

Structural Reforms for Asia's Growth Rebalancing

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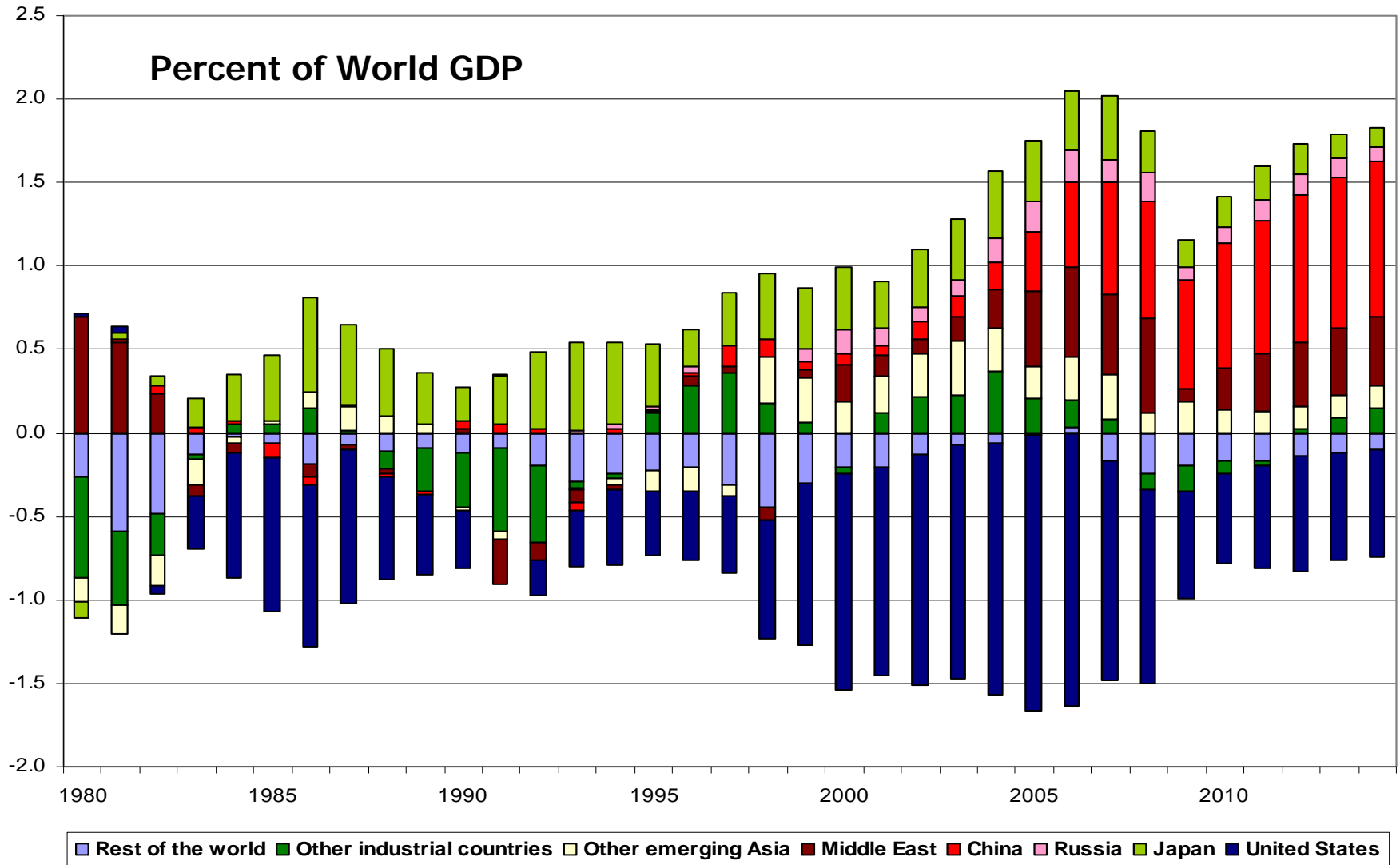
Outline

- 1. The Global Imbalance and Crisis**
- 2. Economic Analysis of Growth Rebalancing**
- 3. Policies to Rebalance Growth**
- 4. Conclusions**

1. The Global Imbalance and Crisis

- (1) The global payments imbalance**
- (2) The imbalance and the global crisis: A causal link?**
- (3) Impact of the crisis on Asian economies**

(1) Global current account imbalance

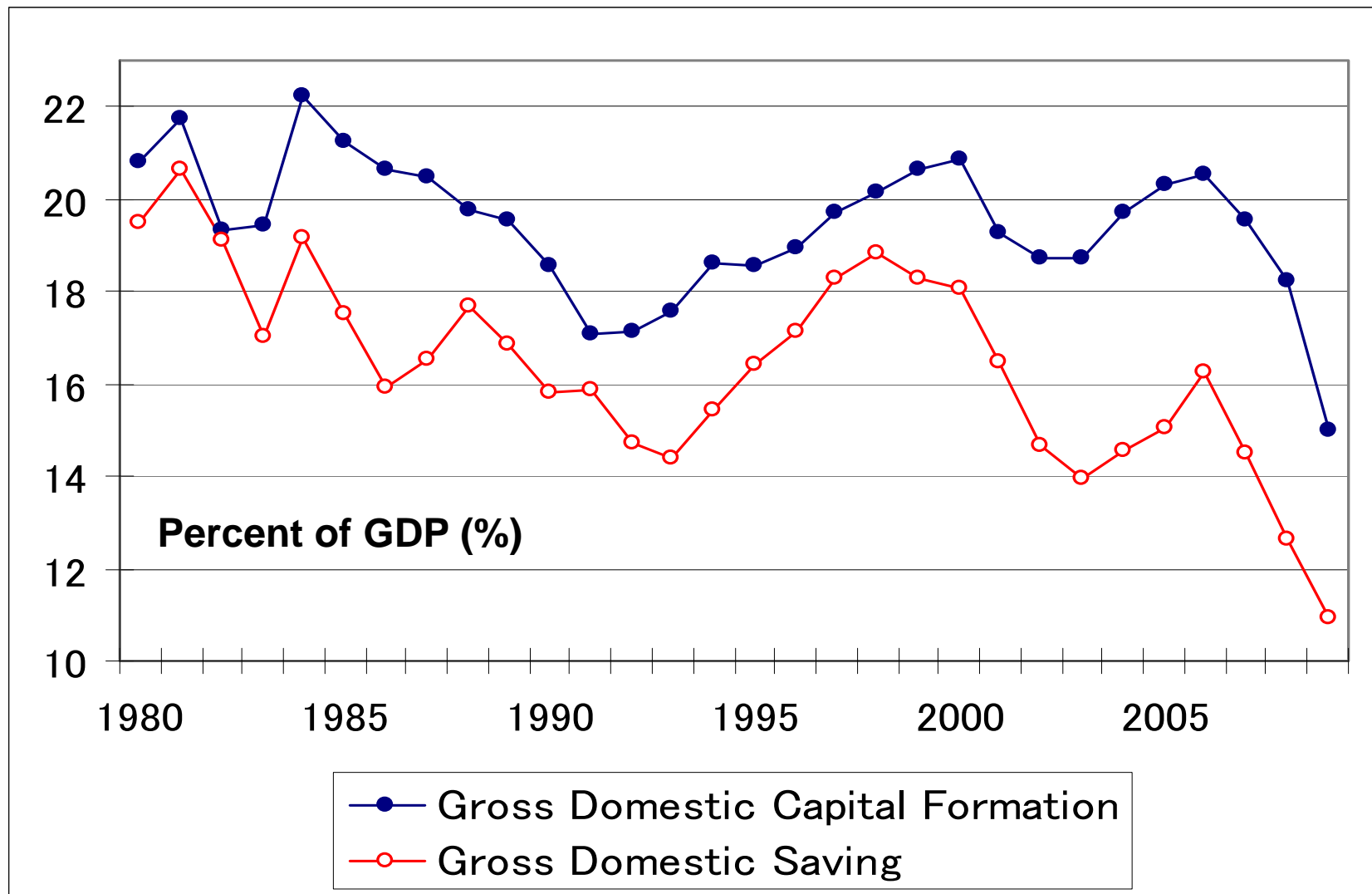


Note: (1) Data for 2009 and beyond are IMF projections

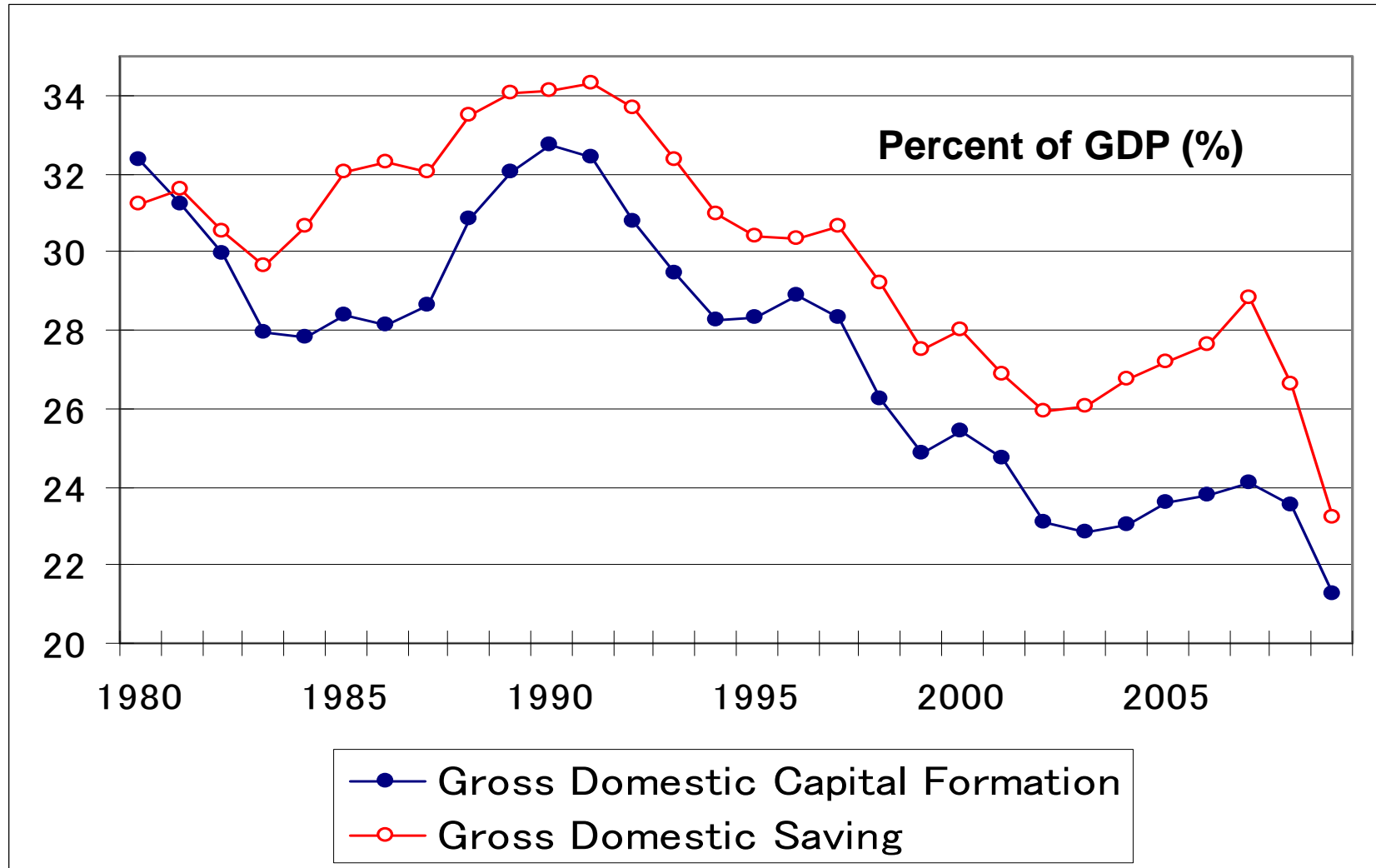
(2) Unlike the original IMF data, other emerging Asia includes Asian NIEs

