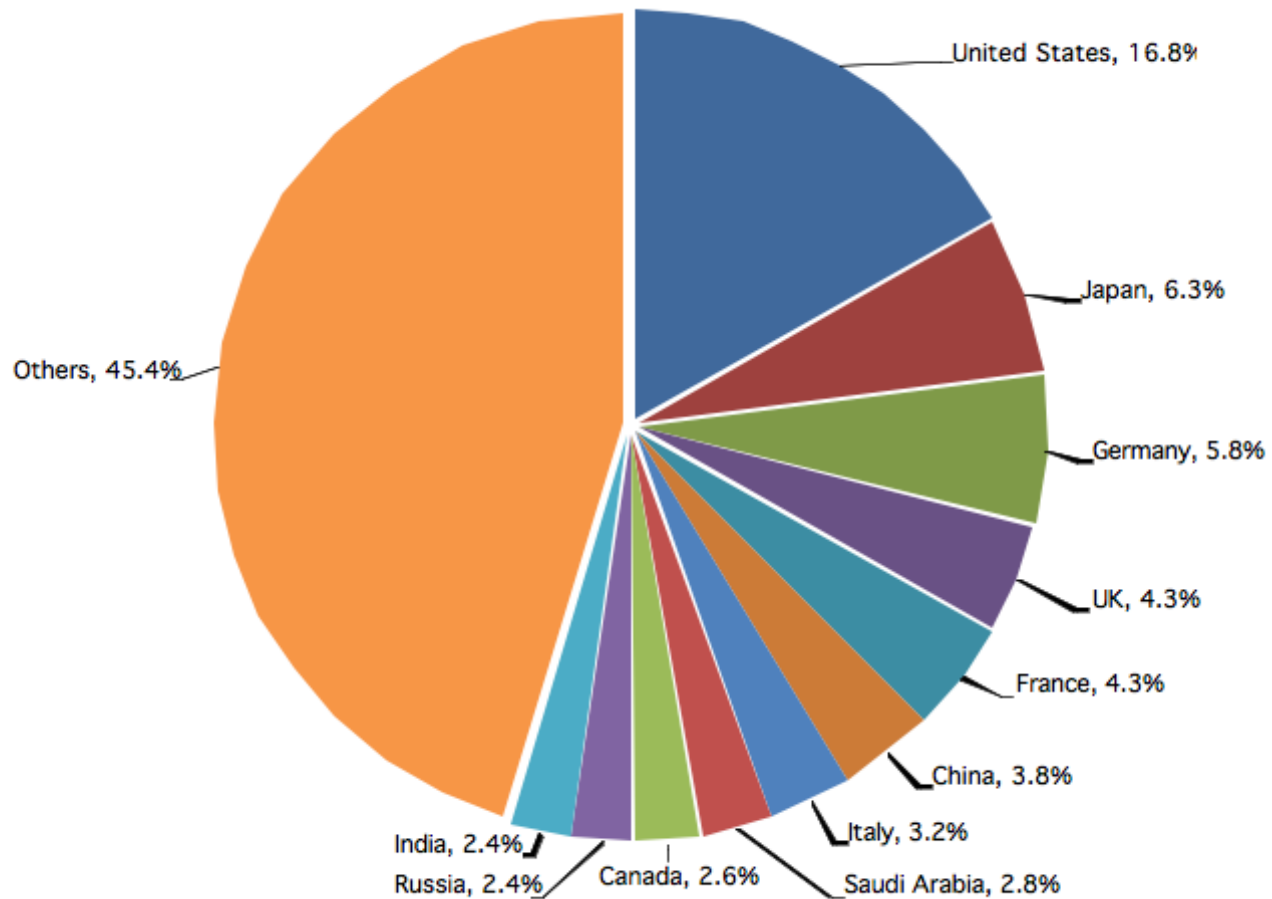
# How Has The WTO (and GATT before it) Fared?

- The combination of reciprocity and non-discrimination has helped create a liberal global trading system
- But is facing fresh problems in further opening up expanding market access – witness the stalled Doha Development Round
- Should the consensus-based decision-making (with the economically stronger members having greatest influence) change? Popular democracy of one state / one vote?
- The idea of single undertaking by all members give way to opt-out clauses?
- The dispute settlement system to become less intrusive in interpreting WTO commitments?
- Focus on trade liberalization and opening markets rather than on harmonization of regulatory standards etc? Dealing with growing FTAs?

# What About IMF's Record?

- Did a reasonably good job of maintaining relatively stable monetary and financial conditions during the Bretton-Woods regime (1945-1971); record less impressive since then
- The handling of the 1997-98 AFC further dented its credibility – problems of crisis management
- The 2008 GFC – problems of crisis prevention – has increased demands for bigger institutional overhauling
- Should IMF's quotas and voting rights be changed to reflect the changing global economic landscape? (slide 17)
- How about greater insulation of IMF decision-making from member countries interference? How to do it?
- Should the adjustment to global payments imbalances be made more symmetric between debtors and creditors? How to do it?

