TRANSFORMING EAST ASIA INTO AN OASIS OF STABILITY

THROUGH DEEPER INTEGRATION

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The last 30 years or so in the evolution of the world economy has been a remarkable period on many accounts. It was a period of deregulation, liberalization of cross-border and behind-border restrictions, mega merger and acquisition, and privatization. It also witnessed the exodus to market economy of former centrally planned economies. China was a pioneer in this matter. During the same period East Asia (the parts of Asia east of Bangladesh?) emerged as the world's growth center in the course of which it slowly discovers the merit of regional integration, evolving around ASEAN which after a very long transition agrees to commit to a deep integration in form of ASEAN Economic Community 2015. East Asia's desire to integrate is strong. Attempts are being made to give a more clear geographical boundaries to East Asia, agree on how best arrive at a deep integration and how major powers of the region resolves the leadership issues, considering that ASEAN's current "leadership" is inadequate to move the region forward to a deeper integration. Puzzlingly, the more open world economy has been afflicted by crises at greater frequency and seemingly also severity. The ongoing crisis is indeed the worst after the Deep Depression of the 1930s.

Severity of a financial crisis differs across economies depending on the financial depth of the respective economies as reflected in the ratio of financial wealth to total wealth, the extent to which a bubble is carried from past cycles and the seriousness in which the financial system suffers from bad practices of governance. Even among East Asian countries crisis has been felt differently. China and India maintain a strong growth. Indonesia is able to grow moderately. The fall of output has been the steepest in Japan. However, trade has shrunken at a worrying pace of around one-third globally at mid-2009 over a year earlier. The deeply integrated Europe has not been doing clearly better in safeguarding its trade. The fall is even more dramatic in a number of countries. The transmission mechanisms are obvious. As asset prices fell demand for investment also faltered and with it demand for capital goods. As income from employment and saving diminished, people cut their consumption of goods and services. Trade in goods and services fell as a consequence.

An intriguing question arises as to how far East Asia can insulate itself better against global financial crisis under a deeper integration of the financial sector, trade in goods and services, the equity and bond markets. Following the financial crisis of 1997-1998 East Asia has embarked on a number of initiatives on financial integration. They include the Chiang Mai Initiative (CMI), the Asian Bond Markets Initiative (ABMI) under the APT scheme, and Asian Bond Fund (ABF) by Executives' Meeting of East Asia-Pacific Central Banks (EMEAP). Admittedly, regional integration is not a panacea against a financial crisis. The current crisis struck also Germany and France despite single currency and other elements of the European Monetary System. Nevertheless, the idea of regional macroeconomic oasis under a deepening financial integration and macroeconomic policy co-operation is worth pursuing. The different elements of financial cooperation in East Asia need an umbrella which may perhaps be called an East Asian Stability Pact where different issues are approached differentially and extent of participation can vary between participating countries or economies. Such stability pact should include cooperation in prudential regulation (including the facilitation of implementation of international standards), co-operation in corporate governance for financial institutions and publicly listed companies, co-operation in matters related to fiscal stability, joint endeavors to accelerate the growth of East Asian bond and equity markets, co-operation in exchange rate stabilization through an East Asian Exchange Rate Mechanism centered round East Asian Currency Unit (EACU) and co-operation in crisis management (emergency liquidity, conditions for its access and interest on emergency loans). A stability pact will help reduce the vulnerability of East Asia to financial crisis of regional and extra-regional origins.

This call for an East Asian stability pact is not new. Idea on Asian Currency Unit has been around since time immemorial. A more comprehensive draft design was proposed by Japan during the Asian financial crisis ten years ago. Perhaps the world is simply too vast as a single financial market to be able to evolve smoothly in the wake of probabilistic failures of governance and recurring periods of exuberance following a successful commercialization of a noble product or process or other sources of wealth. Its vulnerability to a severe crisis may be reduced through a "de-massification" into several regional sub-systems with built-in negative feedback mechanisms, however incomplete such mechanisms may be.

Another intriguing question arises on whether or not the vulnerability to global financial crisis will be reduced under a lower global trade intensity defined as extra-regional trade as fraction of GDP. An autarkic economy would have little in terms of external assets and liabilities that would expose it to fluctuations in the global debt, equity and foreign exchange markets. A higher intra-regional transaction also reduces the exposure of a region to fluctuations of extra-regional origin. Assuming that regional integration in forms of free trade in goods and services, free capital movements, free flows of people leads to a higher intra-regional trade intensity, vulnerability to crisis of extra-regional nature will be reduced.

East Asia has been the most enthusiastic region in pursuing preferential trade agreements in the last 10 years or so for reasons that have remained obscured to some extent. However, many of the agreements are extra-regional in nature. They reflect only partially an enthusiasm about East Asian integration. East Asia is currently faced with the daunting task of consolidating the different bilateral and sub-regional initiatives into a coherent East-Asia-wide agreement. Given its experiences, the APT appears to be best in position serve as core mechanism. Yet, it too needs to be mindful of recent developments and opens its doors for a wider participation.

East Asia integration is much more than just financial integration, flows of goods and services and flows of capital. East Asia is home the world's richest economies and poor economies. Reducing the gap between the poor and rich countries has always been an important part of the talks about regional integration in East Asia. The challenge is enormous. First, the number of poor people is like an ocean compared to that of rich ones. Second, the gap is very severe as reflected in per capita income, health conditions, educational attainments and entrepreneurship as proxy for the use of knowledge. However, agreeing on a meaningful regional alleviation program has proven to be an arduous process.

Given the challenges of integration and co-operation leaders of East Asia should explore a comprehensive approach as suggested by the Asian Development Bank (ADB) in 2008 by establishing a Secretariat for Co-operation where China, Japan, Republic of Korea and newer participants such as India can seek to co-operate directly rather than indirectly under the ASEAN umbrella. Under such arrangement the centrality of ASEAN will diminished. However, ASEAN can still retain a co-leading role, provided that its integration progresses faster than that of the rest of East Asia. ASEAN's centrality as mechanism will also remain indispensable when it comes to non-economic issues.