Source: IMF, WEO October 2009

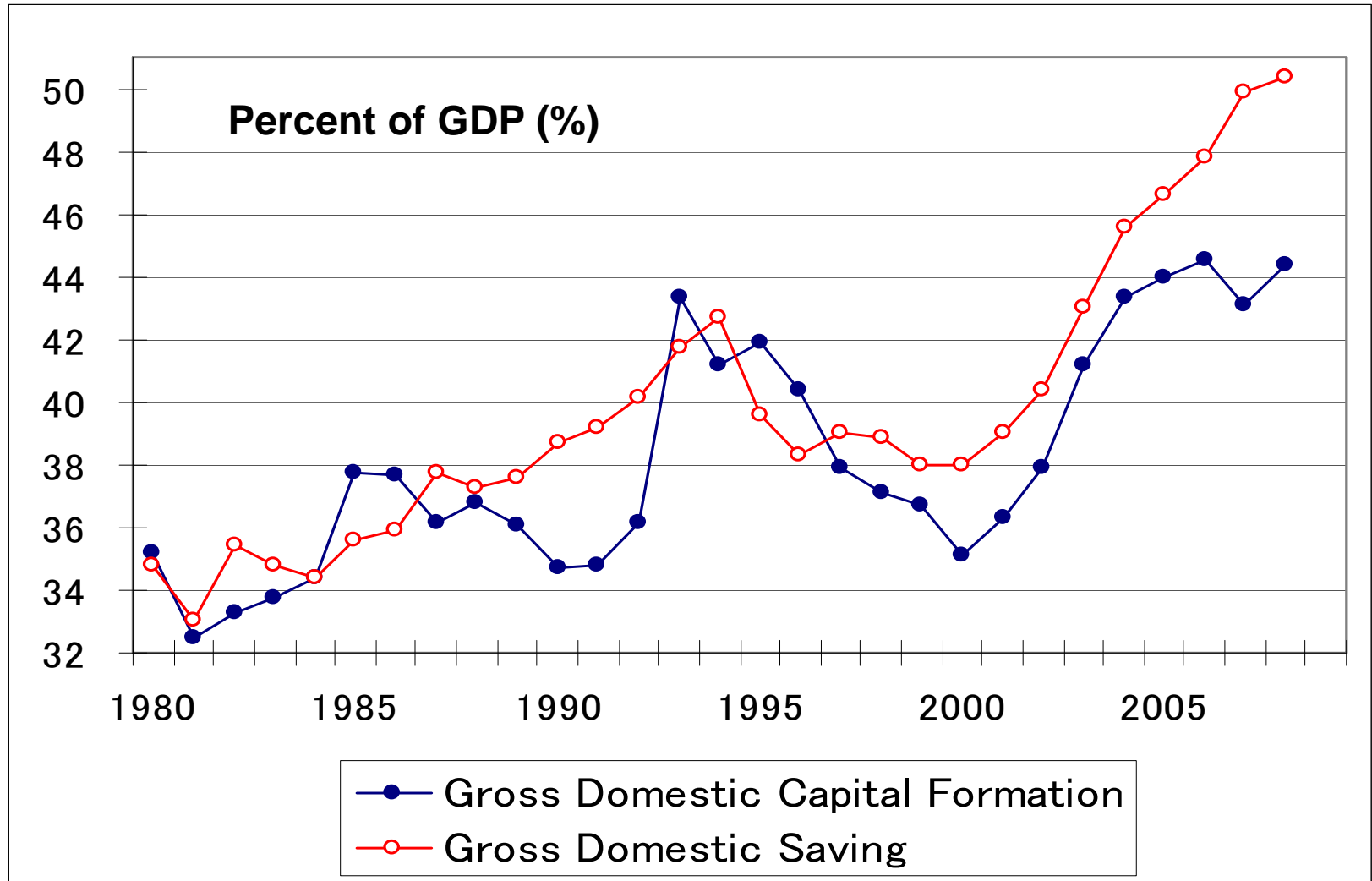
Savings and investment in the US



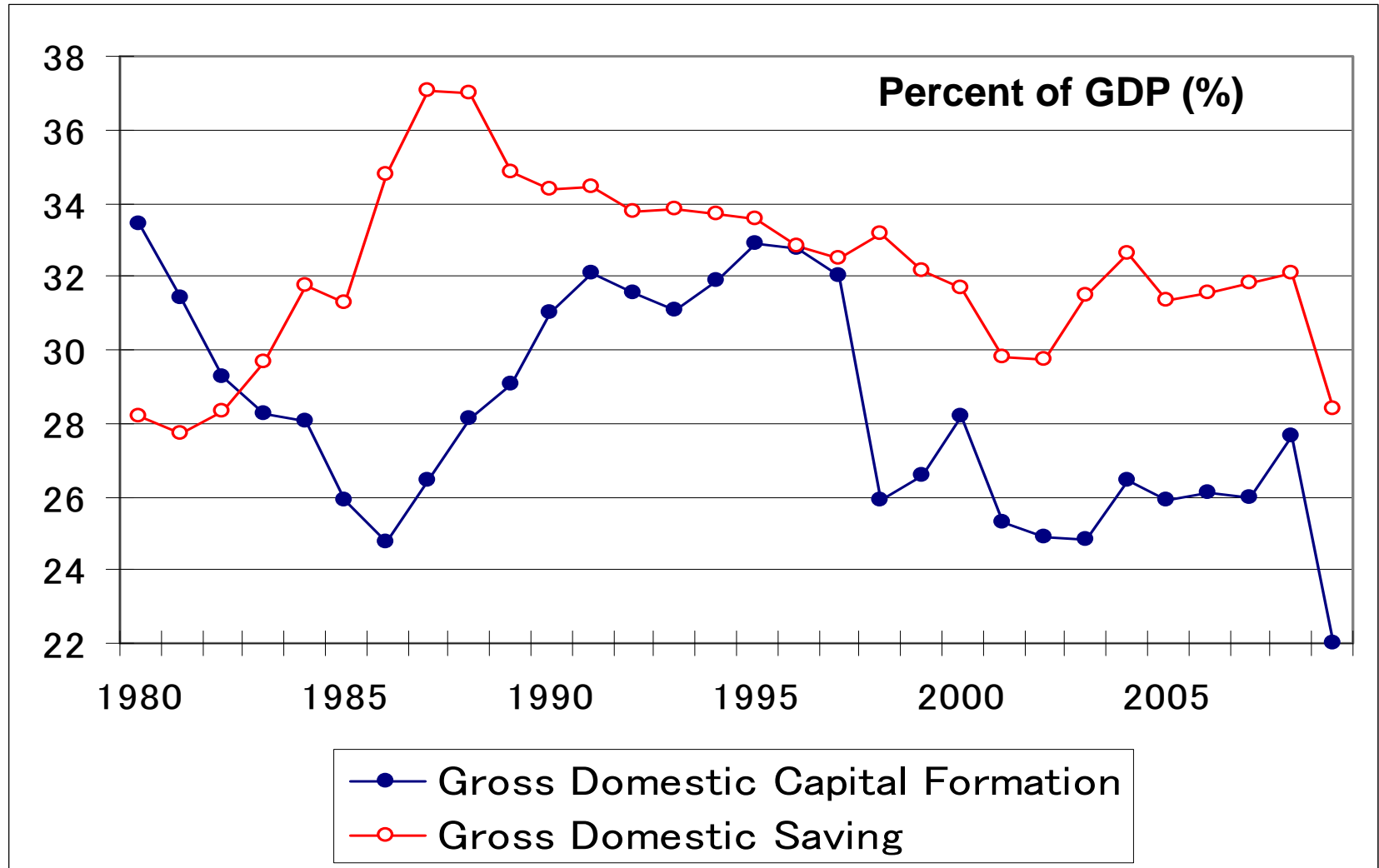
Savings and investment in Japan



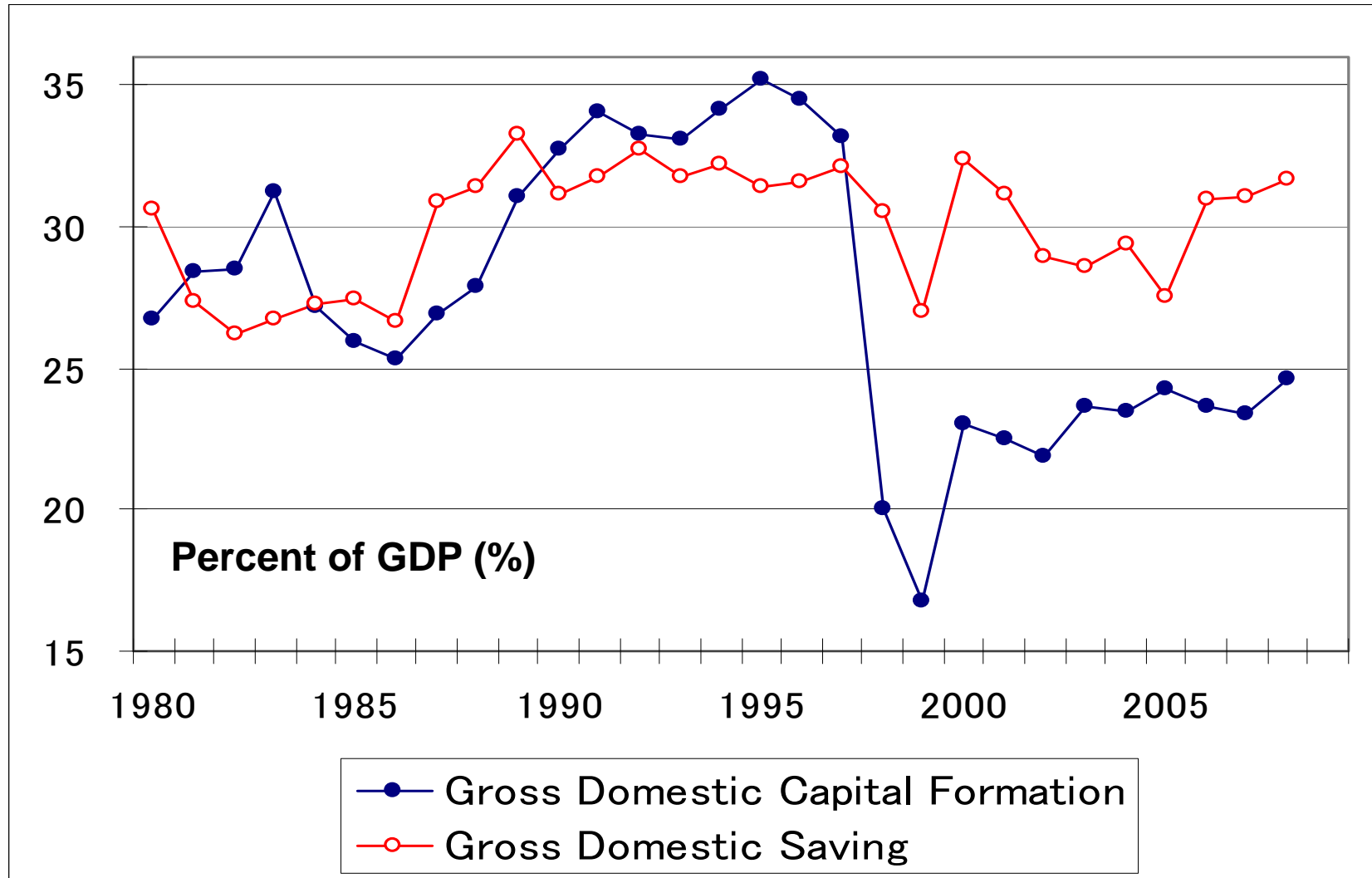
Savings and investment in China



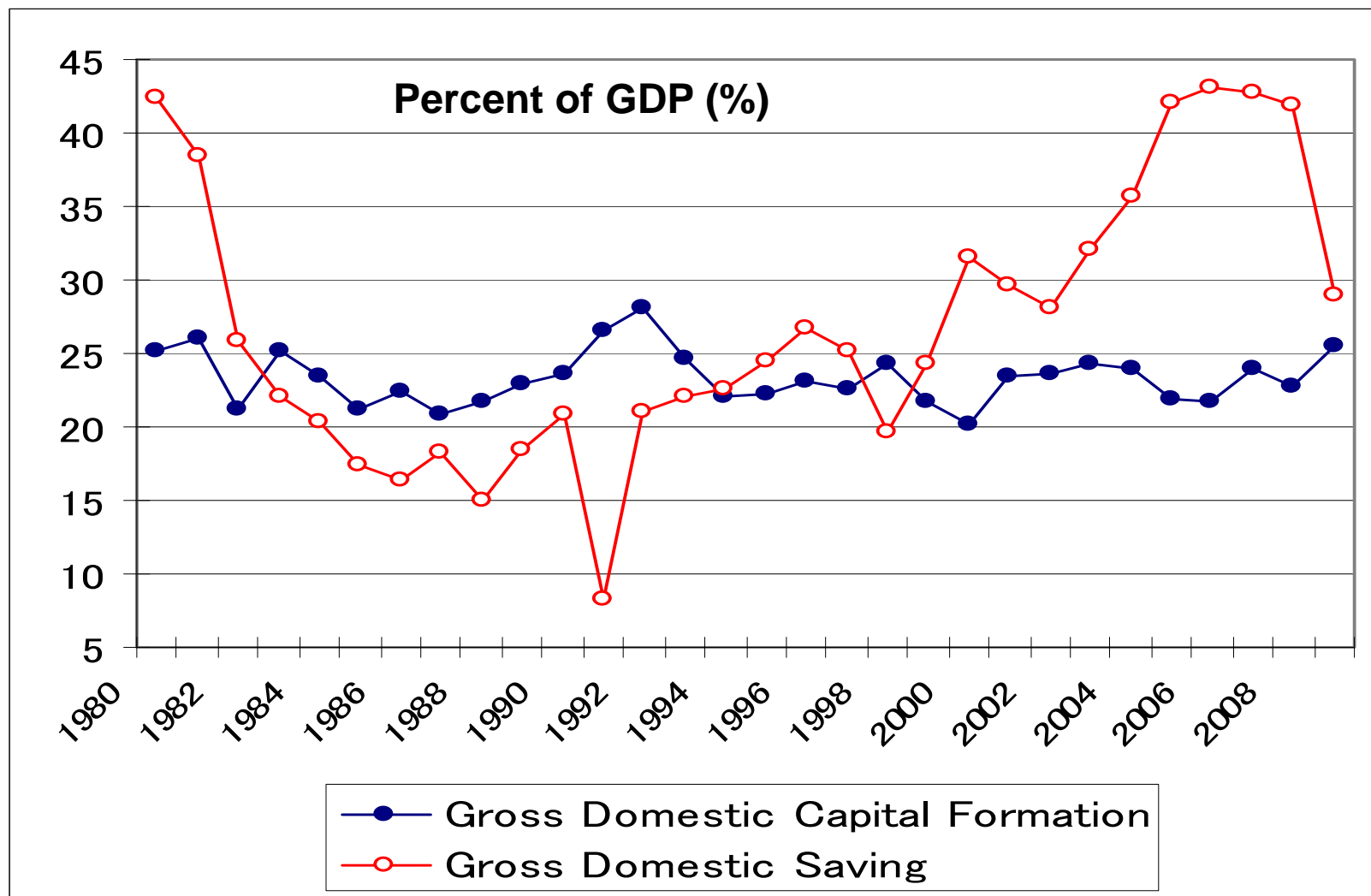
Savings and investment in Asian NIEs



Savings and investment in ASEAN-4



Savings and investment in Middle East



(2) The imbalance and the crisis: A causal link?

Two views of the causes of the crisis:

Policy mistakes in crisis countries (US, Europe)