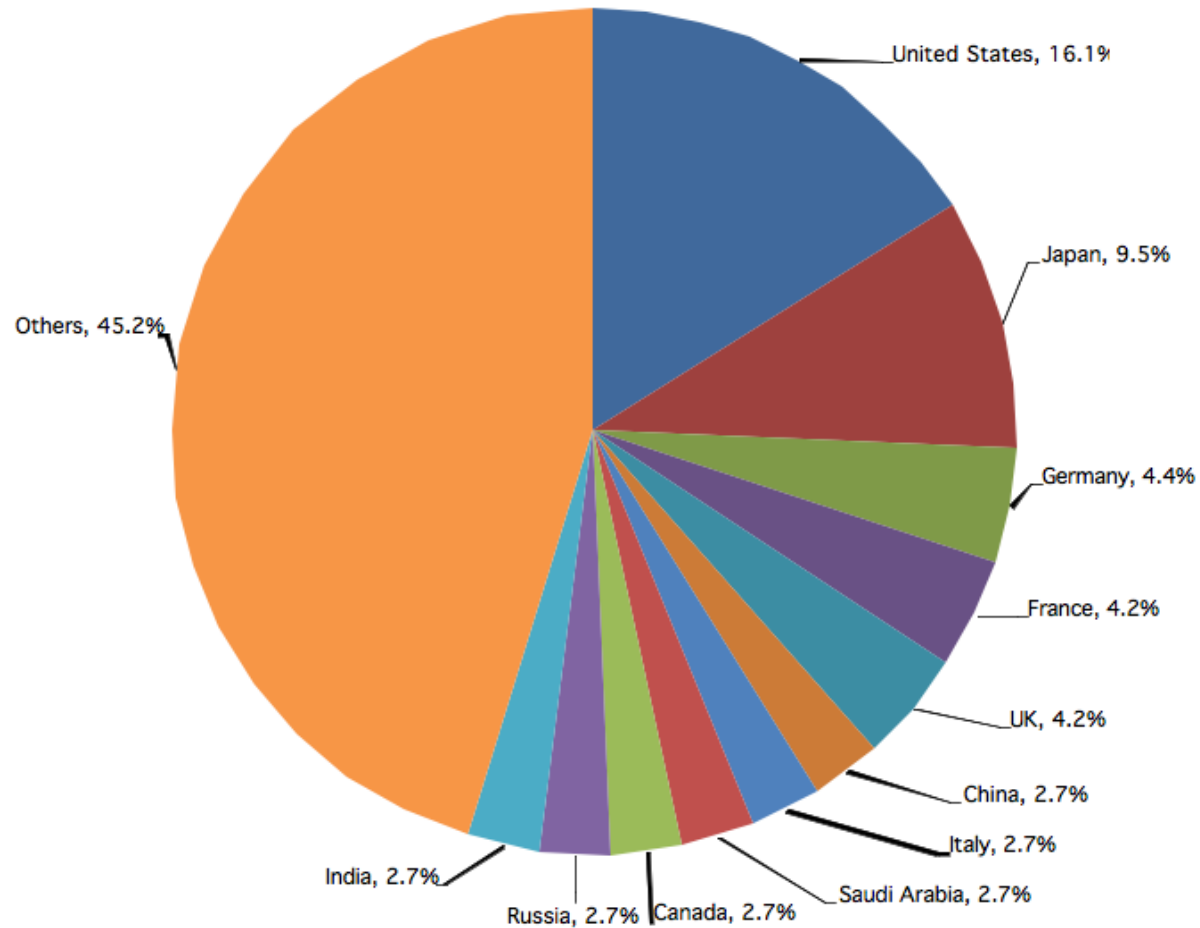
# IMF Voting Rights



# The WB, Its Affiliates, and Global Economic Governance

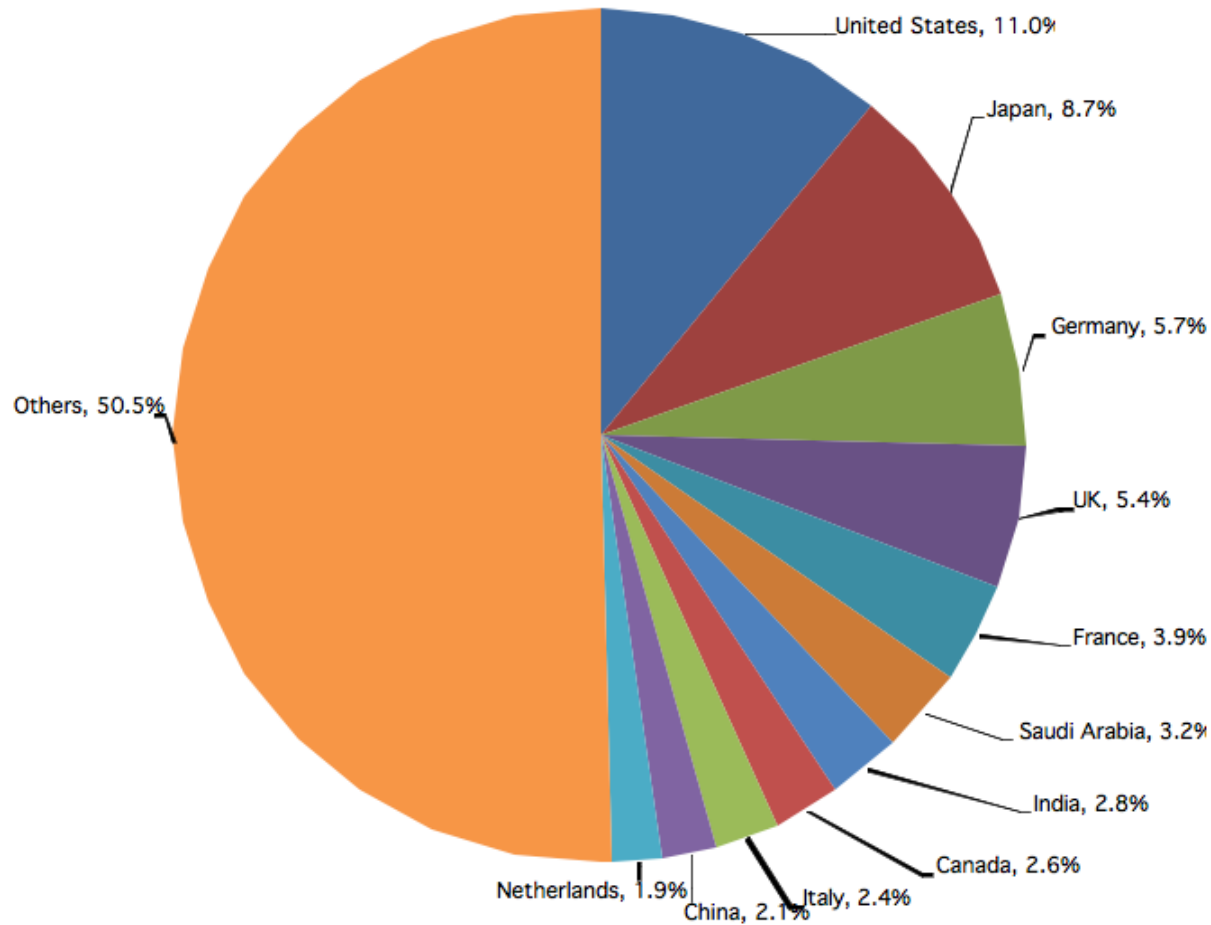
- Did a reasonably good job of financing development projects in its initial years of operations
- Over time, moved away from pure project financing to fund structural adjustment programs, often jointly with the IMF
- More recently, become a broad-based institution, producing a considerable volume of knowledge products on development policy issues
- Need for developing countries to have greater say in development projects, programs, and policies? Change in voting rights? (see slides 19-21)
- Should it narrow and sharpen its focus back to development project financing?
- Should it keep away from environmental issues?

