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AFTER THE PERFECT STORM: MAKING EAST ASIAN ECONOMIES MORE SUSTAINABLE

Session One of the 7th East Asia Congress was moderated by Ambassador Wiryono Sastrohandoyo, Senior Fellow of Centre for Strategic and International Studies (CSIS), Indonesia, and Ambassador Yoshiji Nogami, President of the Japan Institute of International Affairs (JIIA), Japan. The speakers were Dr Kim Chulsu, Chairman of the Institute for Trade and Investment, Korea; Dr Young Soogil, Chairman of Korea National Committee for Pacific Economic Co-operation, Republic of Korea; Ms Elena Okorotchenko, Senior Director, Standard & Poor's Ratings, Singapore; and Professor Emeritus Datuk Dr Mohamed Ariff Abdul Kareem, Executive Director, Malaysian Institute of Economic Research (MIER), Malaysia. **Susan Teoh**, Director of ISIS Information Services reports.

Dr Kim Chulsu noted that the East Asian economy has begun to show signs of a rebound since the second quarter of 2009. A number of forecasting institutions have revised upward the Gross Domestic Product (GDP) growth in emerging East Asian economies. Although the rebound may not have reached pre-crisis levels, there were strong signs of recovery in industrial production and exports.

and government debt. The region's well-capitalized banks and the much improved banking supervision helped to contain the contagion and the impact of the global recession.

Kim noted China's role in this economic rebound in East Asia. China's infrastructure-focused stimulus package, a surge in automobile production, and its strategic stock of new materials, have all boosted China's imports. This,



(From left) Elena Okorotchenko, Kim Chulsu, Ambassador Wiryono Sastrohandoyo, Yoshiji Nogami, Young Soogil and Mohamed Ariff Abdul Kareem

Economists have attributed this rebound to a combination of timely and large fiscal stimulus packages in East Asia. The early rebound was also a reflection of the resilience of the regional economy, with its solid macroeconomic fundamentals such as high foreign reserves, large corporate and private savings, and low corporate

in turn, contributed to the recovery of exports in other countries in the region. Korean exports also rebounded due to the China factor.

Although China was attributed to be the driving force of the current East Asian economic rebound, there are some negative effects of its

efforts such as wasted investment and high inflation. In the future, it is likely the Chinese authorities will consider 'exit strategies' to remove these negative effects.

China, however, will not be able to replace the US, the EU and Japan as East Asia's major export markets for some time to come. The East Asian economies continue to be dependant on these industrial markets for about three-quarters of their exports today.

In answer to the question of how East Asia can maintain its economic growth during this period of global recession, Kim suggested three major sources of growth. Firstly, the region must find a way to substitute external demand with domestic demand. The Chinese government was the first to recognize the problems of its investment-centered, industry and export-led manufacturing growth of the past. China made adjustments and introduced new measures to support private consumption as part of its economic stimulus package. These included tax breaks for automobiles, subsidies for electronic product purchases, increases in pensions and a new health reform programme. Similarly, other East Asian countries introduced various schemes to stimulate their own domestic demand.

A second source of growth for East Asia is the services sector. This sector has been underdeveloped because of the traditional bias towards the manufacturing sector. However, the share of the value-added services to GDP has risen slowly in the region as a whole. An example can be seen in South Korea where the services sector accounted for half of the increase in Korea's real GDP.

Regional economic integration is the third

source of growth. Intra-regional trade has increased rapidly in the last three decades, and it has now reached a level which surpasses that of Nafta. This has been largely due to market forces and production networks in the region.

In addition, a significant number of new regional trade agreements have either been signed and implemented, or are under negotiation. Kim noted that the current crisis appears to be a catalyst for strengthening regional economic integration, whereas East Asian regionalism was the driving force for the 1997-98 Asian financial crisis. According to the database of the Asian Development Bank, as of June 2009, 49 regional trade agreements were under implementation, ten new agreements were signed, and 54 were under negotiation with the countries of Asean Plus Six.

... any region-wide arrangement without co-operation and accommodation among China, Japan and Korea would be unthinkable

He concluded by stating that though Asean will remain the anchor, any region-wide arrangement without co-operation and accommodation among China, Japan and Korea would be unthinkable.

Dr Young Soogil focused his remarks on the challenges of structural reforms, and on the G20 and East Asia. The global financial crisis has demonstrated that East Asia's export-led growth model is no longer sustainable. While the growth of exports from East Asia to the US has hinged on high private consumption demand in the US, this

demand is being financed largely by the continuing inflows of foreign capital, especially from China and other East Asian economies, and sustained by persistent current account imbalances across the Pacific. These capital inflows to the US, together with lax financial supervision, brought about the global financial crisis.