- Failure of macroeconomic policy, particularly monetary policy, to contain a buildup of domestic financial vulnerabilities and systemic risk
- Flaws in financial regulation and supervision
- Weak global financial architecture

* IMF, “Initial Lessons of the Crisis for the Global Architecture and the IMF” (February 2009).

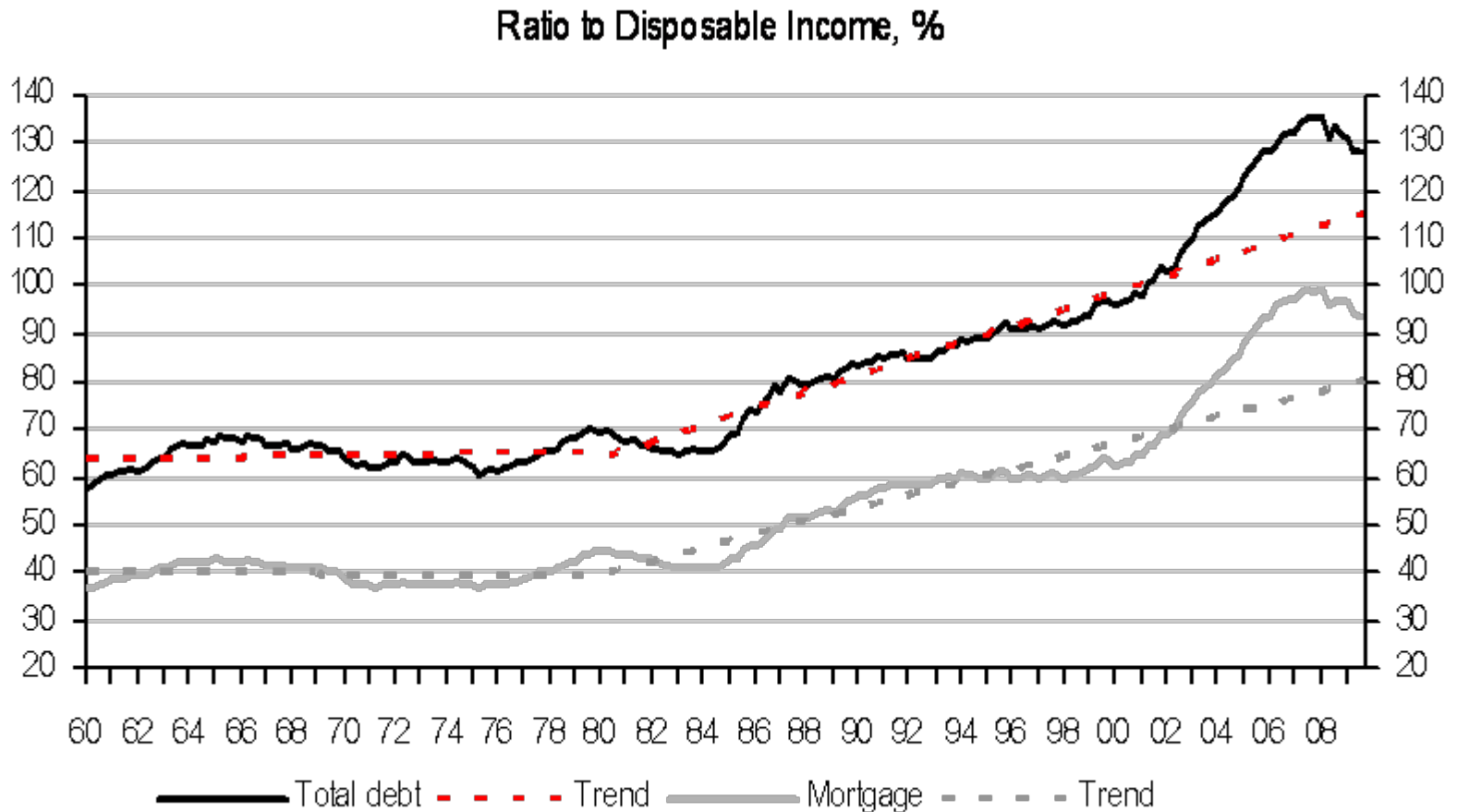
Global payments imbalance

- The arguments by Greenspan (“conundrum”) and Bernanke (“savings glut”) suggest that East Asia supplied ample liquidity to the US and kept the US long-term interest rate too low

The validity of the 2nd view is weaker:

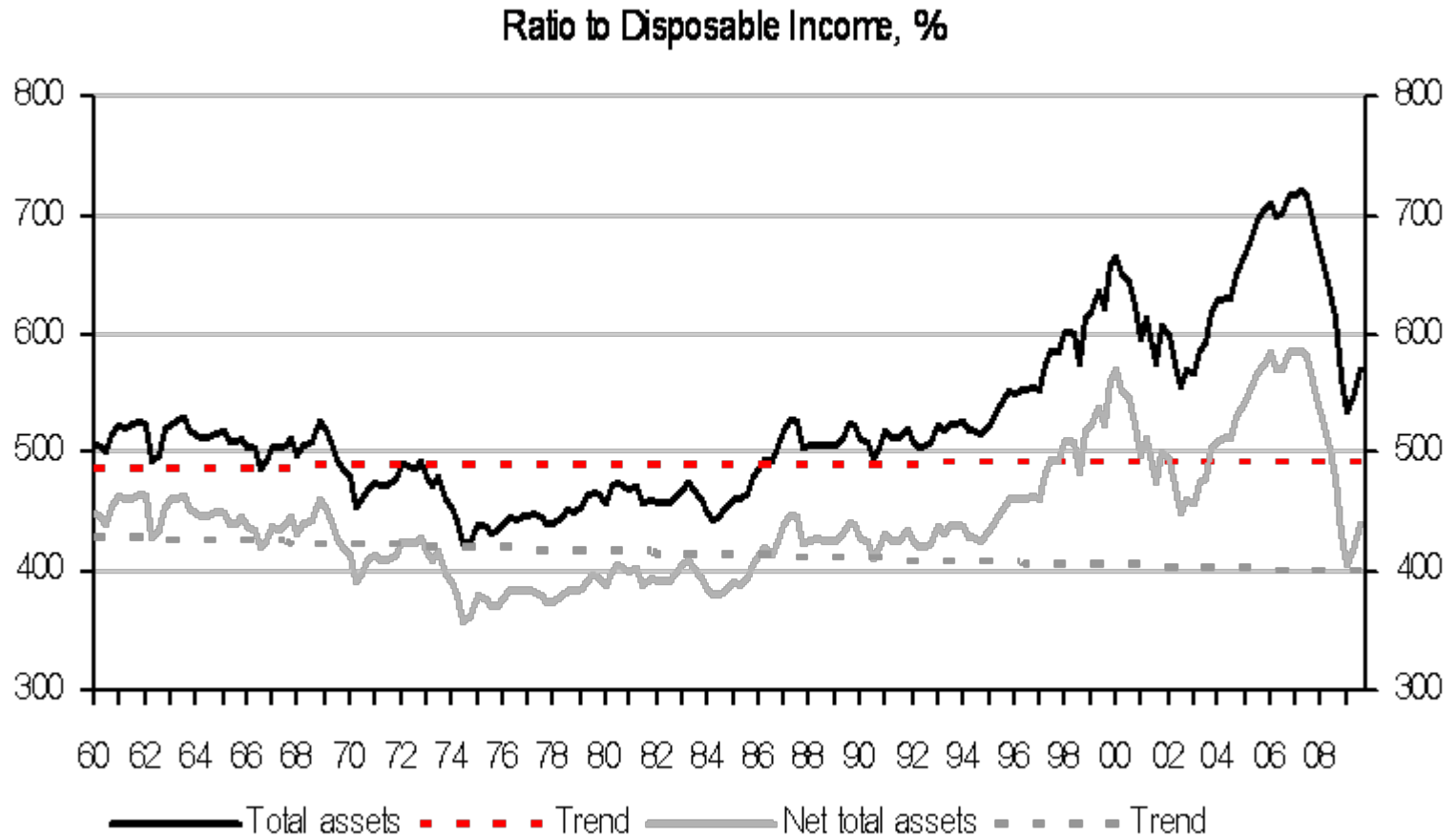
- The current account deficit was concentrated in the US while there were many surplus countries
- The financial crisis was concentrated in the US and Europe
- Not all countries had housing bubbles or crises (eg, Australia and Canada managed well)

US Household Debt Falling



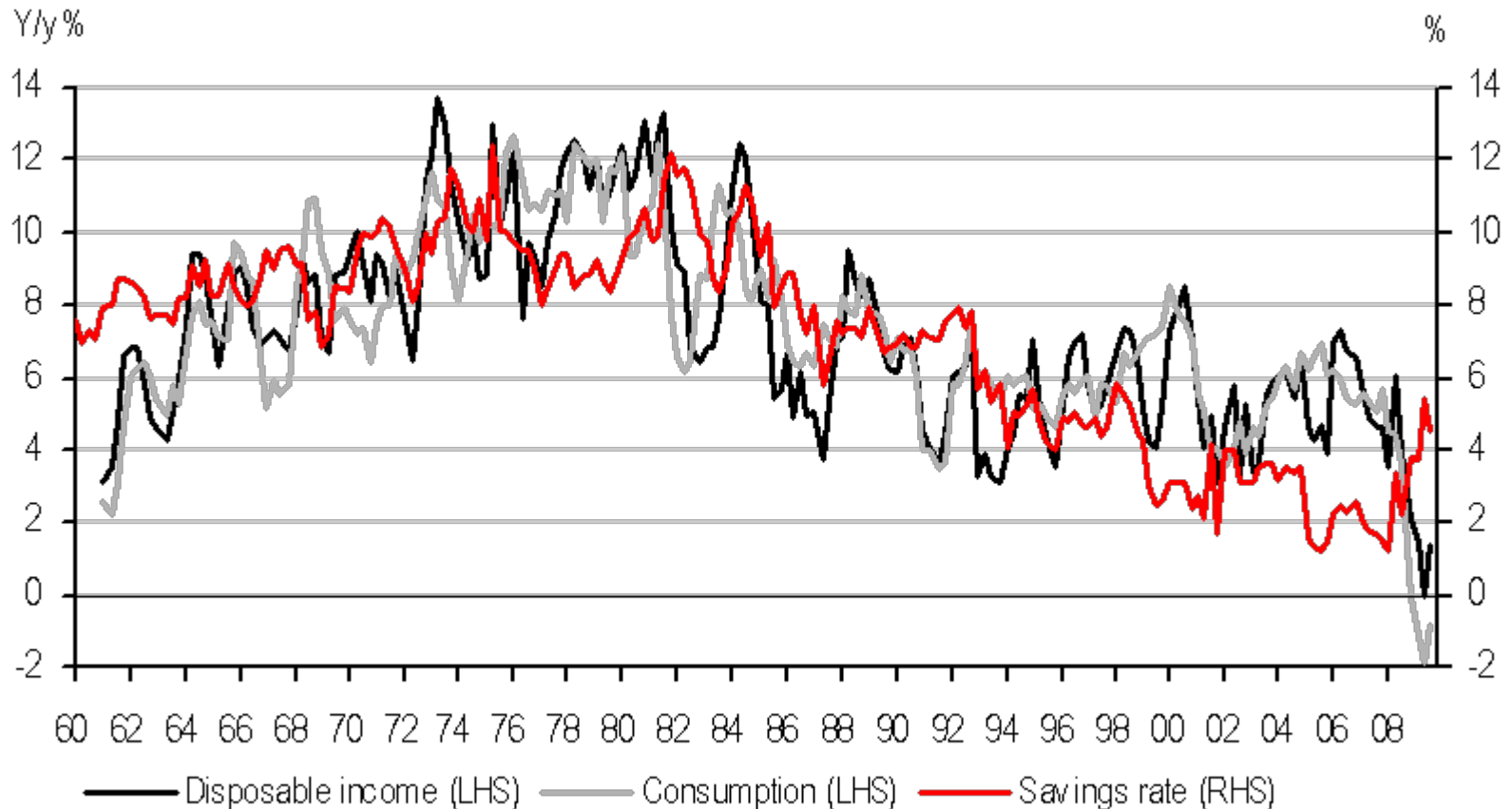
Source: US FRB Flow of Funds, US BEA

US Households Suffered a Massive Loss of Wealth, and Need To Rebuild Balance Sheets



Source: US Bureau of Economic Analysis

US Households' Savings Rate Needs To Rise, and Spending Slow



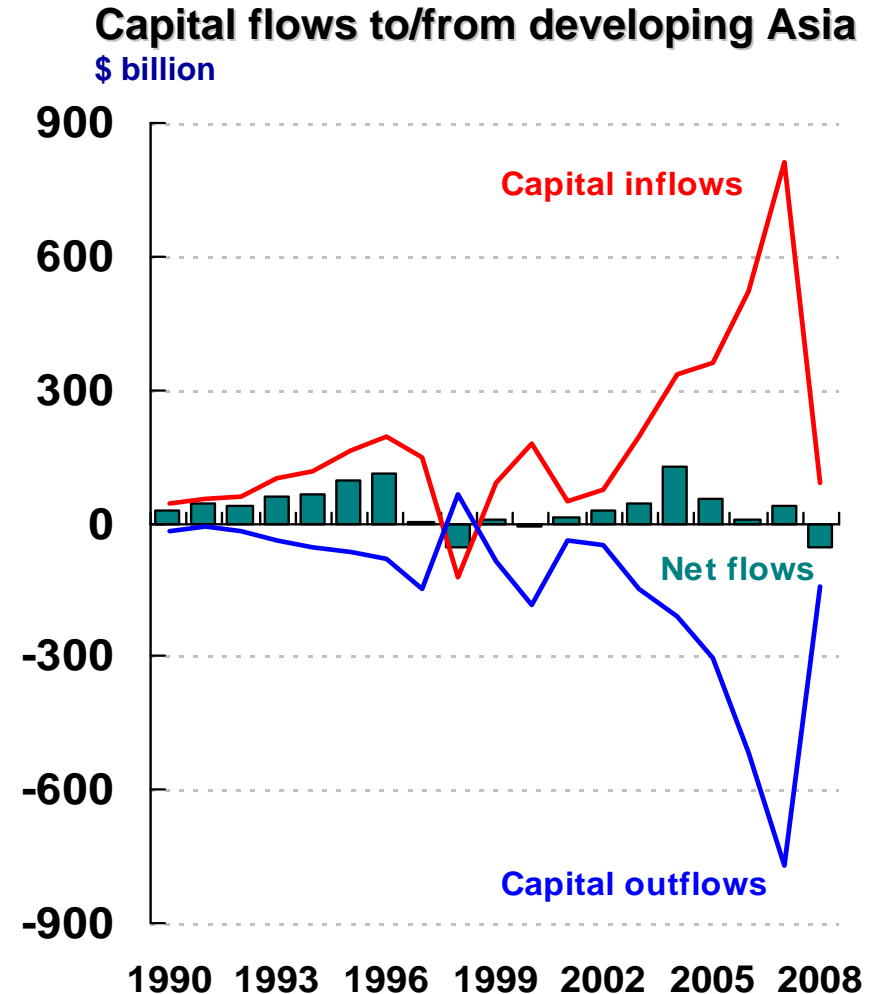
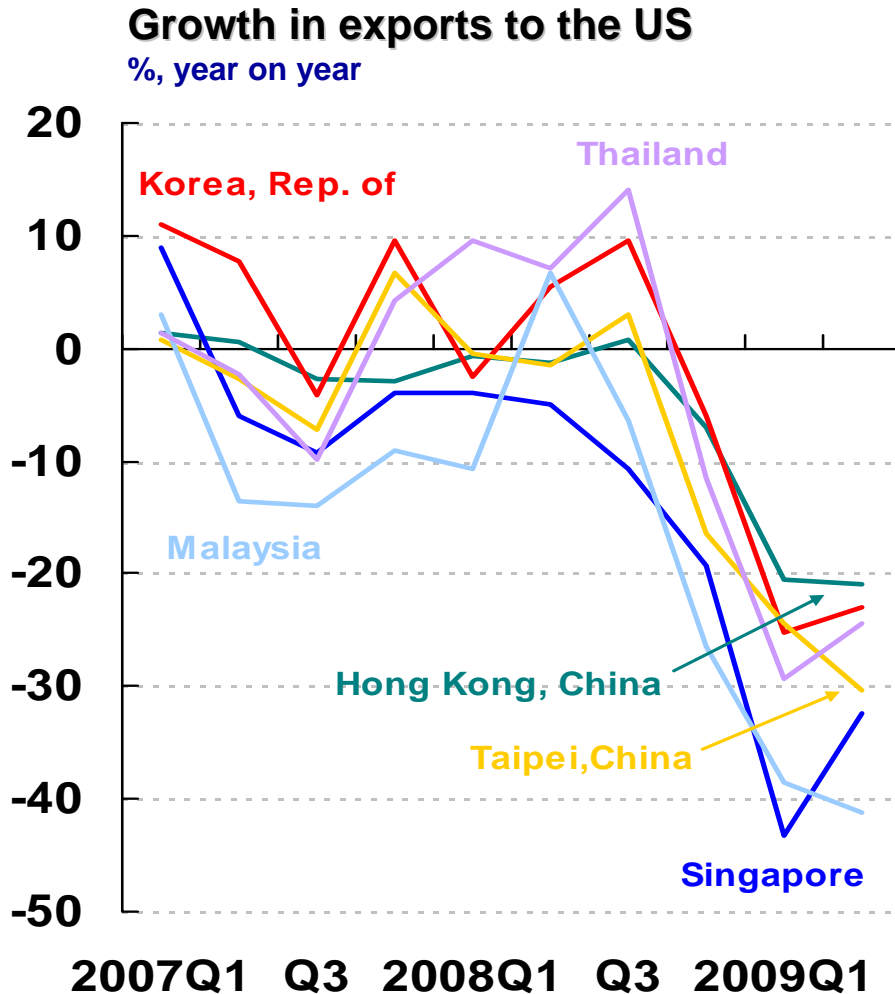
Source: US Bureau of Economic Analysis