# IBRD Voting Rights

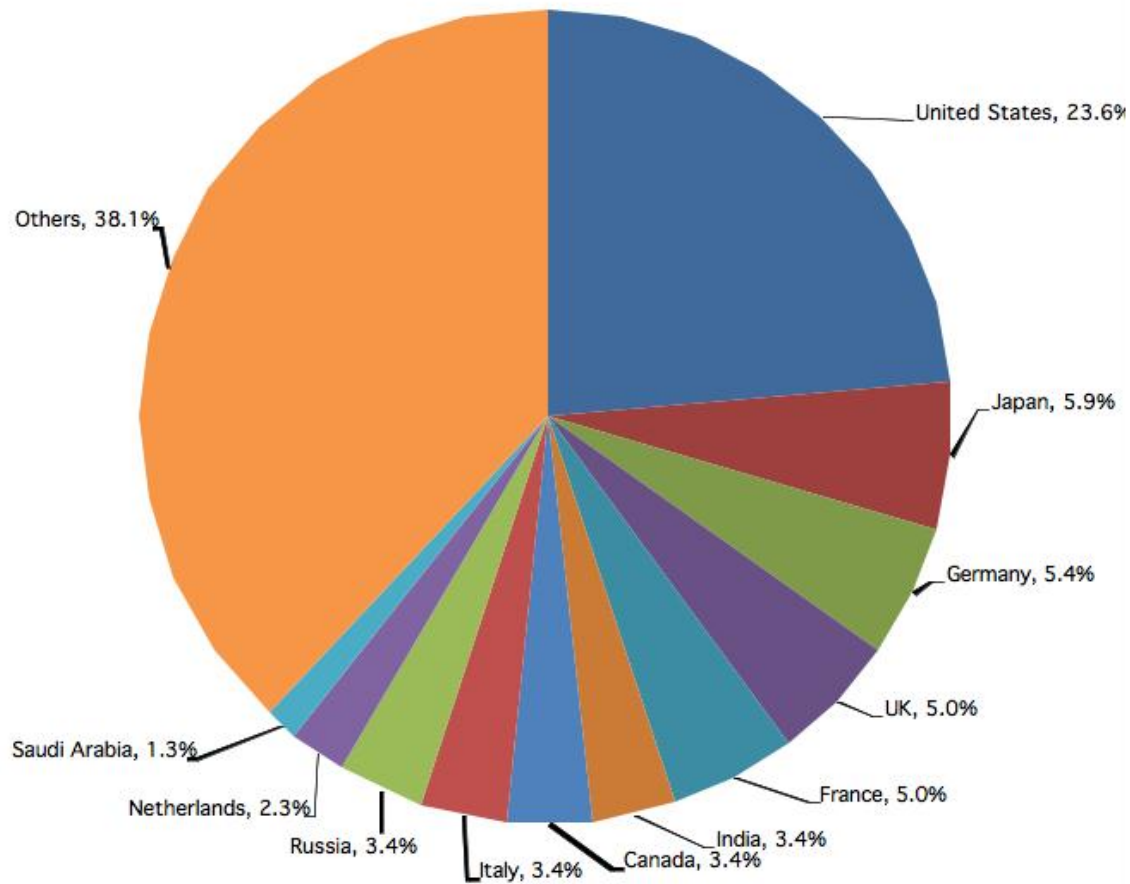




# IDA Voting Rights



# IFC Voting Rights



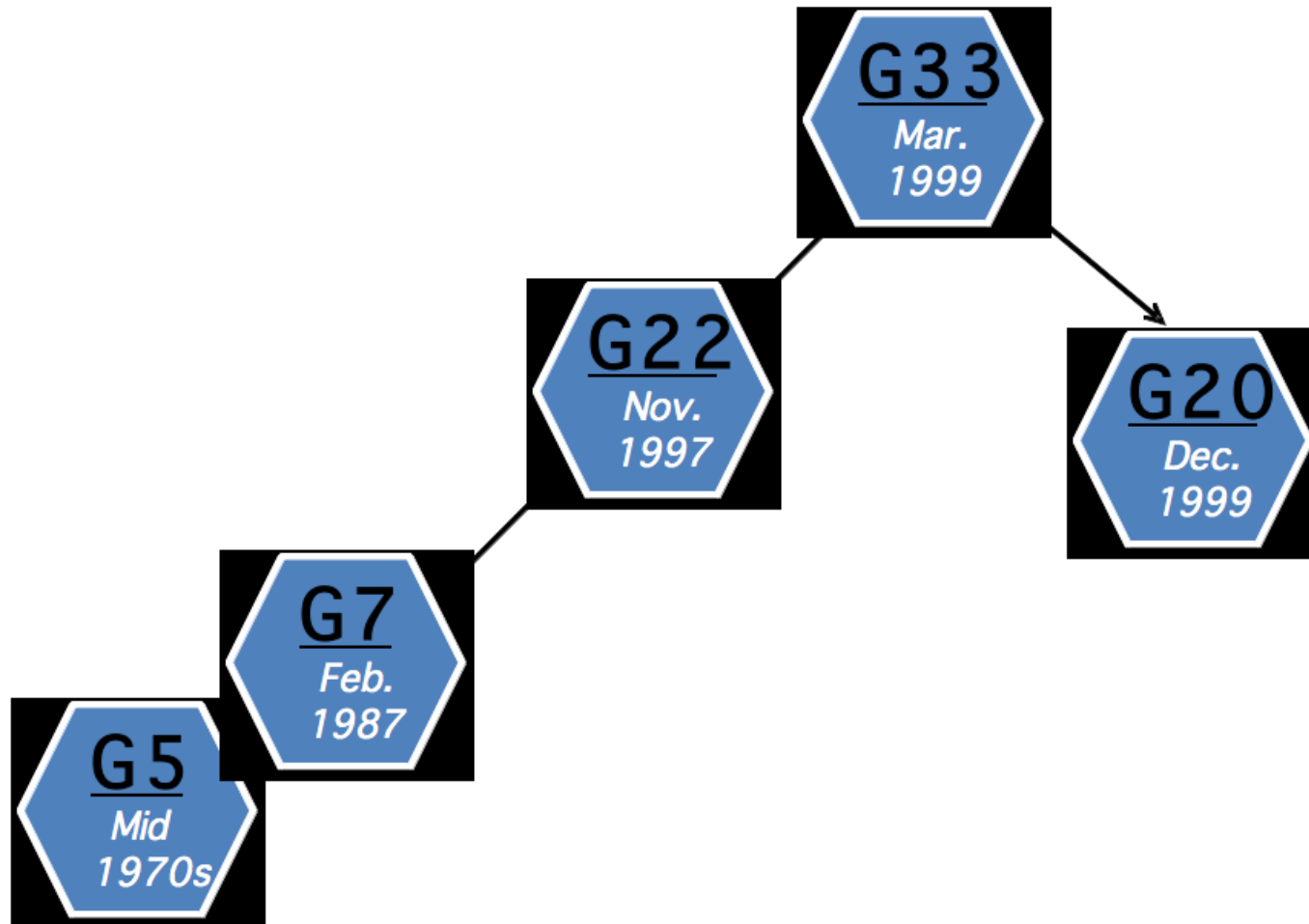
# Will FSB Live Up to its Potential?

- Converting FSF to FSB and expanding membership – a laudable move
- Will FSB be the fourth pillar of global governance? Even with the recent expansion, its membership is much less than the WTO, IMF, and WB
- Does it have enough authority and autonomy?
- Enough resources to be effective? Tiny staffing?
- Should it be converted into a WFO - WTO equivalent for governing global finance?
- Or should global financial surveillance be a joint responsibility of IMF and FSB, or even IMF, WB and FSB? (FSAPs and ROSCs)
- A clearer mandate between FSB and the international standard setting bodies needed?

# Is G20 Built to Last?

- Upgrading of the G20 to Leader's level – welcome initiative
- Heralds a new era in global economic governance?
- Strike a balance between legitimacy (as against G7) and efficiency (as against the UN)?
- But what about G20's legitimacy? G20 not based on any international treaty or agreement, and hence what about excluded countries? Multilateralism light?
- The road to G20 has been somewhat arbitrary? G7 becomes G22 in November 1997; becomes G33 in early 1999; and then G20 later in 1999 (slide 24)
- Then there is the G24 that makes the International Monetary and Finance Committee (IMFC) of the IMF
- Producing concrete results would be crucial for G20's survival

# The Road to G-20



# Conclusions

- Post war years – a watershed in institution building for global governance – WTO and the Bretton-Woods institutions created
- These institutions have done a reasonably good job of achieving their initial objectives and have also evolved over time with the changing global economic environment
- The 1997-98 Asian financial crisis and the 2008 global financial crisis have required big changes in the mandate, operational modalities, and even the voting rights in these institutions
- More recently, the FSB has been added as the fourth pillar of the institutional architecture for global governance
- The G20 is emerging as the premier intergovernmental forum to oversee global economic governance and reform the institutional architecture
- G20 has the potential to strike a balance between representation and efficiency in global economic governance

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- Sabrina Verma, Improving Global Economic Governance: Trade-Related Agenda, Development and Equity, Occasional Paper, South Center, Geneva, August, 2002
- Websites of Institutions and Forums referred to in the slides

# **Asia's Role in Global Economic Governance for the 21 Century Lecture 13**

**Seoul National University**

Graduate School of International Studies

Spring Semester 2011

**Srinivasa Madhur**

Visiting Professor



# Emerging Issues in Global Economic Governance

- Getting the multilateral trade negotiations back on track to ensure continued trade liberalization
- Ensuring an orderly adjustment of the global payments imbalance while at the same time maintaining robust global economic growth
- Managing financial globalization and capital account liberalization
- Reforming the regulatory and supervisory frameworks for financial markets, based on the lessons from the GFC
- Developing an effective framework for global environmental governance (not pursued further in this lecture)
- Striking a balance between legitimacy and efficiency of institutions and forums responsible for global economic governance