In view of this global crisis, Soogil stressed that East Asian countries would have to 'rebalance their growths, shifting to a new, region-led growth paradigm in which growth engines are found within the region as well as in respective national economies.' Such a shift requires a complex array of structural reforms. He suggested the following:

1. Increasing domestic aggregate demand by increasing household incomes through deregulation of labour and other market factors, increasing incomes and other support, such as education and housing for low income people, and discouraging precautionary savings through enhancement of social safety nets such as health care, unemployment insurance, and pensions.
2. Switching demand from the tradables sector to the non-tradables sector, especially services, through real exchange rate appreciation, and extending market-oriented reforms to the services sector.
3. Investing in the development of new growth engines such as the silver industry, tourism, 'conversion technologies,' 'green technologies,' etc.
4. Real exchange rate appreciation through flexible adjustments in the nominal exchange rate, coupled with increases in domestic demand.
5. Creating new growth engines which can be carried out more effectively as regional initiatives such as:
 - 'Connected Asia' -- through strategic investment in infrastructure for connectivity;
 - Greener Asia -- through investment in infrastructure for adaptation to climate change;
 - Secure Asia -- through building programmes in education, health, and social safety nets;
 - Innovative Asia -- through investment in technology and reforms to improve financing and other business environments for SMEs; and
 - Market integration through a region-wide FTA and other arrangements that will help increase regional demand and facilitate the development of new growth engines.

The structural reforms suggested above could be undertaken effectively in co-ordination, and in conjunction with, the concomitant structural reforms undertaken by the US and other chronic current account deficit countries.

G20 Summit

Soogil stressed the importance of the G20 Summit which has brought together those economies that account for more than 85 per cent of global production. These economies could work together in order to play the leading role in promoting global efforts. That was why two meetings of the G20 Summit have been scheduled for 2010 and thereafter annually.

The G20 Summit can be seen as the 'premier forum for international economic co-operation' because nearly half of the members are from Asia Pacific. These include the six Asian countries of China, Japan, India, Korea, Indonesia and Australia. The large representation from Asia signifies 'recognition of the global power shift from West to East,' particularly to East Asia.

The coming G20 Summit, to be held in Seoul, South Korea, from November 13-17, 2010, will have great significance as it will be the first in which an Asian country will be the host. The success of this global endeavour to launch strong, sustainable and balanced growth will depend critically on East Asia's ability to take the global structural reform agenda to the Seoul G20 Summit, as well as exercising leadership in implementing the agenda.

Ms Elena Okorotchenko gave an overview of Standard & Poor's (S&P) use of sovereign ratings (SR) in the region. The SR of Asia in 2009 was quite mixed. By December 2009, most of the Asian countries had shown positive SR except for five countries, in particular Thailand and Vietnam, which had negative SR.

Okorotchenko stressed that the speed of recovery of the US and Europe will have a great impact on Asia. The global economic slowdown has affected Asia as domestic demand was not sufficient to compensate for a reduction in exports, especially to US and Europe. There was a sharp fall in GDP growth in the high-value manufactured export reliant countries of Asia. Corporate defaults have also risen, while Non-Performing Loans (NPL) have grown modestly, except for Malaysia, where NPL has declined.

S&P suggested that Asia's growth could pick up from 2010, but it will not be able to reach pre-crisis levels. The region would still be dependent on government stimulus packages for recovery. These would include the easing of central banks' monetary policies, fiscal stimulus packages, and increasing government debts.

For the SR to be able to sustain these kinds of economic stimuli, one approach would be to have 'exit strategies.' The timing of these strategies would be very important as there can be a high possibility of exiting too late or too early. It is also important to set in place medium-term strategies for fiscal consolidation and debt reduction.

With the introduction of stimulus packages, the external position of Asia has remained stable. Signs of this include the lowering of imports, low levels of external debt with some exceptions, rising or stabilized foreign exchange reserves after a modest reduction, and external liquidity remaining moderate in credit strength.

However, Asia has had to deal with some pressure in relation to the appreciation of Asian currencies. These include the question of protectionism with regards to capital flows or trade, complications in monetary policy, exchange rate and reserve management in Asian countries, and the new challenges of coordinating currency appreciation strategies with trading partners.

