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REGIONAL COOPERATION

Emerging Issues for Regional Cooperation in Asia-Pacific

Toshiki Kanamori

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Executive Editor: Grant B. Stillman

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1. Designing Effective Regional Cooperation for Human Resources Development

Dynamic human resources are one of the dominant factors for developing countries (DMCs) to achieve sustainable economic growth. Donors, including the ADB, are eager to help teach DMC policymakers how to formulate a wide range of public policies, such as fiscal, monetary and tax administration, project management and enforcement of laws and regulations. Although the trend is now mainly towards training using the case study method, many DMC officials lack even an elementary understanding of macro and micro theories and statistics.

Frequently, policymakers in transitional economies learned only Marxist economic theories as schoolchildren. They have limited exposure to contemporary economics and current market trends. Therefore, donors should first check the educational background of their trainees closely and then consider the correct balance between practical case studies and traditional economic theories.

Many popular case studies originally came from developed countries, particularly North America. Certainly economic, social and political conditions differ among countries, and especially between the developed and developing world. Success stories from the American Midwest may not always be helpful to DMC policymakers who are under vastly different political regimes and stages of development.

The relevance of studies from developed countries must always be rigorously checked with the conditions found in each DMC. To ensure demand-driven training, it is essential to obtain meaningful assessments and feedback from participants. In practice, getting frank evaluations is challenging. And how these classroom programs are contributing to solving problems in the real world of the DMCs is proving even more difficult to analyze.

2. Multilateral versus Bilateral Trade Frameworks in an Open Region

Why the current rush for preferential, bilateral or small grouping trade agreements (PTAs)? Frequently cited reasons are: the changed geopolitical environment, growth of intra-regional business networks, success of regionalism in other parts of the world, or the legacy of the Asian financial crisis. We believe the most salient factor is pessimism surrounding the prospects for trade liberalization through the WTO.

As a result, hardheaded strategic calculations about cooperation in the region must be made by each state. Even Japan has had to move away from its long-cherished policy of multilateralism to try to pursue PTA initiatives with ASEAN countries. (Some see this as evidence of Japan's growing concern over the decline of its regional economic dominance with the rise of the PRC.)

Asian regionalism needs to be understood not just in purely economic terms, but also through international power politics (witness the recent thaw between India and Pakistan).

However, the impact of regional integration is harder to analyze. Some experts, relying on simulation results, argue that the welfare effects of multilateral liberalization on countries are much larger than those of bilateral PTAs. Similarly, they think the current proliferation of PTAs or regional trade agreements may undermine the prospects for maintaining and expanding liberal, multilateral trading systems.

It seems to us, theoretically everyone can agree a multilateral liberalization system would be superior to restricted economic integration; but at the same time many accept restricted as the only realistic, albeit second best, approach. We expect the development of regional integration and a multilateral, liberal trade regime under the WTO will not be contradictory, as long as the principle of open regionalism is embraced.

3. Intraregional Migration and Development Assistance

Human resources play a crucial role for economic development in all nations, perhaps Asian policymakers and academics should begin to pay more attention to migration trends. Economic theory argues migration is simply the redistribution of the labor force. Supply and demand disequilibrium and wage differentials in labor markets in rich and poor nations are understood as the main driving forces. In order to achieve optimum resource allocation, migration should benefit both labor exporting countries and receiving countries.

But in the real world, we know of other strong factors—political, social and environmental—which contribute to migration. Illegal migrant workers have been increasing at a rapid pace, not only in the Americas or Europe, but now in the Asia-Pacific region. This in turn causes various degrees of social friction and even unrest in some countries. What can the international donor community do to help?

We can start by recalling an oversupply in the labor market of developing countries is usually caused by a high birth rate and then a population explosion,

which brings on poverty. Before thinking about optimal resource allocations across nations, we could focus again on the reality of poverty in developing countries and try to help them establish industries and create job opportunities without relying on the export of labor (and brain power) overseas. Next, as the famous Ehrlich equation teaches us, in order to alleviate environmental stress, you have to limit populations or reduce people's living standards or enhance technology.

Certainly, the donor community could be promoting more technology transfers and assisting in minimizing population explosions through family planning, health care services etc. In such a case, developing countries could then address environmental degradation without further aggravating poverty or relying on the export of excess labor.