# Getting the WTO and the Trade Negotiations Back on Track

- How to pick up the pieces from the stalled Doha Development Round (DDR)? It ain't over till it's over (Yogi Berra, 1998)
- Rethink the Special and Differential Treatment (SDT) for developing countries – longer time horizon rather than indefinite postponement
- More substantial liberalization of agricultural trade by developed countries
- Reform WTO's "ultra-legalistic" dispute settlement system
- Dump WTO's articles on Anti-Dumping Measures (ADMs)
- Refocus and limit the scope of WTO on governance of a rule-based global system of trade in goods and services
- WTO should not be a WBO (world bargaining organization on anything and everything)

# Ensuring an Orderly Adjustment of the Global Payments Imbalance

- Large US current account deficits and the corresponding current account surpluses by developing countries, especially China, neither sustainable for long nor good for the global economy
- This imbalance also precipitated the 2008 GFC – by keeping global interest rates low for long
- The current IMF-driven adjustment relies too much on debtor country adjustment – a key problem with the Bretton Woods
- Inherent danger of global deflation and recession when the debtor country happens to be the largest economy in the world
- How can the adjustment be made more symmetric between the deficit as well as surplus countries?
- Need for international cooperation – inherent problem of aligning international trade and finance?

# Managing Financial Globalization and Capital Account Liberalization

- Unlike global trade liberalization, less consensus on the benefits of capital account liberalization and financial globalization
- Often, free capital flows could be destabilizing for developing countries
- Pro-cyclicality of capital flows to developing countries – when it rains, it pours, but then the pouring could stop suddenly causing a drought
- Managing huge volatility of capital flows – a key challenge for developing countries with underdeveloped financial markets
- Limitations on self-insurance mechanisms by building large forex reserves problematic
- Need for international cooperation- for developing a consensus on the desired pace and degree of capital account liberalization and mechanisms to assist countries to manage capital flows

# Reforming the Financial Regulatory and Supervisory Framework

## Five lessons from the 2008 GFC:

- Complexity is not innovation; leverage is not credit; risk dispersion is not risk reduction; Self-regulation (light touch regulation) is no regulation; In good times, prepare for the bad (countercyclical regulation); microprudential regulation alone is not enough

## Reform Challenges

- Arriving at a broad global consensus on the extent and forms of regulation; balancing regulation and market freedom; guarding against the temptation of overregulation that could take finance to the 3:6:3 mode
- Developing countries on a different phase of financial market development - need differential treatment on regulatory and supervisory norms?

# Striking the Legitimacy-Efficiency Balance for Global Institutions and Forums

- This is at the core of global economic governance
- WTO has wider membership and consensus-based decision-making (efficiency sacrificed)
- IMF and WB also have wide membership and the decision-making based on weighted voting rights (legitimacy sacrificed)
- Need for regular review and adjustment of quota and voting rights in IMF and WB crucial for sustaining their legitimacy
- The FSB is in its infancy and its effective management and functioning will determine whether it will evolve to be an effective fourth pillar of global governance
- The G20 emerging as the premier intergovernmental forum to set the agenda as well as guide the international institutions in effective global governance - need to be nurtured by both developed and developing countries - a win-win for both

# Emerging **Global Economic Governance Framework – A Snapshot**

## **Global Institutions**

- WTO – trade in goods and services
- WB – development policy
- IMF – monetary, macroeconomic, and financial surveillance
- FSB – financial regulation, supervision, and stability

## **Global Forums**

- G20 (Finance Ministers and Central bank Governors, upgraded to leaders levels in 2008) – as the forum for overseeing overall international policy cooperation
- IMFC, and the Development Policy Committee (both have 24 members) – for overall policy Advice to IMF and the WB, respectively

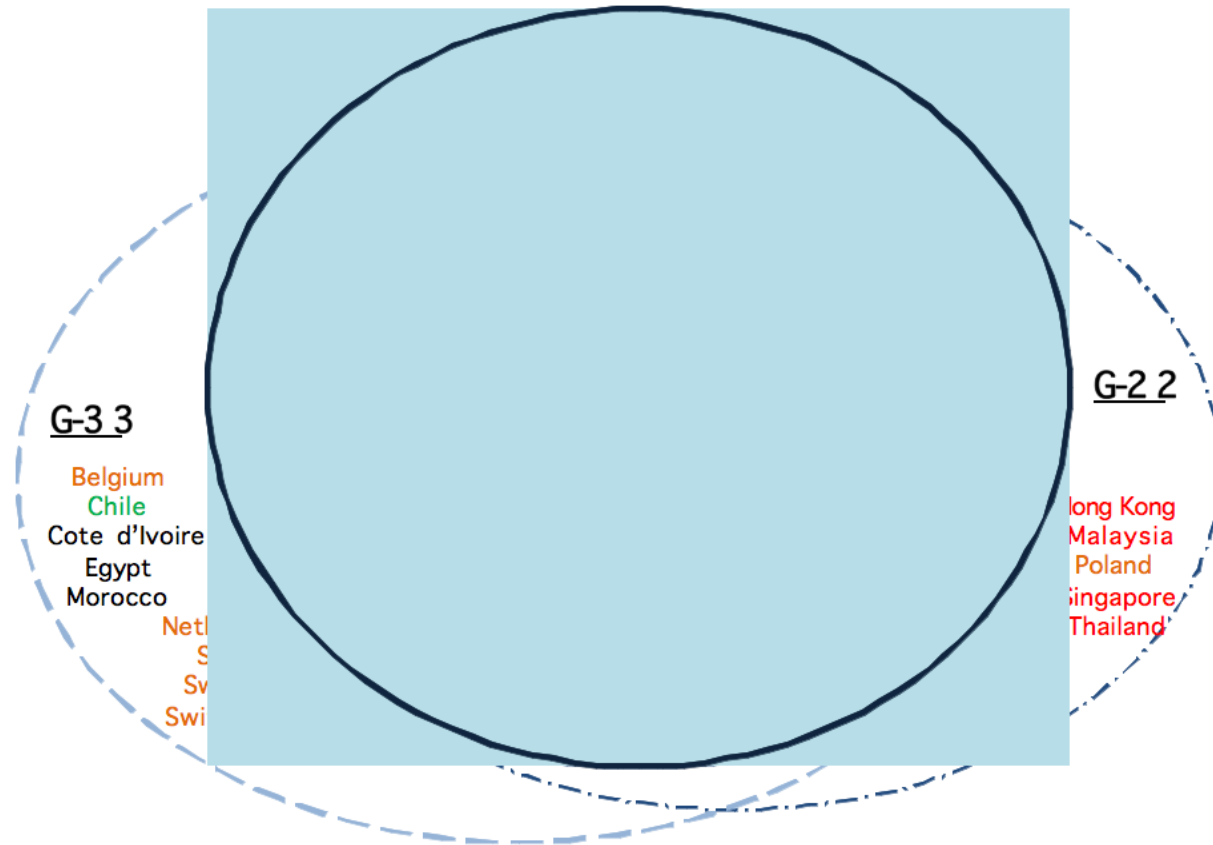
# Emerging Pillars of Global Economic Governance