Final demand for Asian exports still comes from the advanced economies

Final demand composition of Asia's export in 2006

Total Asia's exports = 100.0%					
Inside Asia = 51.8%			Outside Asia = 48.2%		
<i>of which to</i>			<i>of which to</i>		
final demand 16.5%	production 35.3%		final demand 23.2%	production 25.0%	
+	<i>of which to</i>		+	<i>of which to</i>	
	final demand inside Asia 15.1%	final demand outside Asia 20.2%		final demand inside Asia 0.9%	final demand outside Asia 24.1%
16.0%			44.3%		
=			=		
Total final demand inside Asia 32.5%			Total final demand outside Asia 67.5%		

Crises exposed risks of Asia's excessive dependence on US markets



2. Economics of Growth Rebalancing

CGE simulation study model assumptions

- Reduction of US consumption by 5% of GDP, which will induce US current account adjustment through real depreciation of the US dollar against the rest of the world
- US GDP potential growth declines by 1% point
- Exchange rate adjustment by non-US economies with constant bilateral real exchange rates among them, or exchange rate adjustment by East Asian economies only
- Current accounts endogenously adjusted
- Long-run full employment

Note: Kawai and Zhai (2009)

Evaporation of US consumption (together with US growth slowdown) induces trans-Pacific adjustment

	CA (change as % of GDP)	Terms of trade (% change) Real Eff Exch		Real private absorption (change as % of GDP)
China	-1.1	0.5	3.5	1.9
Japan	-1.9	3.3	4.7	2.9
Korea	-1.7	1.0	3.7	2.1
Taipei,China	-0.7	0.4	3.4	1.4
Indonesia	-1.2	0.5	3.6	1.6
MYS&SGP	-0.8	0.3	3.6	2.7
Philippines	-1.4	0.4	3.6	2.1
Thailand	-2.3	0.2	3.8	3.0
Vietnam	-1.5	0.8	2.9	0.3
USA	3.8	-6.1	0.0	-6.6

Asia's output adjustment differs across countries and sectors

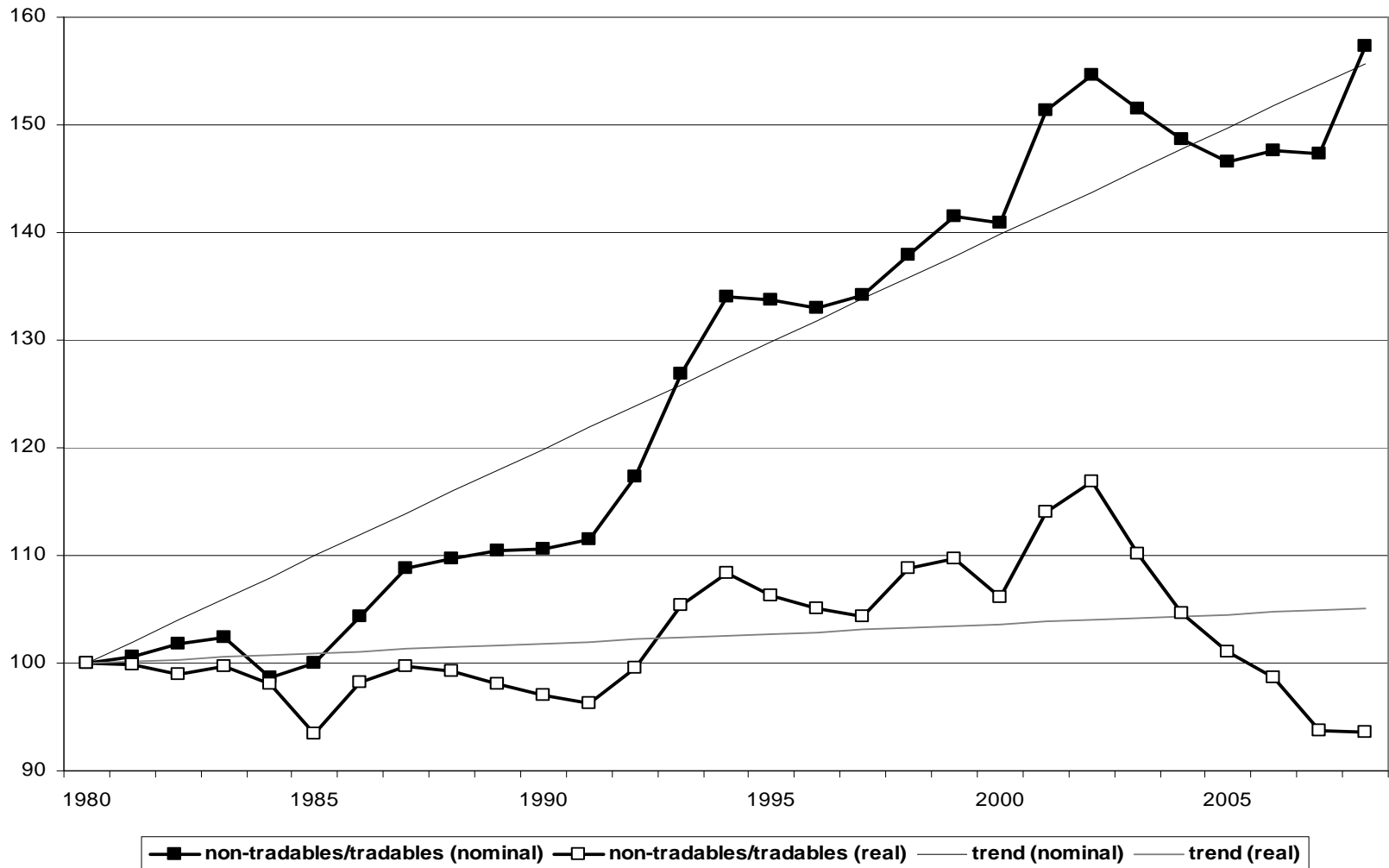
Percentage change in output

	East Asia	China	Japan	Korea	Taipei, China	ASEAN6
Agriculture	-0.8	-0.4	-1.7	-1.1	-1.1	-0.7
Manufacturing	-1.6	-0.7	-3.1	-1.2	-0.2	-0.4
Textile	-3.0	-1.8	-6.9	-5.2	-3.5	-4.0
Apparel	-3.9	-3.1	-2.8	-3.6	-4.4	-7.5
Vehicles	-3.1	0.5	-5.2	-1.7	-0.4	2.0
Electronics	-0.8	-0.3	-2.4	-0.7	0.9	0.6
Machinery	-1.0	0.2	-2.9	-0.6	0.5	1.2
Services	0.4	0.6	0.4	0.2	0.0	0.4

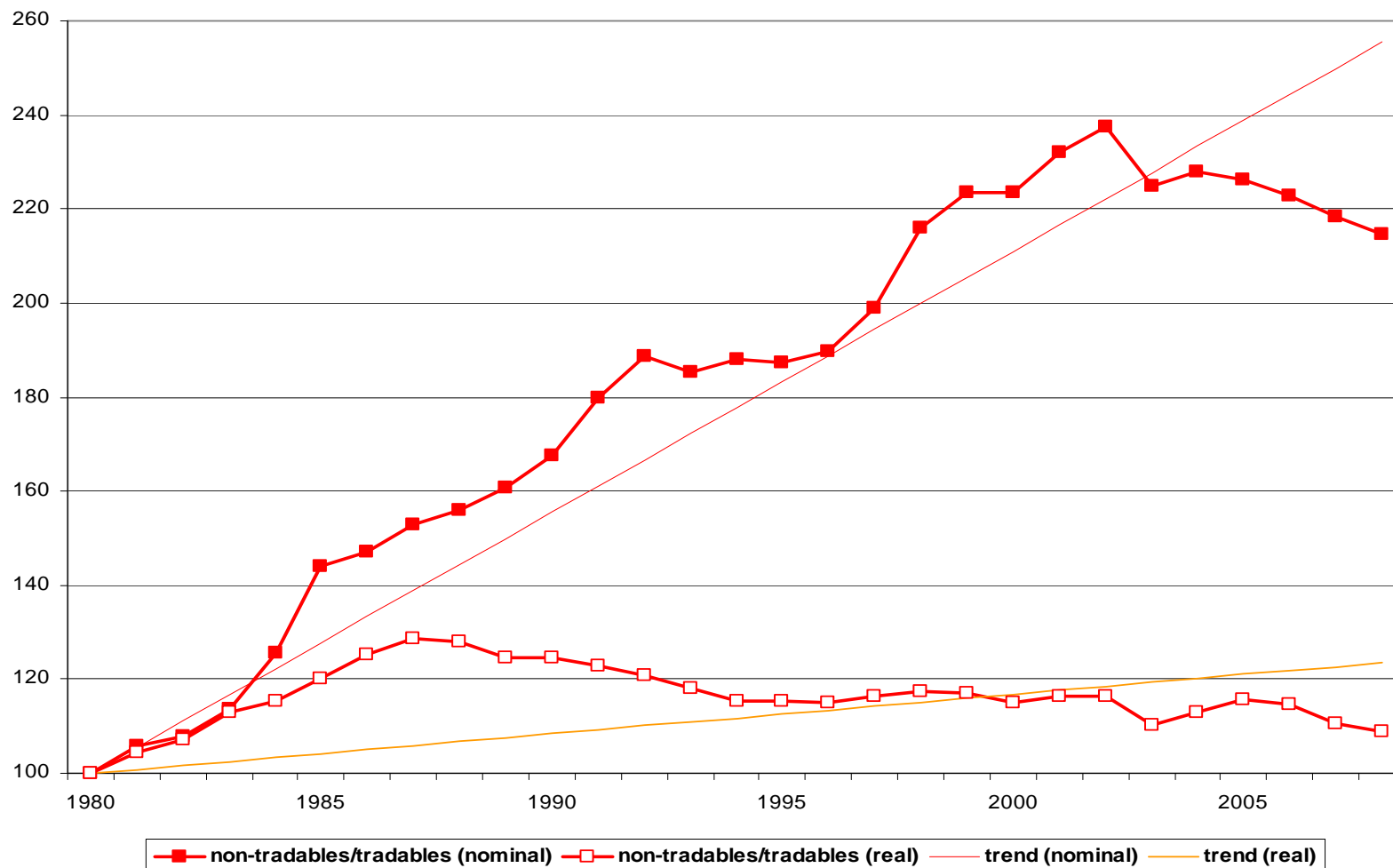
3. Policies to Rebalance Growth

- (1) Current imbalanced structure**
- (2) Supply side policy**
- (3) Demand side policy**
- (4) Regional cooperation and integration**