Okorotchenko highlighted the economic situation in Malaysia. In June 2009, the sovereign rating of its foreign currency was A-, while that of its local currency was A+. Though Malaysia's economy was hit by the sharp global economic

decline, loan quality has not deteriorated and absolute NPLs have continued to decline.

The 2010 Malaysian budget could reduce the fiscal pressure. The government's target for a fiscal deficit of 5.6 per cent in 2010 was a significantly reduced one compared to the 2009 estimate of 7.4 per cent. There were plans to structurally improve expenditure, and to cut subsidies for fuel, food and education by 15 per cent. Malaysia's SR is likely to depend on how quickly growth recovers, how feasible the fiscal consolidation plans are, and how quickly these are implemented.

In her conclusion, Okorotchenko noted that Asia seemed to lean towards a positive bias in its SR. Asia's structural reforms will remain a key factor in the medium term. The structural reforms -- reforms in the financial sector and service sectors, fiscal and labour reforms, public sector and administrative capacity reforms, development of domestic capital markets and strengthening of domestic demand to create alternative export-led growth and regional integration -- will be the drivers of sovereign ratings for Asia.

Dr Mohamed Ariff gave an initial overview of the economic situation of East Asia before the crisis, before raising issues affecting the region's economies with the global downturn.

The growth strategy of East Asia has been export-led, focusing on the US market. Savings are very high -- about one third of GDP is saved. Most East Asian countries have enjoyed large current account surpluses, with some larger than 20 per cent of their GDP. East Asian reserves are about US\$13 -14 trillion and East Asia has been recycling this surplus to finance US deficits. The

US is continuing its deficit and continuing to import from East Asia and in so doing, is helping to keep the dollar strong.

The key lessons learnt from this crisis will enable East Asia to chart a new course of action. One of the lessons to be learnt is to avoid excessive financial exposure (although East Asia has not been exposed much, as revealed during the last crisis). Another lesson is to reduce market concentration -- some East Asian countries have been relying very heavily on the US market. Thirdly, East Asian countries have to build up the 'dollar trap' as it is important to have a strong dollar to protect their reserves and competitiveness. Fourthly, there is a need to check and rectify global imbalances, thus strengthening domestic economies.

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Ariff proposed a few options for East Asia in the face of the global crisis. The first option is for East Asia to stop going in the same direction as before, wholly dependent on the US market, because the US will not consume as much as before. As can be seen, some re-balancing has taken place in the US. Their savings have increased from 2 per cent to 6 per cent of GNP, while their current account deficits came down from 6 per cent to 5 per cent. The US will consume less, save more and import less, which in turn means that East Asia will export less to the US.

The second option is for East Asia to make a U-turn and look inward. This option is suicidal. To be inward looking and self-dependent is a retrogressive step for East Asia.

The third, more viable, option is for East Asia to stay outward-looking, but with a distinct difference. Currently, much of East Asia's investments abroad are outside the region. East Asia has to learn to invest its savings within the region, instead of trying to finance current account imbalances elsewhere, and exporting to these countries. Investing in East Asia, in the process creating a demand, and expanding regional demand, as well as creating employment, will make East Asia a region of growth. It should stay focused in the region, though not at the expense of the rest of the world, because the rest of the world is still important to East Asia.

US and European joint consumption is estimated to be about US\$ 20 trillion whereas Asian consumption is only US\$ 5 trillion. East Asia will continue to need a large external market. It is therefore imperative that East Asia remains outward-looking, but with changes in the direction and composition of its external market.

Finally, Ariff suggested some regional initiatives for East Asia while still participating in the global economy. Many regional initiatives are already in existence such as Asean, Asean Plus Three, East Asia Summit (EAS) and Apec.

East Asia has to be borderless to facilitate trade and investment flows. Although many FTAs have been signed, the FTAs actually act as barriers to trade because there are too many exemptions, and the rules of origin are too rigid, leading to higher transaction costs. East Asia may

need to harmonize and standardize the rules of origin in order to expedite flow of goods and services within East Asia.

Another initiative Ariff proposed was that of expediting integration of the highly segmented financial market. Policy driven initiatives in East Asia are necessary to support market-driven forces so that East Asia can be a viable entity on its own.

Finally, Ariff suggested that a coordinated exchange rate policy is important for the East Asian region to avoid a situation of one country within the region negating another country's effort in market intervention. Such a regime may assist in stabilizing East Asian currencies. The Asian Monetary Fund (AMF) may perhaps be the future of East Asian financial stability.

