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Comment on Eisuke Sakakibara

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From his post in the Japanese Finance Ministry, Eisuke Sakakibara was a major player in global economic policy making in the 1990s, so his views on this topic area are of particular interest. In his paper for this volume, those views are expressed through personal reflections on Asia's historical place in the world economy, projections about the future shape of the international political economy, and policy proposals with emphasis on financial cooperation in the Asian region. Given the subject matter of the volume, the third aspect is most relevant, so my comments will centre of that part of the paper. Their main aim is to locate Professor Sakakibara's ideas in the more general discussion of Asian economic cooperation and to identify some questions that need further clarification.

The Status Quo Ante

Sakakibara's discussion of recent developments in Asia dates from the Plaza Accords of 1985, which led to a surge of Japanese investment in other Asian countries. He refers to this process by the commonly used phrase "Flying Geese Formation', whereby Japan was alleged to transfer its technological prowess to its less developed neighbours in a staged process. Although used with great frequency in the literature, this concept is nonetheless controversial since (a) it takes for granted the role of Japan as "lead goose" and (b) assumes that the other "geese" are all adopting the same features.[1] Both assumptions

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will become relevant in analysing the proposals for increased financial integration below. Another characteristic of the flying geese model is that this form of regional integration, which centred on foreign direct investment and trade, was governed by market mechanisms rather than inter-state treaties. Indeed, Asian integration schemes in general have been less institutionalised than their western counterparts in Europe or the developing world. This tradition would be scrapped in the proposals that we will examine below.

Reasons for Change

Asian growth rates in the post-war period were spectacular, exceeding those of other regions by a substantial amount. Exactly what role the Flying Geese Formation played in the success of Asia's development may be debated, but other regions increasingly looked to East Asia for an example of a national development model, including the regional integration component.[2] All of this came to an abrupt halt in 1997-98, as a financial crisis hit the region. Among the side effects of the crisis was a reconsideration of the nature of regional integration; Sakakibara's discussion of reasons for change derives to a large extent from experiences during the crisis. These centre on the policy conditionality accompanying loans by the International Monetary Fund (IMF) to Korea, Thailand, and Indonesia as well as the failure of the United States to take an active role in dealing with the Asian crisis in contrast to similar situations in Latin America. Beyond the crisis, however, geopolitical changes were also taking place as Japanese economic power declined, while that of China rose rapidly. The decade-long recession in Japan has reduced the resources the country can invest abroad, while China's dramatic growth has raised its profile in economic as well as political and military terms. The resulting disequilibria with respect to the Flying Wild Geese scheme clearly require some kind of restructuring.

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1 For a critique, see Mitchell Bernard and John Ravenhill, "Beyond Product Cycles and Flying Geese: Regionalization, Hierarchy, and the Industrialization of East Asia", In: *World Politics*, Vol. 47, January, 1995. pp. 171-209.

2 See, for example, Michael Mortimore, "Flying Geese or Sitting Ducks? Transnationals and Industry in Developing Countries", In: *CEPAL Review 51*, December, 1993, pp. 15-34.

The Actors

The processes already mentioned imply a necessary shift in the cast of characters in the regional drama – and in their relative importance. Taking the mid-1980s as a starting point, a study of the literature reveals almost total concentration on Japan, on the one hand, and the "four tigers" (Korea, Taiwan, Hong Kong, and Singapore), on the other. By the late 1980s and early 1990s, South-East Asia was beginning to attract attention, but in an essentially passive role as a recipient of investment from Japan and the four tigers. China (and Indochina) were still on the sidelines. A dramatic indication of the failure to take China into account is Sakakibara's admission that he did not even consult China before announcing his proposal for an Asian Monetary Fund (AMF) in 1997. Now, however, he appears to be moving in the opposite direction and according China a (the?) central place in his new proposals. When he says that "the Flying Geese Formation is now being quickly realigned – with China in the lead", it is not clear if he means that China will replace Japan as the lead goose or if China is simply taking the lead in forcing change more generally. In either case, China has joined Japan as the dominant actors in the new scheme that he proposes although, as will be discussed below, the relationship is far from harmonious. The other key player is South Korea, to which Sakakibara assigns the awkward role as "mediator in the cultivation of a common will between China and Japan".

The Proposals

The discussion thus far has provided background for this section on the proposals *per se* for a new regional integration system in East Asia. Sakakibara's paper is confined to a presentation of his own views. As mentioned earlier, these are the views of an informed and influential policymaker, but they do not exist in a vacuum. It is thus useful to consider his proposals in light of the extensive literature that has emerged on this topic since Malaysian prime minister Mohamad Mahathir proposed the East Asian Economic Caucus in the early 1990s. Obviously not all of it can be discussed in these brief comments, but some other proposals can be compared with those of Professor Sakakibara.