Since lack of accurate data on migration is another obstacle to tackling this problem, donors could also provide more technical assistance in this field. Finally, to cope with illegal migration, we need forums where policymakers, NGOs and international organizations could exchange their views and share information on possible solutions.

4. Financial Implications of the Asian Bond Market Initiative (ABMI)

The APEC Finance Ministers' meeting from time to time highlights the importance of regional bond market development. APEC ministers have wholeheartedly endorsed the idea of the ABMI and APEC's role in promoting it. ABMI was originally proposed by Japan under the framework of ASEAN plus 3 in 2002 and since then significant progress has been made. The basic thrust of ABMI is to develop efficient and liquid bond markets in Asia in order to meet the needs for indigenous medium and long-term financial resources and enable further economic development in the region. There are several points worth noting about this initiative, which is also receiving ADB technical assistance.

First, in many countries in the region although savings rates are relatively high, quite a large amount of savings remain underutilized. This in turn means that although many Asian countries still suffer from poverty, the cause of poverty is not necessarily a shortage of money. The core issue, therefore, is how to mobilize unused financial resources for various productive investments which contribute to development.

The underlying message of ABMI appears to be Asian countries have relied too heavily on banking channels in the past and now they have come to realize they need to develop more sound, diversified and liquid capital markets. Our research fully supports this proposition. We also believe a comprehensive approach on how to mobilize unused resources will become even more critical in the future, taking into account the budget constraints many donor countries now face.

Second, we realize money flows have become undeniably more cross-border and volatile, which while worrying should contribute to the better usage of finance within the region, as savings from one country might quickly end up being transferred to more attractive investment opportunities in others. But many Asian developing countries have not fully deregulated their capital account transactions and governance or market infrastructure is still weak. Enhancing market infrastructure properly is one of the key priorities of ABMI.

5. Role of Regional Credit Agencies in Development

Mobilizing local savings for financing is extremely important for the continued economic progress of DMCs, and to this end the growth of bond markets in Asia-Pacific has been encouraged in recent years. There has been too much reliance on the banking sector till now and the establishment of sound capital markets would be a sensible diversification. But one of the major bottlenecks to the development of capital markets is the remaining asymmetry of information among market participants, particularly in Asia. That is why we think the role of trusted credit rating agencies will become critical for the growth of regional capital markets.

The Association of Credit Rating Agencies in Asia (ACRAA) was set up four years ago with the participation of a dozen or so domestic credit rating agencies (DCRA) operating regionally. Promising ideas discussed within ACRAA include harmonization of rating standards and practices and the possible establishment of an Asia-wide credit rating agency. However, there are strongly held competing views about the merits of international credit agencies versus regional or DCRAAs.

You can reasonably argue that a rating for a company should be done by only one agency otherwise investors might get confused or, alternatively, different credit agencies may give the same company different ratings which are more relevant. This is likely, because domestic and international scales are often

different; particularly where capital account transactions are not yet liberalized, domestic investors are only interested in the home market (for which DCRA's normally have much more accurate information about their local companies).

It seems we cannot avoid the fact that different credit agencies may use other indicators or criteria and arrive at dissimilar ratings. (When an international credit rating agency downgraded Japanese sovereign bonds the government strongly protested this as being groundless.)

But what is most important here seems to be how to ensure a sound and competitive market environment for credit rating agencies and promote the transparency of each rating agency whether it be international or domestic. So long as transparency and accountability of credit agencies are ensured by regulators, the market and themselves, investors may usefully compare and contrast different ratings from their own standpoints and rely on their own informed judgements.

6. The Environment and Development Assistance after the Kyoto Protocol

The borderless nature of regional environmental issues poses complex challenges for cooperation. The international community now commonly requires environmental standards as prerequisites for sustainable economic development. A prime example of this can be found in the Kyoto Protocol which came into force in February 2005.

The Protocol's guiding principles are economic efficiency, environmental integrity and support for sustainable development. Specific targets and timetables are established for reductions in greenhouse gas emissions to be achieved by the signatories. Its success is far from certain. As the Kyoto process has shown, the global community has had to struggle to reach a common action consensus for issues crossing political geographies.