FINANCIAL COOPERATION AND THE FUTURE OF THE DOLLAR IN EAST ASIA

The second session of the East Asia Congress tried to address the future of the coordinated exchange rate regime in view of reduced US dollar influence. The session started with presentations from Masahiro Kawai, Dean and CEO of the Asian Development Bank Institute, Yi Jong-goo, the Standing Commissioner for Financial Services Commission, Republic of Korea, and Professor Augustine H.H. Tan of Singapore Management University. The moderators for the session were HRH Prince Samdech Norodom Sirivudh, Member of Parliament and Chairman of Board of Directors, Cambodian Institute for Cooperation and Peace, and Wang Yuzhu of the Department of Regional Cooperation Studies Institute of Asia-Pacific Studies, Chinese Academy of Social Sciences, China. ISIS Researcher **Nor Izzatina Abdul Aziz** reports.



(From left) Augustine H.H. Tan , Masahiro Kawai, Samdech Norodom Sirivudh, Wang Yuzhu and Yi Jong-goo

Masahiro Kawai began by establishing the role of the US dollar in the international monetary system, and then spoke on the reform options for the international monetary system in view of the weakening influence of the US dollar. In the second part of his presentation, Kawai dwelt on the challenges in international financial cooperation, and the exchange rate regime for East Asia.

The reduced influence of the US dollar as the dominant currency in the international monetary system, beginning in the 21st century,

calls for a reform, especially as the actions of the issuer of the US dollar, the Federal Reserve, have leaned towards domestic concerns rather the world's. To avoid the world being held hostage to the whims of the Federal Reserve, several propositions have been mooted. Among them are:

- a) Introduction of a world single currency system (Cooper 1987);
- b) Introduction of a Special Drawing Rights (SDR) standard (Zhou 2009);

- c) Introduction of a multi-polar key currency system (Bergsten 2007) ;
- d) Improving the current condition of the US dollar standard.

The proposition by Richard Cooper in 1987 centred on the establishment of a common currency for all industrial democracies, with a common monetary policy and a joint Bank of Issue to determine that monetary policy. The Central Banker for the Republic of China, Zhou Xiaochuan, in the meantime proposed enhancing the IMF's SDR as a super-sovereign reserve currency by increasing SDR allocation for members. With a broad SDR role, it should be able to satisfy fully the members' demand for a reserve currency.

C. Fred Bergsten of the Peterson Institute for International Economics later extended Zhou's suggestion by suggesting that US dollar reserve holders can have a separate International Monetary Fund (IMF) account for SDR and the SDR be denominated in a basket of currencies that can be 44 per cent dollars, 34 per cent Euros and 11 per cent each of yen and pound sterling. However this idea would not have been effective without the weight of the Yuan being placed in the basket.

Currently there are three pillars of financial cooperation in East Asia, namely, i) the economic and financial surveillance mechanism for information exchange, policy dialogue and peer pressure, ii) the liquidity support facility, through the Chiang Mai Initiative, to contain currency speculation, contagion and crises, and iii) Asian bond market development to mobilize Asian savings for investment. A possible addition to this list of cooperative measures is an Asian Financial Stability Board to promote financial system stability.

Kawai pointed out that despite close

interdependence of East Asian economies, there has been no exchange rate coordination. Situations that might cause setbacks to exchange rate coordination in East Asia include i) the fear of allowing domestic currencies to appreciate ii) the holding of sizeable foreign exchange reserves, and iii) the lack of an anchor currency.

Kawai came out with several suggestions on overcoming these setbacks. One would be through a collective currency appreciation against the US dollar, which can maintain relative currency stability within the region and promote financial and macroeconomic stability while minimizing loss of price competitiveness.

Another is the creation of an Asian currency unit (ACU) as the anchor currency in the region. This suggestion came about since the Yen as a currency failed in its internationalisation effort while the Yuan currently is inconvertible. Apart from the creation of an ACU, a currency basket system can be adopted much like Singapore's foreign exchange model. The currency system can include SDR along with the Dollar, the Euro, the Pound sterling and the ACU in its basket.

More emphasis should be placed on the creation of an ACU in the future as although the system proposed is complex and hard to establish now, having it as a currency basket index is a useful starting point. Informal policy coordination by central bankers in the future can include the use of the ACU. Among its other uses is the developing of ACU-denominated bonds.

Kawai ended his presentation by saying that in the short run, East Asia should work with the global community to improve the functioning of the US dollar system, while at the same time increasing their exchange rate flexibility against the US dollar. Kawai feels that in the medium to

long-term, East Asia should establish its own exchange rate arrangement or even a common currency. The importance of exchange rate policy management was stressed as it will be the key to the management of capital inflows for macroeconomic and financial system stability.