Sakakibara's main message is that East Asian countries need to move forward rapidly in the area of financial integration, not waiting for trade integration to develop further. Specifically, he says, "it is my view that cooperation, and ultimately integration, should proceed simultaneously rather than sequentially in trade, FDI, and international finance, which differs from the process that took place in Europe". In order to achieve this goal, he proposes two main tasks. First is coordination of foreign exchange policy, leading to the formation of an Asian currency unit (ACU) that would float within a flexible band, similar to the ECU and the snake. The need to defend the value of the ACU leads to the second task, which is the creation of an institution to pool the region's huge foreign exchange reserves. As the reincarnation of his earlier proposal for an Asian Monetary Fund, the new institution would be based on the so-called Chiang Mai Initiative of 2000. The Chiang Mai Initiative, with its ASEAN+3 (Japan, China, and Korea) membership, is an agreement to provide bilateral swaps in the event of a member needing access to foreign exchange. The new institution would meet regularly to coordinate policies and conduct surveillance of each other's economies.

How does this set of proposals relate to others that have been put forward, both in Asia and elsewhere in the world? Two differences merit consideration. First, the Sakakibara proposals are more optimistic, but less clear, than most others. A recent paper by two influential economists from the United States (Fred Bergsten, director of the Institute for International Economics) and Korea (Yung Chul Park, professor at Korea University and former government official) strongly supports greater financial integration in Asia but is more doubtful about chances for success.[3] In particular, they are concerned about the "looming economic rivalry" between Japan and China (p.78), to which Professor Sakakibara pays little attention. Furthermore, they place much more stress than does Sakakibara on the need for a regional surveillance mechanism among member countries to monitor policies that might have negative ramifications for the region as a whole and to avoid moral hazard in lending. A related paper, published by Bergsten's institute, "conditionally" supports the Chiang Mai Initiative, expressing

[3] C. Fred Bergsten and Yung Chul Park, *Toward Creating a Regional Monetary Arrangement in East Asia*, Research Paper No. 50, Asian Development Bank Institute, Tokyo, 2002.

approval about the fact that it is much more modest than the AMF proposal.[4] The author also emphasises the necessity to get support from, and to cooperate with, the IMF. The relationship with the IMF was a major stumbling block for the AMF, over the issue of whether a new regional institution would be a substitute or complement. Unfortunately, Sakakibara does not spell out his position on this issue, although he implies that he now favours a regional financial institution that would complement the IMF. His rather oblique comment in the concluding section of the paper is: "Establishment of regional mechanisms consistent with existing global institutions seems to be the best strategy, at least for the immediate future."

A second difference between Sakakibara's proposal and others in the literature is their relative scope. Sakakibara focuses exclusively on government-to-government relations, while others usefully add in proposals for private sector development and the strengthening of existing financial institutions. One such proposal is that of Thai prime minister, Thaksin Shinawatra, to establish an Asian Bond Fund. Regional governments would contribute a small percentage of their international reserves to a fund dedicated to purchasing bonds of member countries and thus strengthening national bond markets – a concern of most Asian governments after the financial crisis.[5] This proposal was put into effect in June 2003. While small in scale, some see it as an initial step that could become more important in the future. A second proposal is the one by Yung Chul Park in this volume, which focuses on the need to develop locally based private sector institutions in financial services, such as commercial banks, investment banks, insurance, derivatives, and merger and acquisition firms. Currently, Park argues, such institutions are heavily dominated by foreign firms, which leaves the region vulnerable to the whims of outsiders. These proposals dealing with private sector institutions could, of course, be combined with an inter-governmental institution as proposed by Sakakibara.

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[4] C. Randall Henning, *East Asian Financial Cooperation*, Institute for International Economics, Washington D.C., 2002.

[5] See discussion by Ramkishen Rajan, "A Bond Fund for Asia", In: *Far Eastern Economic Review*, March 20, 2003, p. 43.

Implications for Other Regions

Although Professor Sakakibara has no reason to mention it, the debate on East Asian regionalism is resonating beyond the borders of the countries directly involved. This is especially true in Latin America, but also in South Asia and Africa to a lesser extent. Central and Eastern Europe, of course, have already begun the process to join the European Union, so the regionalism debate has been resolved there. In Latin America, regionalism has mainly focused on trade until now. Recently, however, discussion has begun within the sub-regional associations, especially Mercosur, about macroeconomic coordination and even a common currency. Likewise, more emphasis has been accorded to regional financial institutions, several of which already exist in Latin America. The two most important are the Andean Development Fund (CAF), which lends money for investment projects to members of the Andean regional group, and the Latin American Reserve Fund (FLAR), which provides balance-of-payments support to member countries.[6] Both are fairly small-scale operations, but there have been proposals to expand their scope. In this context, Latin America has been an interested observer of the Asian debates about financial integration, but it might also be useful for East Asia to study the successes and shortcomings of CAF and FLAR. Such dialogue has already begun. An important example is the Interregional Meeting on Financing for Development, organised by the Regional Commissions of the United Nations as a preparatory forum for the Monterrey Conference in March 2002, which gave major consideration to regional financial institutions.[7] Continued interchange would be useful for all.

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6 For a description of these institutions, see Daniel Titelman, *Multilateral Banking and Development Financing in a Context of Financial Volatility*, Financiamiento del Desarrollo Series No. 121, Section V, 2002.

7 See "Summary of Conclusions", Interregional Meeting on Financing for Development, Mexico City, Section II.5, January 2002.