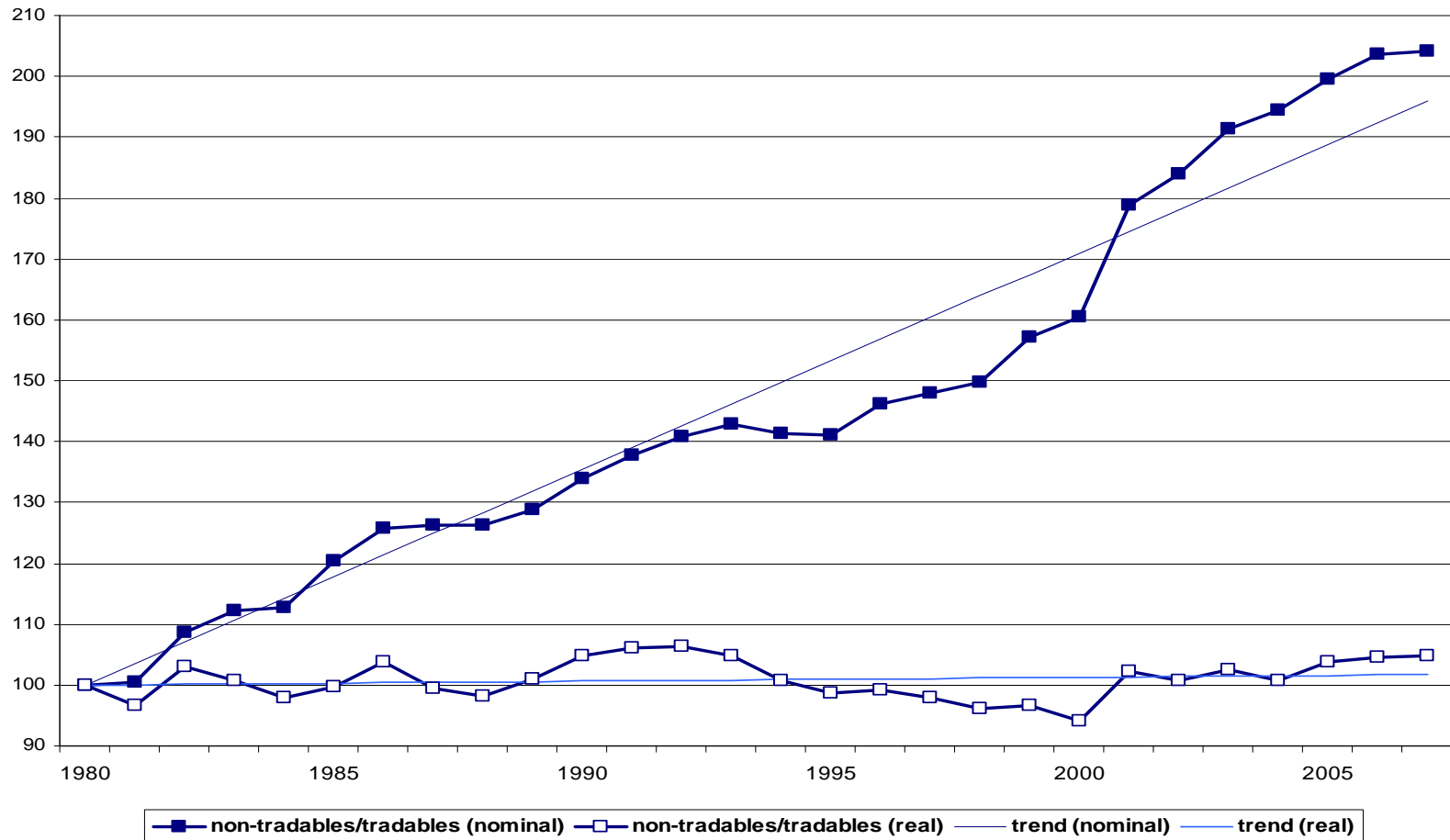
Japan's industrial structure recently shifted to the tradables sector



China's industrial structure has also shifted to the tradables sector



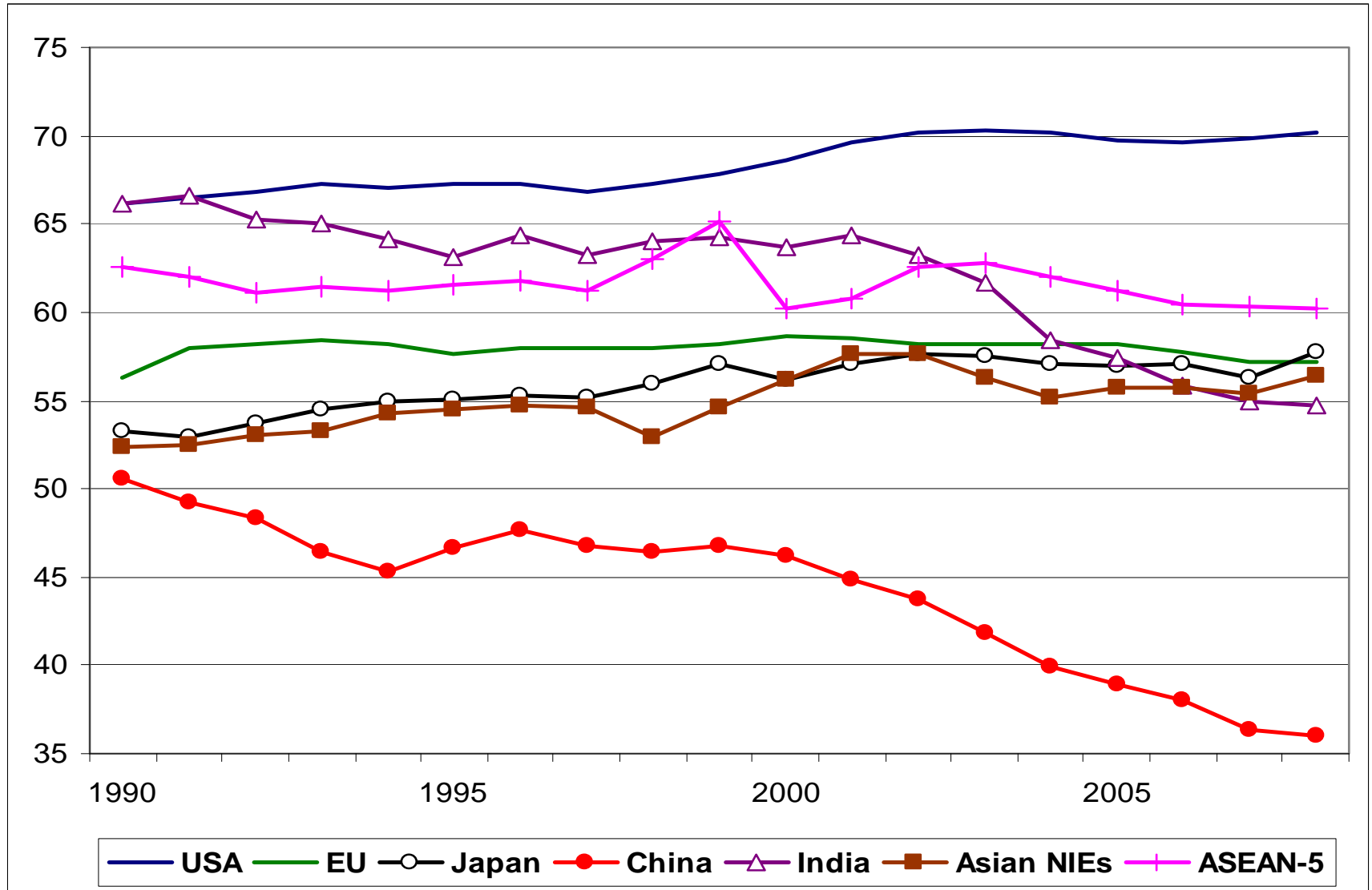
While the US industrial structure has shifted to the nontradables sector



(1) Supply side policy

- Deregulation of the nontradables sector (health care, education, social services) as to promote productivity growth
- Business supporting services with IT
- Reduction of domestic distortions in factor markets (energy, resources, labor, land, credit, etc) particularly in China
- Improvement of financial systems for better financial intermediation
- Promotion of the green industry (energy efficiency, clean energy, environment)
- Support of SME development & investment
- Investment in human resource development and knowledge