The theme of **Mr Yi Jong-goo's** presentation was financial regulatory reform and cooperation among Asian countries. He highlighted two approaches in achieving financial system stability. Both approaches are based on two questions, i) what is the most effective regulatory/supervisory framework for financial system stability, and ii) what specific financial regulatory reforms are needed.

To achieve an effective financial supervisory framework, two more questions must be addressed. The first one is, who should be the systemic risk regulator, and the second, how should it be coordinated among financial authorities. Yi is of the opinion that while the questions can be applied in general, the answer will be that there is no one-size-fits-all framework because each country's unique circumstances must be taken into account.

Using countries like the United States, the United Kingdom and Korea as examples, Yi shows that the financial policy/supervisory framework of each is currently being reformed to prevent future meltdown. Financial system stability is now being added as a function of the Bank of England, while the same mandate has been in existence in several agencies in the United States.

Reform of the financial regulatory system must be in place to prevent a recurrence of the financial crisis. Yi outlined four steps towards reform. These are i) specific regulatory reform ii) clear reform timeline iii) consistent

implementation of new rules and iv) monitoring of the implementation by the IMF or Financial Stability Board (FSB). FSB is a new outfit under the G-20 that is being tasked to reform financial regulations.

Despite praising the FSB for heading in the right direction, Yi feels that it needs to consider concerns of emerging market economies (EMEs), such as foreign exchange market stabilization, stronger information-sharing among supervisors, and reduction of moral hazards among too-big-to-fail financial institutions.

With respect to foreign exchange market

Reform of the financial regulatory system must be in place to prevent a recurrence of the financial crisis

stabilization in EMEs, Korea proposed a stronger role for International Financial Institutions (IFIs) to ensure stable foreign currency liquidity and stronger supervision of domestic/foreign financial institutions to stabilize foreign exchange and foreign currency funding markets. Yi mooted foreign currency liquidity insurance and the expansion of the multilateral currency swap arrangement.

Under stronger information-sharing among supervisors, Yi said that there are three areas that need to be improved. These are, the operation of supervisory colleges, information on exchange of hedge fund supervision, and the exchange of Over The Counter (OTC) derivatives transaction-related information. Yi suggested several approaches to reduce moral hazards among too-big-to-fail banks that included careful review of impacts on capital flows and local market conditions, and differences in legal or

regulatory systems.

The role of IFIs like the IMF and FSB must be strengthened to ensure regulation takes place effectively. However both institutions must first seek clarification of their roles to avoid overlapping work areas and better coordination among national authorities and international standard setters.

He concluded by saying that at the regional level, coordination among regulators is desirable, since global rules may not apply. With the increasing involvement of Asian countries in G-20 and FSB, Asian views on regulatory reform can be heard but much more can be achieved with better co-ordination.

Professor Dr Augustine Tan outlined the factors that have reduced the economic influence of the United States over the world, at the core of which is China.

The rise of China as an economic powerhouse is reminiscent of the US ascent last century, only it is happening faster. Tan referred to the Peterson Institute for International Economics Study which projected that the international economic position of the United States was likely to deteriorate enormously due to a growing current account deficit and an exponential increase of net debt (\$50 trillion in 2030). In this projected scenario, the United States would be transferring seven per cent of its GDP to foreigners every year in order to service its external debt.

US economic power will decline further as activities to finance its debt will raise real interest rates, while defence cut-backs will weaken its military power. This will lead to

declining future growth rates. Tan believes there is a huge probability that the US will repeat the lost decade of Japan's economy. Factoring in all these conditions, it is likely that the US dollar's prominence as a reserve currency in the future will be reduced; a possible future scenario is the rise of the Yuan's value and influence.

The rise of the Yuan to prominence as the world's reserve currency and world currency of last resort has generated interesting outlooks for both China and the world at large. Tan warned however that the transition between the British Pound and the US dollar took decades to materialize. In view of this, he offered several medium-term suggestions that could help Asia.

The first is to review the viability of the Asian monetary union. In reassessing this, the example of the European Currency Unit will not entirely work in Asia. Second, the East Asian integration process through East Asia Economic Community must be reviewed to determine how inclusive or exclusive the process should be. Tan suggested China increase efforts to mobilize the Yuan around the world, relax capital controls, and make sure the Yuan is flexible enough to adjust. Finally, Tan suggested China takes appropriate action to make the Yuan the world's reserve currency.