G-20





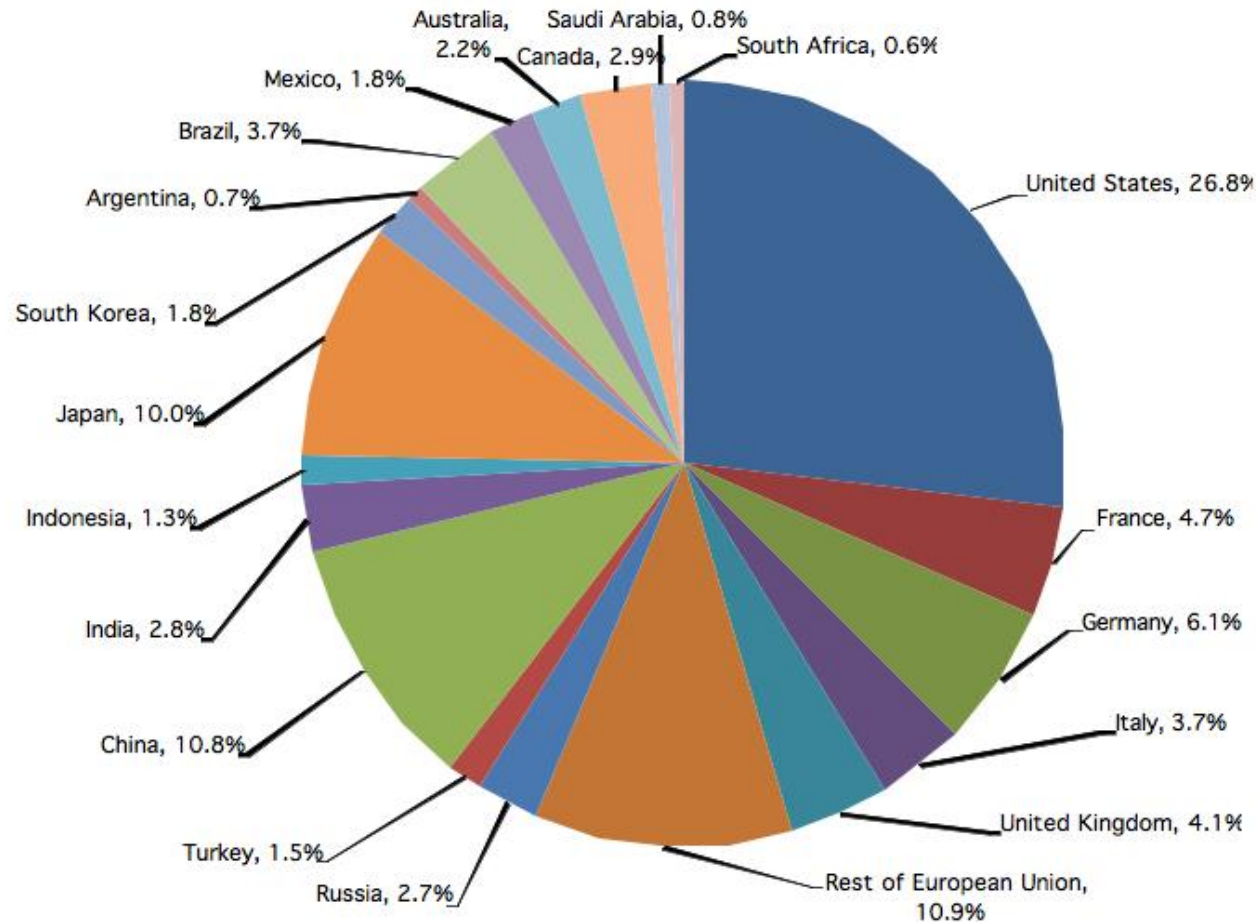
# Emergence of G-20 as the Premier Global Forum



# Asia, the Global Economy, the G20, and the Bretton Woods Institutions

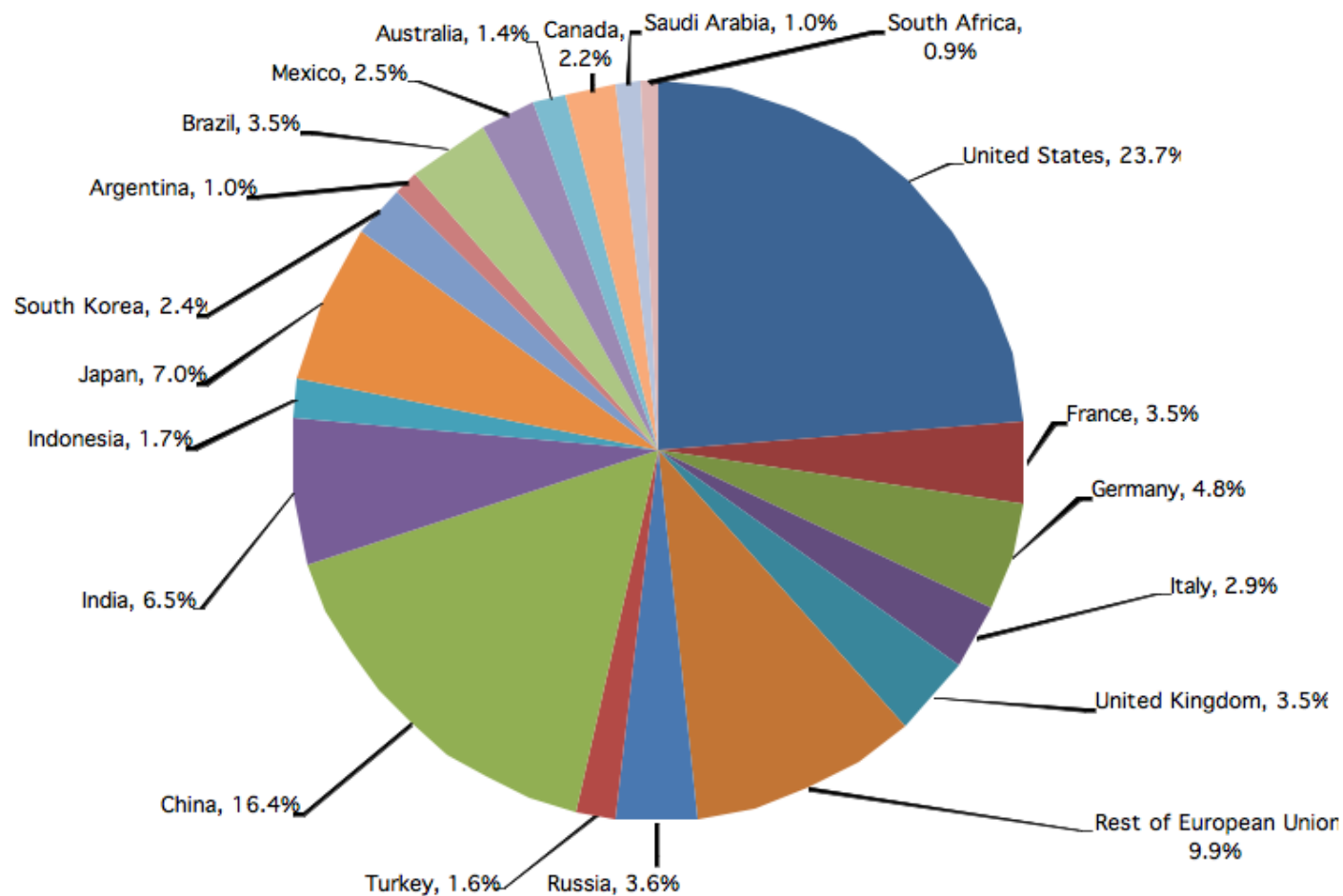
- Asia's share in the global economy increased significantly since 1950 (Lecture 1): a latest study (ADB 2011) says:
  - Asia's share in global GDP at market exchange rates to rise from 27 % in 2010 to 51% by 2050 (comparable to its share in early 19th century)
  - At market exchange rates, Asia's GDP could increase from \$16 trillion in 2010 to about 150 trillion by 2050 (China \$5.7 tril to \$63 tril); (India \$1.4 tril to \$40 tril); (Indonesia \$700 bil to \$11 tril); (Japan \$5.4 tril to \$8 tril); (Korea \$1 tril to \$4 tril)
- The above five Asian countries also have a significant presence in the G20 (accounting for 27% of G20's GDP at market exchange rate, 1/3 of GDP at PPP, and 2/3 of population, Slides 12-14), although their voting power ( a proxy for decision-making power) in IMF and World Bank however is less impressive (slide 15)
- Overall, Asia has the potential to play an increasing role in shaping global economic governance for the 21st century