Asia's consumption/GDP ratios are low

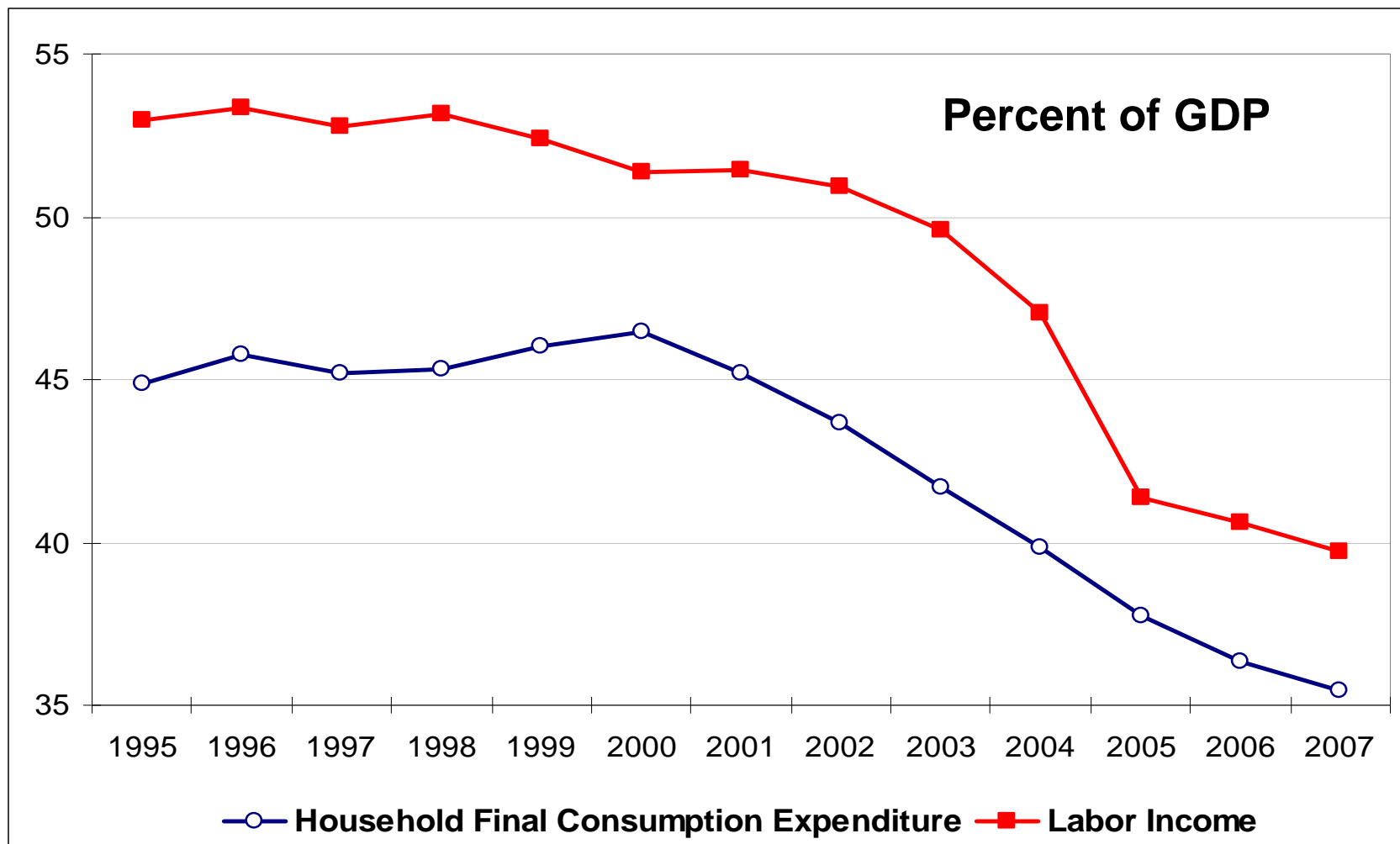


(2) Demand side policy

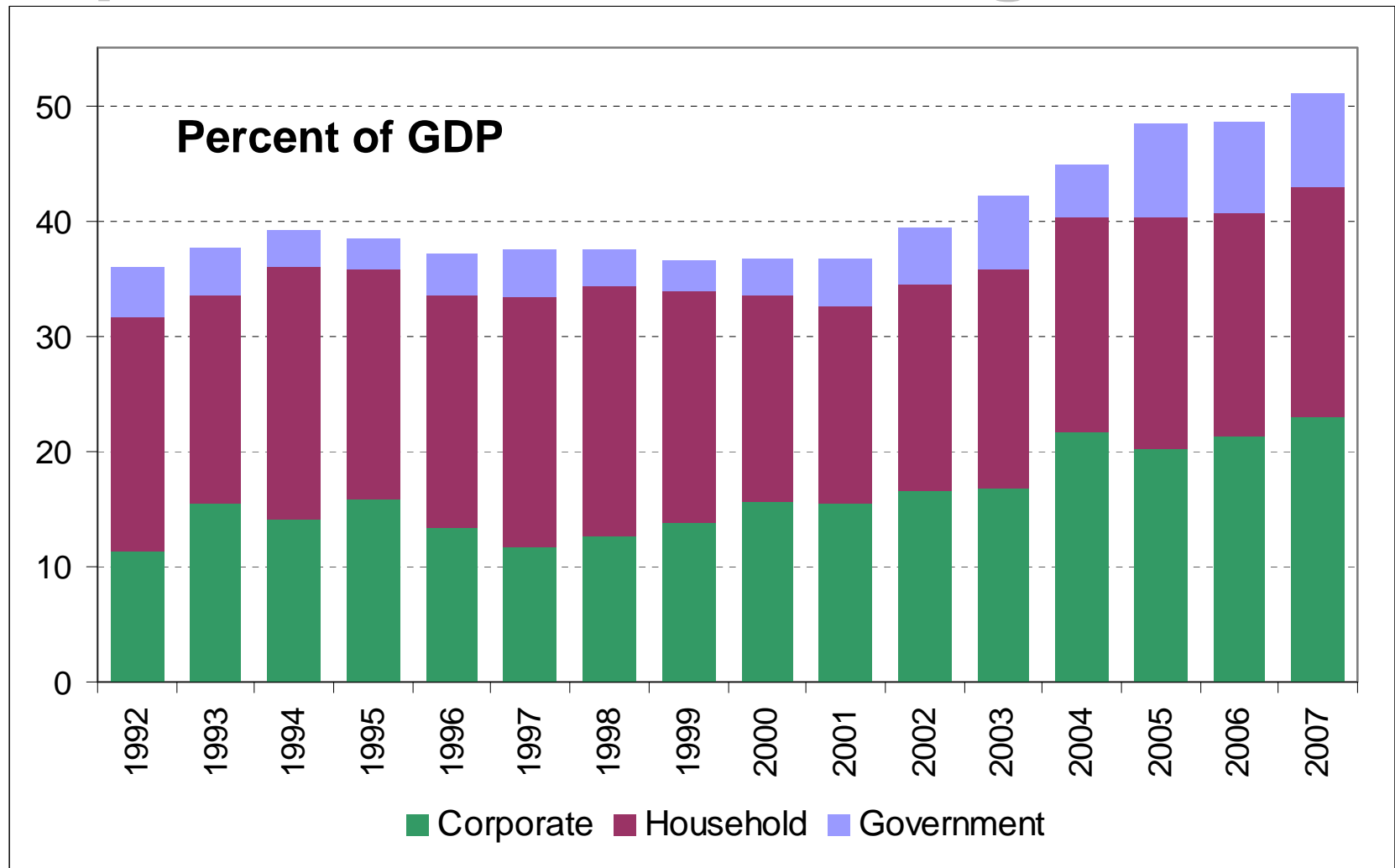
1. Stimulating household consumption

- Raising the level of household income (or discounted sum of life time income)
 - Redistribution of retained earnings (or corporate savings) towards households
- Raising the propensity to consume (time preference)
 - Redistribution of income towards low-income households whose propensity to consume is high
 - Strengthening of social sector protection to provide greater security thereby stimulating propensity to consume

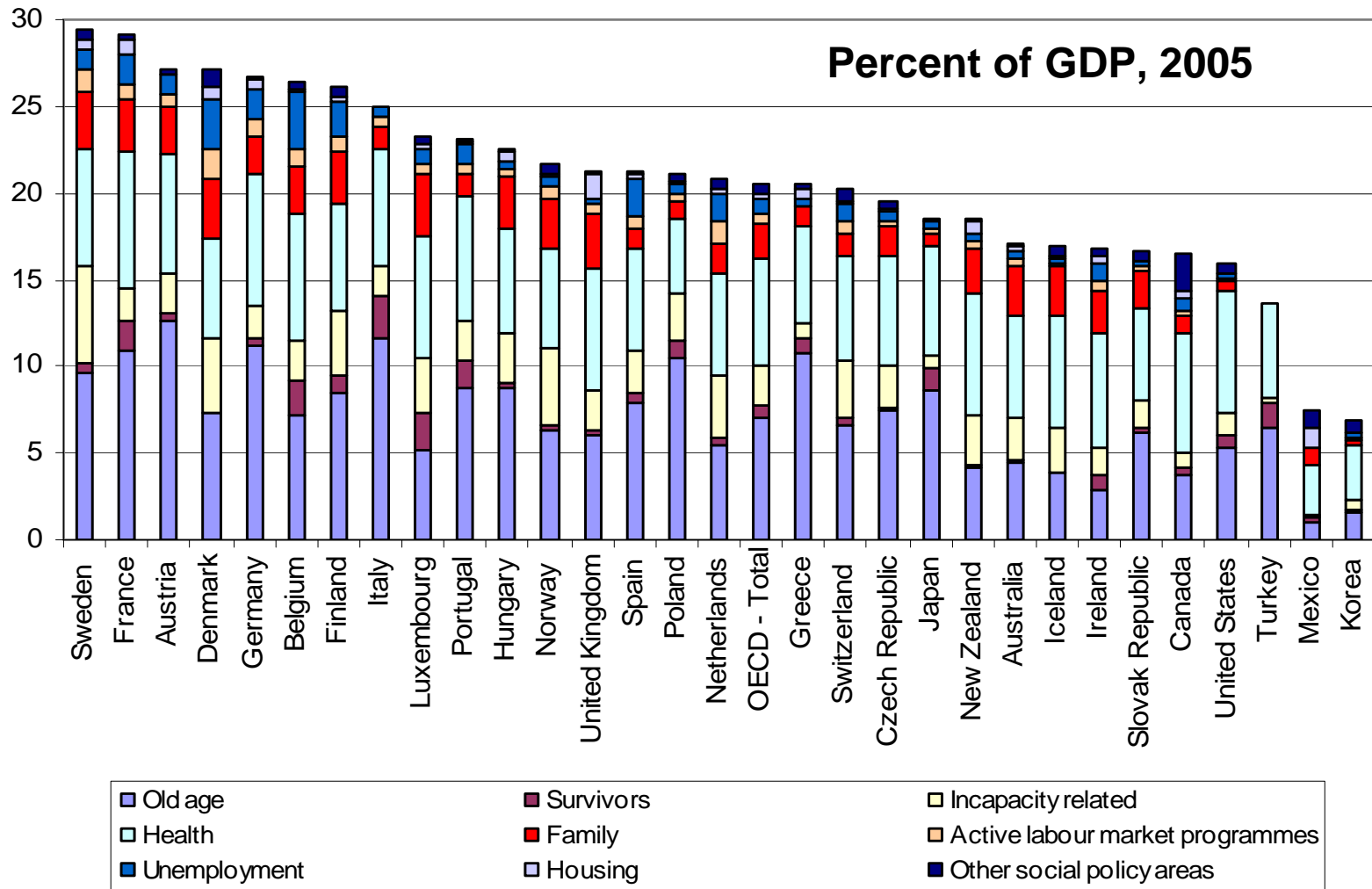
China: Labor income and household consumption