The session closed with speakers agreeing they foresee the decline of the US dollar in the next decade or two, and pointing out changes that must take place in the global financial architecture as well as in its major players — mainly China.

Where is East Asia in the Knowledge Race?

The panelists at Session Three of the East Asia Congress were Professor Said Irandoust, President, Asian Institute for Technology, Thailand, Dr Zhang Jianxin, Director, Research Institute of Higher Education, Yunnan, and Dr Mao Risheng, Research Fellow, Institute of World Economics and Politics, Chinese Academy of Social Sciences. The session was co-chaired by Dr Augustine H H Tan of the Singapore Management University, and Dr Ponciano S Intal Jr of the Economic Research Institute for Asean and East Asia (ERIA). In his opening remarks, Dr. Tan spoke on the importance of knowledge in the development of the East Asian region, and its crucial role in spurring the developmental process of the region. **Terence Too**, Analyst at ISIS Malaysia, reports.

Dr Said Irandoust began by providing a snapshot of various indicators for measuring the status of knowledge development in East Asia. Knowledge is measured by two key indices: the Knowledge Index (KI) and the Knowledge Economy Index (KEI). Both indices focus on similar indicators, specifically: institutions, innovation, education and information and communication technology (ICT).

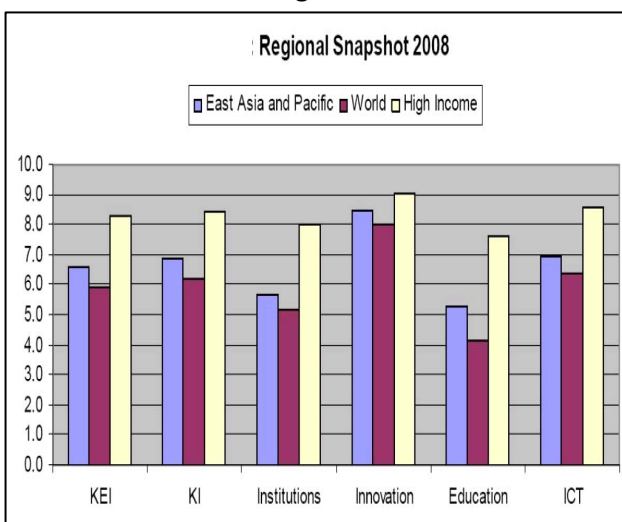
The first, the KI, measures the capacity of a country or region to generate, adopt and diffuse knowledge; the second, the KEI, measures the ability to utilize the full potential of knowledge created by its institutions. On an aggregate level, East Asia's knowledge performance is higher than

the world average, but it still lags substantially behind OECD countries, particularly in the areas of institutions and education (Fig. 1).

In examining the various indicators, Irandoust identified various strengths and weaknesses in the region with regard to the various knowledge components. In comparing a country's knowledge performance against its potential (KEI vs. KI), Irandoust found that Singapore, Australia and Hong Kong were the regional leaders; the knowledge performance in these countries exceeded their potential. Taiwan, Malaysia, Thailand and Indonesia were fairly evenly matched in terms of knowledge performance and potential, while South Korea and Japan showed the greatest lag in performance relative to potential, reflecting institutional deficits in the use of knowledge.

The measurements in the indices show that the more developed countries in the region performed more strongly than the poorer countries. The higher income economies of Japan, Korea, Singapore, Hong Kong and Taiwan showed strong performances in physical infrastructure and innovation systems. However, performance was weaker in terms of educational institutions for Japan and Korea, and in terms of education

Figure 1



for Singapore and Hong Kong. Taiwan, noted Irandoust, was the standout performer in East Asia over the 1995-2008 period, significantly outperforming its knowledge potential. In developing East Asia, Malaysia was the standout performer over the same period, consistently ranking above other developing countries, and even outperforming Korea on institutional effectiveness.

Irandoust highlighted two components central to building and developing an East Asian knowledge economy. These were, to realize the changing role of universities and to rethink the prevailing mindset on knowledge.

Universities have become increasingly important to the economic growth and development of a country, especially as more countries and regions aim to become the most innovative and competitive. Economies have become increasingly knowledge-based as well as global. Innovation, and the ability to utilize innovations are crucial to development and economic growth. This highlights the importance of need-driven research and development, which must be strongly linked to business development. Also important in this respect is adequate funding for universities to secure world class resources and facilities.