# Asia and G-20 (GDP, CER)



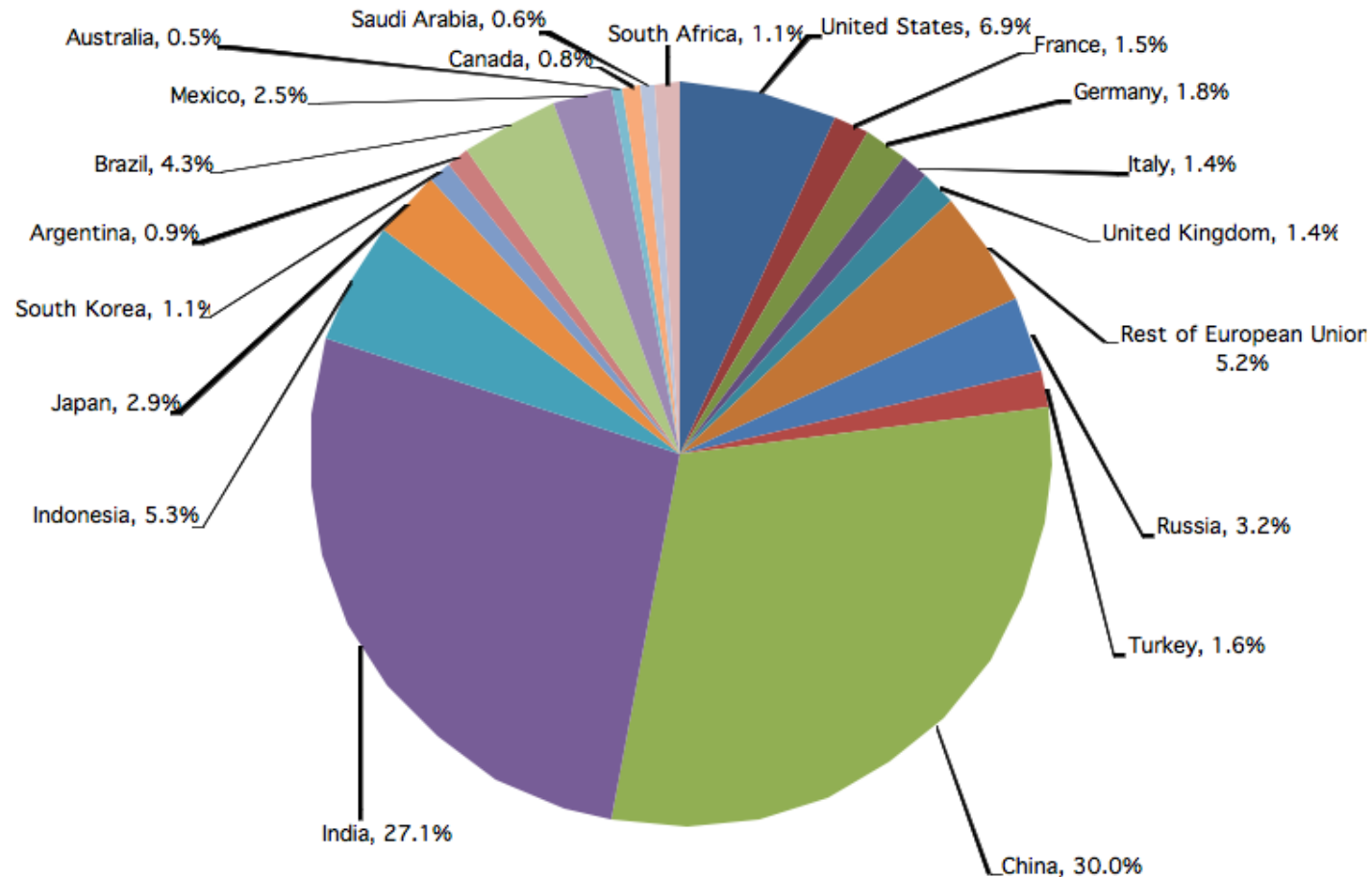
Source: IMF, 2010.

# Asia and G-20 (GDP, PPP)



Source: IMF, 2010.

# Asia and G-20 (Population)



Source: IMF, 2010.

# Voting Power in IMF and World Bank and Economic Weights of Top 30 Economies

Table 1: Ranking and Shares of IMF/World Bank Voting Powers and Economic Weights of Top 30 Economies in the World, 2009