Based on this understanding, several other ambitious multilateral legal frameworks have been formed since the 1990s. They include the Global Environment Facility (GEF)—upon which many conventions depend for funds—, the International Framework Convention on Global Warming, the Biodiversity Convention and the Convention to Combat Desertification.

All these treaties tend to have common action structures. They identify broad commitments to be fulfilled by the contracting countries. Additional

commitments for developed countries are often included. Subsequently, the sources and means for delivery of financial mechanisms are established.

With \$3 billion pledged for operations from 2002 through 2006, the GEF remains the prominent financial mechanism. GEF projects focus on six areas of biodiversity, climate change, international waters, land degradation, the ozone layer and persistent organic pollutants. And the parties have agreed on three new funds—the Special Climate Change Fund, the Least Developed Countries Fund and the Clean Development Mechanism Adaptation Fund, to be administered by the GEF.

Debate continues over the wisdom of each convention establishing independent financial mechanisms, and not relying on the GEF. Developing countries are eager to set up independent mechanisms, whilst developed countries stress the merits of continued GEF reliance. The politics surrounding global issues are often reduced to the classic “North versus South” problem.

The South is uncomfortable because the GEF was initiated by the World Bank. Therefore, they fear decisions reflect a north-centric perspective, and promote northern priorities. The North worries about the significant number of conventions being created under UN auspices, where south-centric needs tend to take precedence over the North’s economic agenda.

Given the availability of resources together with the efficiency and coherency of administration and monitoring, a beefed-up GEF is probably merited. Events seem to be headed in this direction. However, bearing in mind the historical disputes between north and south, the GEF is expected to continue strengthening partnerships with regional multilateral development banks, the private sector and NGOs.

7. What the Yuan can Learn from the Yen

The renminbi exchange rate has attracted significant attention from both market participants and government officials. Assessing how the renminbi’s sharp appreciation will impact the economy of the People’s Republic of China remains a heated discussion point among experts. Here history may offer us some insights.

Japan’s economy underwent two periods of sharp yen appreciation subsequent to World War II. The first period occurred when President Nixon suspended the convertibility of the dollar to gold in 1971. This shock led major currencies, including the Japanese yen, to shift from fixed rate systems to

floating rate systems. The yen then sharply appreciated from 360 to 260, which lasted for several years. The second big yen appreciation coincided with the “Plaza Accord” of 1985. Radical adjustments were made for major currencies vis-a-vis the US dollar. Between 1985 and 1987 the Japanese yen increased from 240 to 120.

Interestingly, both periods were marked by high economic growth in the United States coupled with a subsequent deterioration of US trade and fiscal balances. Concurrently, Japan was enjoying export-driven economic growth and a significant trade surplus. Political and geographical considerations were also important. During these two yen appreciations, the United States was involved in the Viet Nam War and an intensifying Cold War. These were times of increased US military expenditures which aggravated the US fiscal balance. Of course, the situation in Iraq is placing similar burdens on the US economy right now.

Are there any lessons we can draw from the yen’s experiences then? Japan’s primary concern during sharp appreciations was the impact of the yen on the export-driven manufacturing industries and the consequent economic slowdown. To address these worries, Japan attempted to maintain a pegged rate system as well as minimize further appreciation by stimulating domestic demand. Excessive domestic adjustments were made to maintain the external equilibrium. Monetary policy appeared to lose its free hand. And notably, Japan’s economy suffered from hyperinflation or “economic bubbles” following both appreciations.

Another point to remember is that the yen’s appreciation in both periods triggered large-scale and far-reaching changes in Japan’s industrial structure. In the 1970s, assembly-type machinery industries such as automobile and electronic appliances became mainstream. They replaced traditional heavy steel and chemical industries. Following the yen’s sharp appreciation in the 1980s, more high value-added industries began growing domestically. Manufacturing companies started operations overseas by using FDI.

We can see there is a trade-off between adhering to a fixed rate system and maintaining an independent monetary policy under free international capital transactions. In the PRC the liberalization of capital actions is not yet complete. And nuanced options other than a pure pegged system or a perfect floating system do exist.

The People’s Republic of China always needs to keep in mind who might become the eventual winners and losers from currency fluctuation as the yen model has shown that impacts are long-range and far-reaching.