Irandoust noted a new and emerging perspective of knowledge where, in contrast to the old system where universities spoke to society, society now talks back to universities. In this new system a social perspective is applied to science, and new knowledge is generated for practical application, with high relevance, utility and economic impact. Irandoust envisions a situation of greater creativity in higher education, where research is intentional, purposeful,

manageable, and responsive to markets.

In addition to the importance of the role of universities, Irandoust notes that there has to be a critical re-examination of the mindset on what knowledge is, or is about. A more holistic view is needed, and a better understanding of why and how knowledge is created. Knowledge is not without its values, consequences and impacts, and there is a need to build not just k-economies, but more importantly, k-societies, where knowledge can be applied and meaningfully connected to new contexts, and where regional potential for research and

Economies have become increasingly knowledge-based as well as global

educational collaboration can be exploited and the benefits maximized.

In his concluding remarks, Irandoust noted that a focus on international rankings was leading some countries to focus on creating a few world class universities rather than focusing on improving the system. Creating a world class system is more important than creating a few world class universities, he said. He highlighted the importance of promoting creativity for higher economic growth and encouraged universities to place the capacity to change at the heart of their purpose. Looking forward, Irandoust envisaged an increased role for the private and public sectors in working with universities, through public-private partnerships focused on employability, innovation and the commercialisation of research results.

The next speaker, **Dr Zhang Jianxin**,

focused on the evolving paradigms in higher education, in particular the increasing intertwining of higher educational institutions and society. In the past, Zhang noted, universities operated at the periphery of society as ivory towers which accumulated and preserved knowledge, and which had as its primary mission, the training of capable persons, along with carrying out research and serving society. However, over time, universities evolved and moved closer to the 'core' of society, with new connotations and functions. Zhang posited that in the current knowledge race in East Asia, universities have, in addition to the three missions stated above, another mission: that of upgrading knowledge competitiveness.

Zhang posited that as society becomes increasingly globalised, universities have to evolve again to meet changing needs. She outlined four major progressions in this transition.

First, institutions of higher education now have to serve as :

- Sources of motivation for new ideas as well as for the better integration of resources;
- Incubators for innovation and an engine for industrial innovation; and
- Bridges between existing knowledge and technologies, and new ways of thinking.

Second, the way in which knowledge is dealt with also has to change. Universities have to shift from being mere preservers of knowledge, to become transmitters of knowledge, and finally, to be creators of knowledge.

The third transition concerns human

resources and the development of students' abilities. Universities have not only to nurture the scholarly abilities of students (i.e. study ability), but also the ability of students to create and innovate, adapt, compete, and to cooperate in an increasingly globalized world.

The fourth transition concerns the 'boundlessness' of institutions of higher education today, specifically in terms of:

1. Physical boundlessness, with many universities operating branch campuses, twinning programmes, and off-shore institutions;
2. Boundlessness of learners, with a wide range of students including local and foreign students in host and guest countries, and adult students and life-long learners;
3. Boundlessness of curriculum, which encompasses virtual campuses, twinning programmes and internet learning; and
4. Boundlessness of study, referring to the expansion of learning to both in-class and after-class situations, and flexible study.

Zhang concludes that never in history has knowledge-based economy and knowledge activity-based education been connected so closely. As such, in addition to teaching and research, the new mission of institutions of higher education must be to upgrade knowledge competitiveness.

The final speaker, **Dr Mao Risheng**, examined China's position in the knowledge race from an international trade perspective. He noted that China's competitiveness currently comes from specialization, quality and variety. Indeed, China has made substantial gains in competitiveness in terms of low-technology

products, and is rapidly rising in the area of other higher technologies. However, such gains in competitiveness have been uneven; China is still less competitive than Japan and Korea in both low- and high-tech products such as footwear and transport equipment.

Mao noted that the rapid gains in China's competitiveness stemmed from its low labour costs, foreign direct investment, and exchange rate policy. However, this has led to a number of challenges, including a low profit margin and

... the rapid gains in China's competitiveness stemmed from its low labour costs, foreign direct investment, and exchange rate policy

deteriorating worker welfare, environmental damage, worsening terms of trade, problems with the international payment balance, and increasing trade disputes with other countries.

In order to address these challenges and continue to be competitive, Mao said he believed that China would need to transition from an export-based growth model to a knowledge-based one. It has to put more money into education, and research and development activities, so as to be more innovative. It should import more, especially high-technology products, from other countries, and adjust its foreign direct investment policy. It should do more to encourage local enterprises, as well as encourage more competition and cooperation with other companies to become more innovative.

IS EAST ASIAN REGIONALISM STILL RELEVANT?