	IMF Quota & VP		World Bank VP				GDP		Trade	FXRs	Population							
	Quota	VP	IBRD	IDA	Current	PPP												
US	1	17.09	1	16.77	1	16.36	1	12.16	1	24.61	1	20.42	1	10.68	23	0.62	3	4.56
PRC	6	3.72	6	3.66	6	2.78	13	1.88	3	8.47	2	12.56	2	8.85	1	29.44	1	19.82
Japan	2	6.12	2	6.02	2	7.85	2	9.53	2	8.75	3	5.96	4	4.54	2	12.23	10	1.89
India	13	1.91	13	1.89	7	2.78	7	3.13	11	2.13	4	5.05	17	1.64	7	3.17	2	17.81
Germany	3	5.98	3	5.88	3	4.48	3	6.30	4	5.79	5	4.02	3	8.29	34	0.45	15	1.22
UK	4	4.94	4	4.86	4	4.3	4	5.37	6	3.77	6	3.06	6	3.37	32	0.47	22	0.92
Russia	10	2.74	10	2.69	7	2.78	50	0.31	12	2.12	7	3.02	14	2.06	3	4.98	9	2.10
France	4	4.94	4	4.86	4	4.3	5	4.04	5	4.62	8	3.02	5	4.13	42	0.34	21	0.93
Brazil	18	1.40	18	1.38	13	2.07	14	1.60	8	2.72	9	2.88	24	1.15	9	2.85	5	2.84
Italy	7	3.25	7	3.19	7	2.78	9	2.57	7	3.66	10	2.49	8	3.27	36	0.42	24	0.89
Mexico	16	1.45	16	1.43	20	1.18	24	0.74	14	1.51	11	2.10	16	0.92	14	1.15	11	1.60
Korea	19	1.35	19	1.33	22	0.99	27	0.68	15	1.44	12	1.95	10	2.75	6	3.25	26	0.72
Spain	17	1.40	17	1.39	15	1.74	21	0.89	9	2.53	13	1.95	15	2.05	58	0.16	27	0.68
Canada	9	2.93	9	2.89	7	2.78	8	2.69	10	2.31	14	1.84	11	1.32	27	0.52	36	0.50
Indonesia	23	0.96	23	0.95	23	0.94	22	0.87	18	0.93	15	1.38	30	0.85	20	0.74	4	3.44
Turkey	36	0.55	36	0.55	36	0.53	28	0.63	17	1.06	16	1.26	29	0.97	19	0.85	18	1.05
Australia	15	1.49	15	1.47	17	1.52	15	1.23	13	1.72	17	1.22	20	1.28	37	0.40	49	0.32
Iran	29	0.69	29	0.69	18	1.48	141	0.08	29	0.57	18	1.19	36	0.54	171	0.00	17	1.10
Taipei,China	-	-	-	-	-	-	-	-	25	0.65	19	1.05	18	1.52	5	4.27	47	0.34
Poland	33	0.63	33	0.63	30	0.69	10	2.10	21	0.74	20	0.99	26	1.12	17	0.90	33	0.57
Netherlands	11	2.37	11	2.34	12	2.21	11	2.02	16	1.37	21	0.94	7	3.28	64	0.11	59	0.24
Saudi Arabia	8	3.21	8	3.16	7	2.78	6	3.30	26	0.64	22	0.85	19	1.34	4	4.87	45	0.38
Argentina	22	0.97	22	0.97	21	1.12	25	0.73	30	0.54	23	0.84	42	0.38	26	0.53	31	0.60
Thailand	39	0.50	39	0.50	45	0.41	38	0.39	33	0.46	24	0.77	23	1.15	12	1.64	19	0.99
South Africa	25	0.86	25	0.85	25	0.85	54	0.30	32	0.50	25	0.72	35	0.54	38	0.40	25	0.73
Egypt	43	0.43	43	0.44	41	0.45	33	0.49	43	0.32	26	0.67	55	0.27	40	0.38	16	1.14
Pakistan	41	0.48	41	0.48	33	0.59	20	0.92	46	0.29	27	0.62	61	0.19	62	0.12	7	2.43
Colombia	58	0.36	53	0.36	44	0.41	32	0.50	36	0.40	28	0.58	56	0.26	45	0.28	29	0.67
Belgium	12	2.12	12	2.09	14	1.8	17	1.13	20	0.81	29	0.55	9	1.49	67	0.10	72	0.16
Malaysia	30	0.68	30	0.68	37	0.52	37	0.40	42	0.33	30	0.55	25	0.88	15	1.14	44	0.41
EU		32.39		31.85		28.54		32.40		28.39		21.19		35.71		6.39		7.39
G20		79.14		77.87		75.85		72.18		87.84		83.24		75.00		74.00		65.76
East Asia		14.57		14.43		14.44		14.85		22.23		26.02		26.43		58.85		31.67

Note: VP= voting powers; GDP (current) = at current prices in the US dollar; GDP (PPP) = at PPP international dollar; FXRs = foreign exchange reserves. EU= European Union. UK= United Kingdom. US= United States.

Source: IMF, *World Economic Outlook*, April 2010 database; IMF, *International Financial Statistics*, CD-ROM; IMF and World Bank, website.

# If the global economy is a hand, Asia is its Thumb?

- Africa the little finger - failed to catch up with other continents - yet, when it gets hurt, the the whole hand s affected
- Latin America the ring finger - symbolizes love, passion, and the sensuous beats of the mambo, samba, and tango
- US the middle finger - longest of the fingers, really stands out and anchors every function that the hand performs and is key to all of the fingers working together efficiently and effectively
- Europe the index finger - the cradle of democracy and western civilization and the basis for most of the laws we use in conducting global business
- **Asia the thumb finger - strong, powerful, and ready to assert as a major player on the world's economic stage (slide 16)**



# Asia's Potential "Thumb Role" in Global Governance





# Realizing Asia's Potential "Thumb Role" in Global Governance

Asia is emerging as the center global economic gravity, but will It also emerge as as a center of global governance? Growing economic size is only a necessary, but not a sufficient condition for Asia's bigger role in global governance. Realizing the potential would require:

- Developing the willingness (preference) to play a bigger role
- Building regional forums and institutions to move global governance towards a multilateral, federal structure
- Reducing the region's external economic dependence (growth rebalancing, promoting organic growth)
- Providing leadership both at the regional and global levels

# Developing the Willingness

- Is Asia ready to assert itself in global economic governance? Or does Asia has a preference for free riding?
- Japan's experience: despite its rapid rise during the 1960s and 1970s, it did not play the role of a protagonist in global governance of the world trading system? Inability to commit credibly to domestic market opening up? Japan's commercial power does not match the size of its domestic market?
- China's experience: self-designation as a developing economy in transition - a constraint on a bigger role? Reluctant to embrace a bigger, and possibly costly, role in global governance?
- How about India, Indonesia, or Korea?
- Will stronger willingness emerge, as countries get bigger and richer?

# Building Regional Options and Developing an “Asian Voice”

- Key to negotiating a bigger role in global governance with incumbents (established economic powers)
- Some notable progress since 1997-98 AFC, yet many challenges remain
- Need for greater focus on regional integration in general and strengthening the institutional base for integration in particular (lectures 7-11)
- Priorities include, an Asian Free Trade Area (AFTA); a robust regional financing and surveillance mechanism (CMIM and AMRO culminating in AMF); an Asian Financial Stability Dialogue
- Greater role for these regional institutions in promoting a federal or multilayered global governance framework (national, regional, and global layers)

# Reducing External Dependence for Growth

- Despite successive economic miracles, Asia still depends heavily on export markets in US and Europe for growth
- Need to rebalance the sources of growth away from exports to domestic and regional demand
- Lessons from Japan's lost two decades - failure to change gear from external to domestic demand after the Plaza Accord
- Learning from Japan, China to bring about the transformation from being a mere producer-exporter to a consumer-importer
- Possibly, with the continued strong growth in the region, a much stronger middle class could emerge providing the much needed regional source of growth
- Closer regional integration could also help expand the market size

# Providing Leadership

- Asia's power distribution - a further impediment to achieve a coherent regional coalition
- Will the five Asian countries that are member of the G20, be able to coordinate and develop a collective voice on issues and press the resulting agenda in the G20?
- Will the traditional rivalry between Japan and China come in the way of Asia, or even East Asia, speaking with one voice in global forums?
- Will Indonesia - the only ASEAN country in the G20 be willing and able to represent the ASEAN's economic interests in the G20?
- Will India represent the South Asian economic interests in the G20?
- Should the Asian 5 in the G20 hold regional/subregional consultations before the G20 meetings, so that they could present a consolidated Asian view on relevant issues in the G20?
- Will a shared Asian leadership model emerge over time that could enable the region to play a bigger role in global governance?

