13

Comment on Eisuke Sakakibara

Amar Bhattacharya

Professor Sakakibara's discussion of regional cooperation follows quite nicely on the discussion on Eastern Europe, where deep integration is taken for granted. It has already happened in trade, and now the micro and macro alignment in finance is quite far advanced. The only remaining issue is whether the terminal monetary integration will happen in 2006 or 2008.

This shows you how far at least in one region things have gone. In Latin America, we did not discuss integration but the Free Trade Arrangement for the Americas (FTAA). There is a political commitment to launch that by 2005, although it is not clear whether it would lead to a single currency type arrangement. There are also questions about the way the FTAA will relate to sub-regional arrangements such as Mercosur.

East Asia stands out for its relative lack of regional institutions, which is, as Professor Sakakibara points out, is abnormal given the scale of Asia. He cites some numbers to make this point, but it is even more striking if you run the clock a little bit fast forward. If you take a long view, by 2020 China will be fast approaching the US as the largest economy of the world. South East Asia as a whole will also exceed the size of many G-7 countries if it resumes growth at 5 or 6 percent annually.

The other thing Professor Sakakibara points out is that Asia is very open, that its share of world exports is already about 27 percent and that this number will increase, especially with China entering the WTO. In terms of the international financial system, as Professor Park points out, East Asia has more than 1.1 trillion of foreign

From: Financial Stability and Growth in Emerging Economies
FONDAD, September 2003, www.fondad.org

exchange reserves, much of which is intermediated elsewhere.

All this is impressive, and raises the question of why East Asia has not seen a more rapid pace of regional integration and does not occupy a more prominent place in the multilateral order. As Professor Sakakibara said, it has to do with politics, and with the issue of governance of the global system. I will focus more on the economic side, raising four different issues.

My first point is on trade. It is not just that East Asia is benefiting from global market places, as Professor Sakakibara mentioned, but it is that East Asia stands to gain the most from a multilateral approach to trade – more than any other region in the world. Our calculations at the World Bank, for example, show that if there were full-scale multilateral trade liberalisation, the increment to income for East Asia would be 2 percent, a huge amount compared to 1.2 percent for other developing countries and compared to 0.5 percent for the rich countries. East Asia's approach to the trade agenda has to be therefore quite different given its large stake in the global trading system.

My second point, to put the trade picture in perspective, is that the world today in terms of trade barriers is very different than when Europe was contemplating its trade integration or even when Mexico and the US were contemplating their trade integration. Against that background, there is a lot of discussion in East Asia about regional trade arrangements. There is a whole variety of regional proposals – there is ASEAN+3, there is ASEAN+3 + New Zealand + Australia, there is APEC Preferential Free Trade Area, there is APEC MFN-based liberalisation – and the important point about all these arrangements is that the benefit is the greater the larger the number and more diverse the membership is.

Using just the example that Professor Sakakibara mentions in his chapter, ASEAN+3 as a basis for trade liberalisation would give global gains on the order of 11 billion dollars. For APEC the increase approaches something like 48 billion dollars in terms of global welfare.

Again, the important point is that East Asia benefits much more from multilateral trade liberalisation than it does from sub-regional or bilateral arrangements. Does this mean that there is no role then for regional action? No, there is a role, but the actions are much more in the area of trade facilitation, in the area of harmonisation and in the area of investment policy. This is one of the objectives of the non-discriminatory free trade arrangements that some countries have been pursuing on a bilateral basis in the region.

My third point is on finance. As Professor Park mentioned, capital markets are global, which has implications for the nature and scope for regional action. Certainly the formation of a currency union can be a powerful catalyst for trade and financial integration. But it works also as a political driver of integration, in the sense of getting finance at the micro and the macro level right. However, as Professor Sakakibara said, the building of a currency union will inevitably take time in East Asia, so there are things you can do in the short run such as improving coordination in terms of exchange rate regimes.

The second aspect of financial integration where there is potential for regional action has to do with financial stability, where Professor Sakakibara has proposed better regional arrangements to deal with contagion risks. There are some difficult issues here. One is covariance risk. Inevitably the risks will be greater within the region, and it is not clear that regional arrangements will necessarily be the best approach for risk pooling. Another difficult issue that arises is the need to make a determination on the balance between financing and adjustment and how to "bail-in" the private sector. These judgments and agreements will be most effective if all actors are involved, globally and regionally. The fundamental point therefore is, that while you could think of a regional financial stability arrangement as a complementary to international mechanisms, as indeed the Chiang Mai Initiative has been conceived as, it is very difficult to think of it as an alternative, which is implicit in the chapter of Professor Sakakibara and which seems to be implicit in his presentation.

So I would argue that if you have global financial markets, then you have to have global arrangements – obviously reinforced through regional mechanisms.

The fourth point Professor Sakakibara did not mention, and where I think there is scope for regional cooperation, is regional infrastructure. Professor Park mentioned that there is a big risk that Asia will be over-run by foreign financial institutions. The answer he provided is not to keep foreign institutions out, but to develop the market infrastructure, to develop the standards and to develop the human capital so that you are able to compete. Indeed, I would argue that is the key, rather than to be concerned about ownership and keep the foreigners out.

Professor Sakakibara is right that there are weaknesses in the global governance system, but it would be a mistake to withdraw to a regional system. If anything, Asia is now well equipped to play a large role and it should seek a larger role in global governance. The entry of China into the WTO shifted the balance of trade in favour of Asia. Given the changing role of Asia in trade and finance, it is entirely appropriate that Asia is seeking a greater role in international financial institutions and, indeed, in global financial governance.

So the agenda on enhancing regional cooperation in a globalising world rests on three pillars. First, Asia should seek a greater role in the global financial governance system, just as it strengthens regional arrangements. Second, I would argue very strongly that Asia has a disproportionate interest in a multilateral system of trade. There is a big risk that there could be a spaghetti bowl of confusion if Asia goes for multiple regional trade arrangements and multiple bilateral free trade arrangements, which are potentially inconsistent and can detract from the attention and span of policymakers. Third, in the financial arena, while there is considerable scope to pursue regional initiatives, such as in developing bond markets, these should be seen as complementary to strengthening the international financial architecture if we are to address the concerns on crisis prevention and resolution in globally integrated capital markets.