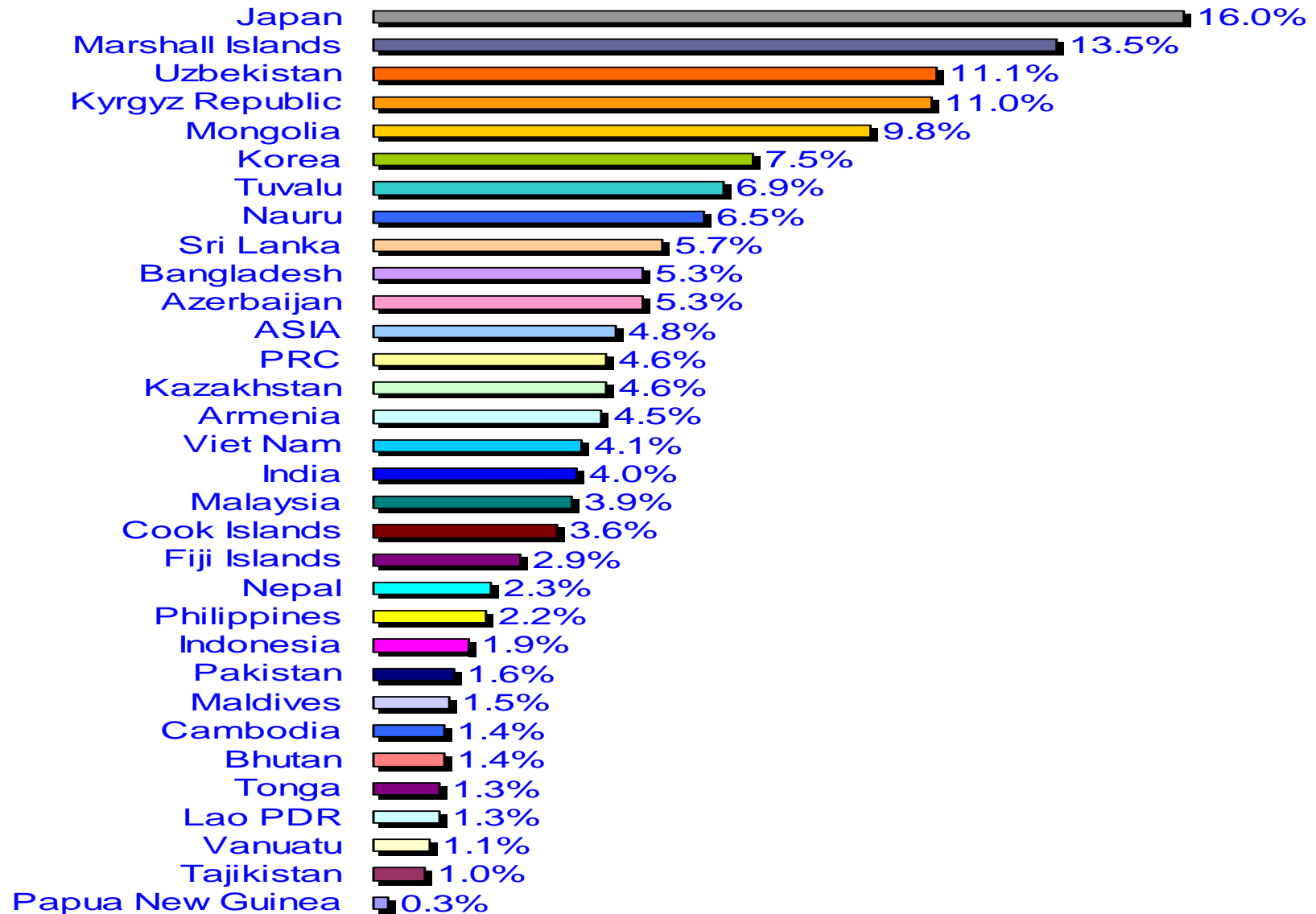
China: Distribution of savings among corporates, households & government



Social spending in Japan and Korea are low among OECD countries



Social protection expenditure as % of GDP



(2) Demand side policy

2. Promoting corporate & infrastructure investment

- Improvement of investment climate
- Infrastructure investment with public sector support (enhancing physical connectivity)
- Role for public private partnerships (PPPs)

Rebalancing growth

Stimulate demand for Asia's adjustment

- Large economies (Japan and China) must focus on domestic-demand driven growth
- Japan must develop its growth strategy by addressing the challenge of population aging and public debt, and focusing on green growth and cooperation with emerging Asia
- China needs to focus on social sectors (education, health and pension), rural sectors, the environment and energy efficiency
- India and ASEAN need to focus on investment through better investment climate and infrastructure investments

Many of these policies are consistent with the promotion of inclusive growth, environmentally sustainable growth

Inclusive growth

- **Inclusive growth** promotes access to opportunities for growth and spreads the benefits of growth more equitably among all people and businesses
- Social sector protection
- Support for SMEs

Environmentally sustainable growth

- Anti-pollution, anti-climate change
- Energy efficiency and conservation

(3) Regional cooperation & integration

A region-wide FTA

- ASEAN+3 or +6 FTA and investment area
- Liberalization and harmonization of investment rules

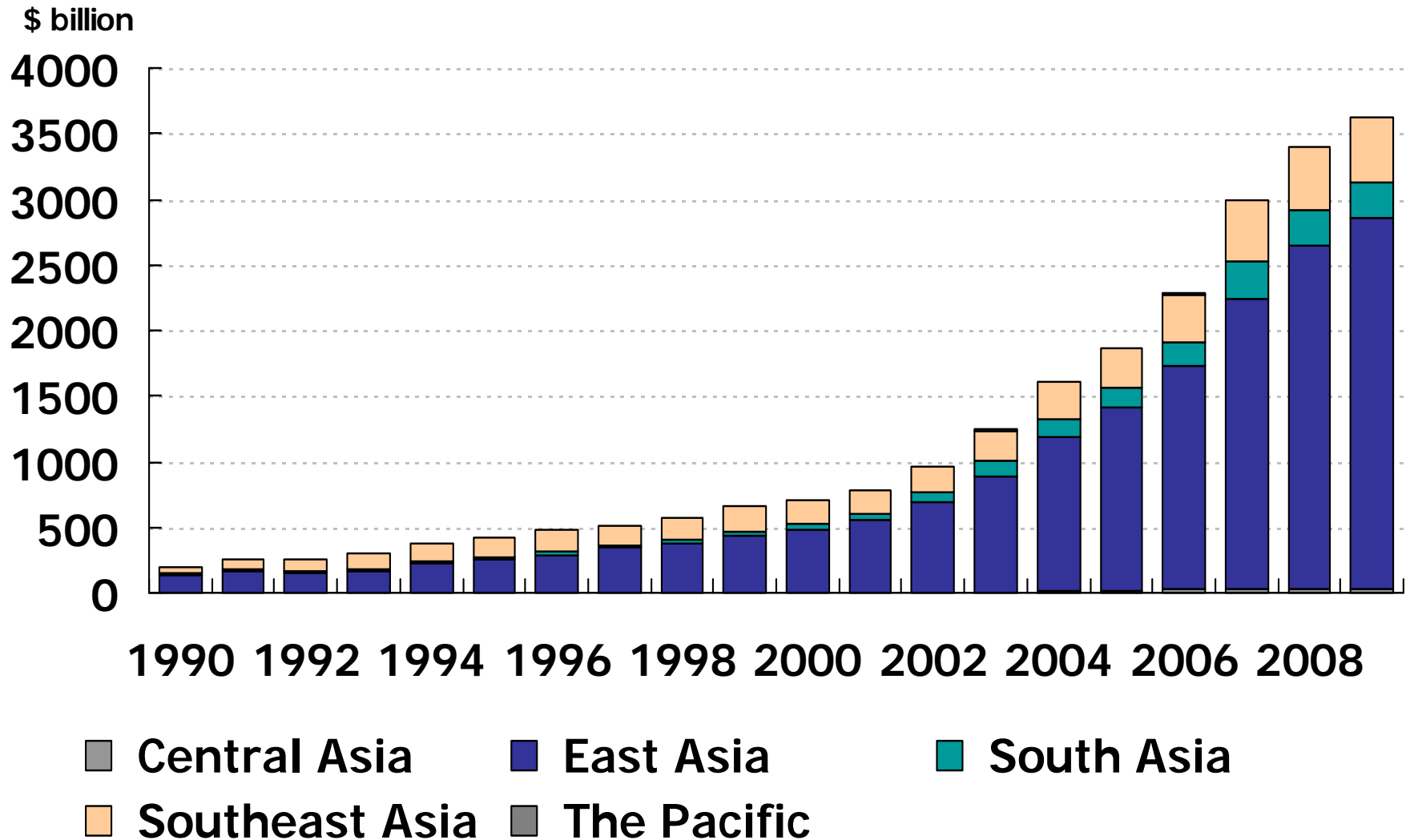
Financial market integration

- More efficient financial intermediation at the national level
- Regional financial intermediation through financial market integration (Asian Bond Markets Initiatives and Asian Bond Funds, including credit guarantee and investment mechanism)
- Macroprudential supervision and regulation

Financial safeguards

- East Asian economies are reluctant to go to the IMF because of the bad experiences during the 1997-98 crisis
- A credible CMIM (and eventually an Asian Monetary Fund) needed to convince East Asian economies to accept growth rebalancing
- An AMF will be created by putting in place CMIM, delinking it from IMF, and creating a professional secretariat
- It is key to enhance regional surveillance
 - Involve central bank governors in the ASEAN+3 process
 - Establish an independent, professional secretariat for CMIM
 - Establish an Asian Financial Stability Dialogue (AFSD)

Developing/emerging Asia has built sizable foreign exchange reserves



A case for collective currency appreciation

- A rise in the relative price of nontradable goods (and hence real exchange rate appreciation) is an important mechanism of growth rebalancing through current account adjustment
- The heightened economic interdependence in the region requires concerted exchange rate adjustment
- In addition, the rising inflows of capital into the region calls for more flexible adjustment of exchange rates to maintain domestic macroeconomic and financial sector stability
- A collective currency appreciation vs. the US dollar is effective in maintaining the relative currency stability within the region, promoting financial and macroeconomic stability, and facilitating growth rebalancing, while minimizing the loss of price competitiveness for each country

4. Conclusions

- The global imbalance was a factor behind, even though not a dominant cause of, the global financial crisis
- Nonetheless, East Asia needs to reduce imbalances as it cannot continue to rely on US and European markets, which requires new source of growth
- In the longer run, East Asia needs to develop a new growth paradigm:
 - (1) A shift away from external (US&EU)-demand driven growth to **domestic and regional demand** led growth
 - (2) A greater focus on **inclusive growth** (equity, access to opportunities)
 - (3) A greater focus on **environmentally sustainable growth**: a shift from a high- to low-carbon economy

Conclusions (cont'd)

- External rebalancing is a must for Asia to maintain stable economic growth, which requires structural reforms in both the supply and demand sides of the economy as well as closer regional policy cooperation in Asia
- Asia can seize this opportunity by also focusing on inclusive growth and environmentally sustainable growth
- Asia's exchange rate management will be key to not only growth rebalancing but also macroeconomic and financial system stability

Thank you

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