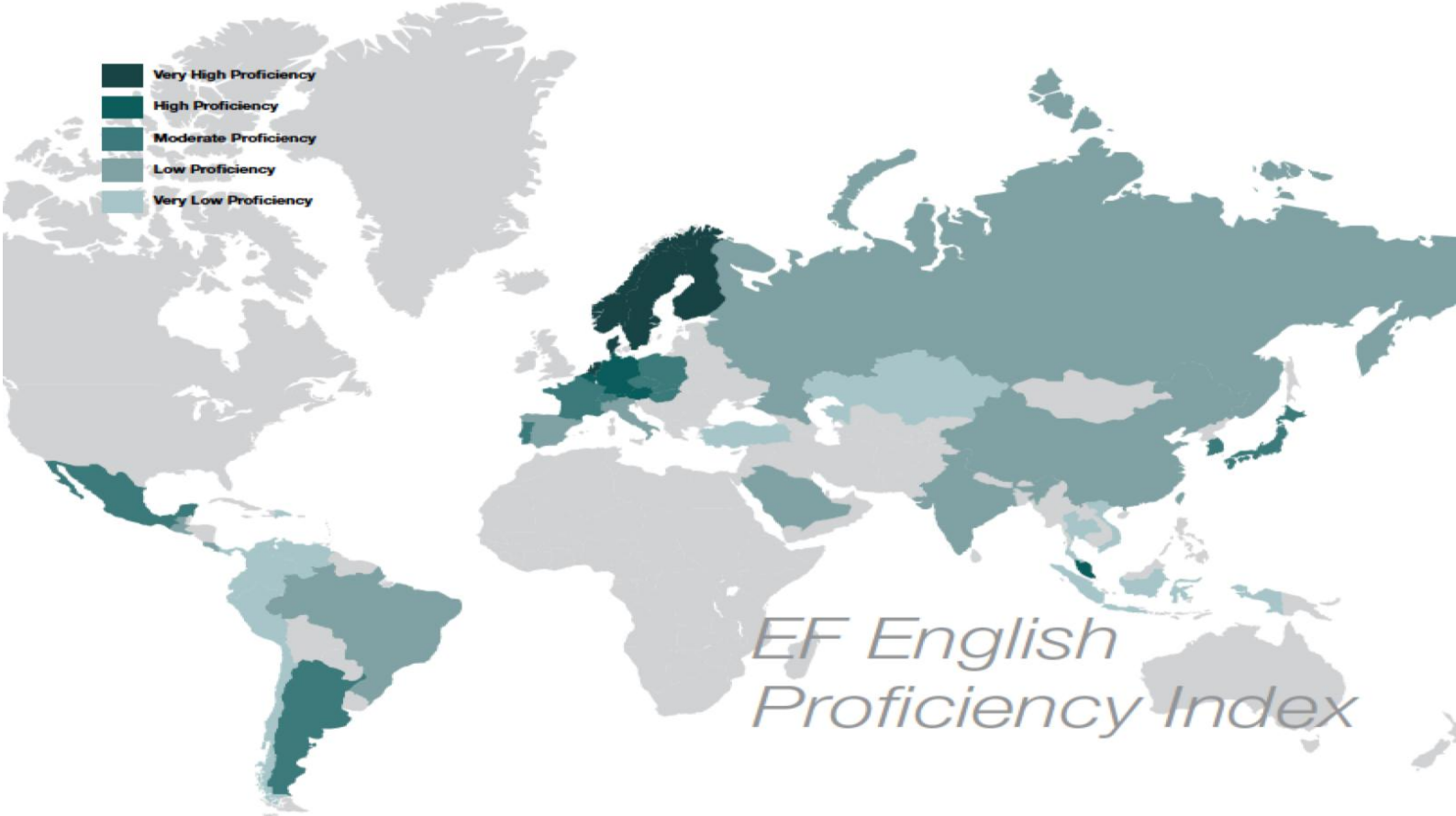
# What Role for Asia's Regional Forums and Institution in Global Governance?

- How can Asia's regional forums and institutions play meaningful role in global governance?
- Should forums such as the ASEAN, ASEAN+3, EAS, SAARC meet before the G20 meetings to provide their common positions on issues to the G20 through the Asian 5 members of the G20?
- Should these forums gradually be represented in the G20, just like the EU is now represented?
- How can institutions like ADB, AMRO and CMIM be playing a constructive role in economic surveillance and crisis management of Asian economies?
- Should these institutions play the "first responder" role in crisis management for Asian countries?
- Does the region need a Council of Asia (Lecture 11) as a regional counterpart to the G20?

# **Asia's Internationalization - Another Key Determinant of Its Global Governance Role?**

- Asia successful in globalizing its economies through trade (in goods and services), FDI, and to varying extents through financial capital flows.
- Its record is less impressive in internationalizing its economies through freer flows of ideas and people
- Except for a couple of countries (like Singapore, Hong Kong, and Malaysia) immigration is severely restricted
- Immigration restrictions also hinder freer creation and flow of new ideas, despite the IT revolution etc
- Another proxy for internationalization is the people's skills and proficiency in English - today's international language (Slides 25-26)
- Will the lack of internationalization of Asian people be a hindrance for Asia playing a bigger role in global economy and governance? Will Asia address this constraint over time?

# 2011 English Proficiency Index Country Ranking Mapping (EF)





# 2011 English Proficiency Index Country Rankings (EF)

Rank	Country	EF EPI Score	Level	Rank	Country	EF EPI Score	Level
1	■ Norway	69.09	Very High Proficiency	23	■ Italy	49.05	Low Proficiency
2	■ Netherlands	67.93	Very High Proficiency	24	■ Spain	49.01	Low Proficiency
3	■ Denmark	66.58	Very High Proficiency	25	■ Taiwan	48.93	Low Proficiency
4	■ Sweden	66.26	Very High Proficiency	26	■ Saudi Arabia	48.05	Low Proficiency
5	■ Finland	61.25	Very High Proficiency	27	■ Guatemala	47.80	Low Proficiency
6	■ Austria	58.58	High Proficiency	28	■ El Salvador	47.65	Low Proficiency
7	■ Belgium	57.23	High Proficiency	29	■ China	47.62	Low Proficiency
8	■ Germany	56.64	High Proficiency	30	■ India	47.35	Low Proficiency
9	■ Malaysia	55.54	High Proficiency	31	■ Brazil	47.27	Low Proficiency
10	■ Poland	54.62	Moderate Proficiency	32	■ Russia	45.79	Low Proficiency
11	■ Switzerland	54.60	Moderate Proficiency	33	■ Dominican Republic	44.91	Very Low Proficiency
12	■ Hong Kong	54.44	Moderate Proficiency	34	■ Indonesia	44.78	Very Low Proficiency
13	■ South Korea	54.19	Moderate Proficiency	35	■ Peru	44.71	Very Low Proficiency
14	■ Japan	54.17	Moderate Proficiency	36	■ Chile	44.63	Very Low Proficiency
15	■ Portugal	53.62	Moderate Proficiency	37	■ Ecuador	44.54	Very Low Proficiency
16	■ Argentina	53.49	Moderate Proficiency	38	■ Venezuela	44.43	Very Low Proficiency
17	■ France	53.16	Moderate Proficiency	39	■ Vietnam	44.32	Very Low Proficiency
18	■ Mexico	51.48	Moderate Proficiency	40	■ Panama	43.62	Very Low Proficiency
19	■ Czech Republic	51.31	Moderate Proficiency	41	■ Colombia	42.77	Very Low Proficiency
20	■ Hungary	50.80	Moderate Proficiency	42	■ Thailand	39.41	Very Low Proficiency
21	■ Slovakia	50.64	Moderate Proficiency	43	■ Turkey	37.66	Very Low Proficiency
22	■ Costa Rica	49.15	Low Proficiency	44	■ Kazakhstan	31.74	Very Low Proficiency

# Conclusions

- Asia is emerging as the center of gravity in the global economy; this need not necessarily mean that Asia will also emerge as the center of global governance
- Asia's growing size only creates the potential for it to play a much more significant role in global governance
- Realization of this potential is contingent on the region:
  - Developing the willingness to take on a bigger role in global governance
  - Building regional forums and institutions to move global governance towards a multilateral, federal structure
  - Reducing the region's external economic dependence (growth rebalancing, promoting organic growth)
  - Providing leadership and internationalizing the people

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