The panelists at Session Six of the Congress were Dr. Muthiah Alagappa, Distinguished Senior Fellow, East-West Center, Washington, D.C., Dr Ponciano S. Intal Jr, Senior Researcher, Economic Research Institute for Asean and East Asia (ERIA), Prof Simon Tay, Chairman, Singapore Institute of International Affairs (SIIA), and Prof He Baogang, Chair in International Studies, School of Politics and International Studies, Deakin University, Australia. The Co-moderators of the session were Dr Nguyen Vu Tung, Deputy Director-General, Institute for Foreign Policies and Strategic Studies, Diplomatic Academy of Vietnam and Dr Mao Risheng, Research Fellow, Institute of World Economics & Politics, Chinese Academy of Social Sciences (CASS). **Zarina Zainuddin**, Analyst at ISIS, reports.

The first speaker, **Dr Muthiah Alagappa**, noted that the majority of the speakers from the previous sessions had identified regional arrangements as necessary for East Asia to cope with the global financial crises. They had agreed on the relevance of East Asian regionalism, and had identified possible roles such as financial regulations, the harmonisation of exchange rate policies, and development of safety nets for emerging market economies for such frameworks.

Clearly, Muthiah said, regionalism has a role to play. However, to understand whether it can deliver its perceived benefits, it is important to understand the dynamics and the strengths of regionalism in the East Asian region and to view it in a dramatically changed context, both at regional and global levels.

There is a tendency within the region to look at regionalism in terms of regional organisations – the Asean Regional Forum, the Six Plus Three, the Ten Plus Three, Ten Plus Six, the Ten Plus Six Plus One, and the Asia Pacific Community. Muthiah said he felt that it was more important to focus on the underlying themes, and on the dynamism of regionalism



(From left): Nguyen Vu Tung, Mao Risheng, Ponciano S. Intal Jr and He Baogang

itself.

For the purpose of discussion, he advanced three general propositions:

The first was that although regional organisations, visions and arrangements have proliferated in East Asia, regionalism remains weak. The second proposition pointed out the change in the context of regionalism in East Asia, the position of East Asia in the global context, and the dramatic increase in the nexus between the regional and global levels. The third proposition was somewhat controversial –

regionalism in Asia should de-link itself from the mantra of community-building.

Regional Organisations, Regional Institutions

For the first proposition, Muthiah stressed the importance of distinguishing the differences between regional organisations and regional institutions, and regionalisation and regionalism. There is a tendency to conflate all the four terms in discussions regarding East Asian regionalism.

Regionalism, according to Muthiah, exists when the intensity of interaction amongst concerned states exceeds that with states outside the region – in other words there is a higher level of interdependence among states engaged in regionalism. Regionalism is also frequently seen as a co-operative approach to advancing the common good.

Regional organisations on the other hand are formal organisations created by states to regulate interstate interaction in pursuit of a specific purpose. They may be created to tap an advanced, existing high level of interdependence or may be designed to produce them. Regional organisations (ROs) and regional institutions (RIs) are not the same. ROs are the subsets of RIs. Much of the discussion in Asia centres on regional organisations and not on regionalism per se.

While Asean has been acclaimed by many to be a successful regional organisation, Muthiah feels that it has fallen short on its own goals. Levels of interdependence have increased but not dramatically so. The definition of national interests has not changed in a significant way; problems remain unresolved, and in moments of

crisis, the national approach has dominated.

Muthiah stressed that his intention here was not to cast Asean in a negative light but to put its achievements in a proper perspective, recognising both its limits and possibilities. Asean has recently adopted a charter and put in place several ambitious goals and plans – the question here is will or can Asean realise its own ambitious goals and plans.

Muthiah then discussed proposals for Asean community. The Asean Economic Community is an ambitious programme of economic cooperation, proposed to be realised

The Asean Economic Community is an ambitious programme of economic cooperation, proposed to be realised by 2015

by 2015. Recent studies have indicated that the pay-off would be tremendous for Asean members. It can improve the region's competitiveness, facilitate the creation of product networks, foster diffusion of best practices and help Asean countries protect their interests more effectively.

There appears to be a strong political commitment to the economic vision which Muthiah hoped could be sustained, and that despite some less than sterling experiences in the past, the economic programme can come into full realisation by 2015, as planned.

The second proposal is for a political and security community. Here Muthiah noted, the

agreements and commitments of political visions were less ambitious, reflected by the less grandiose statement on the goals of political development, democracy, human rights and other Asean norms. The blueprint is more or less a codification of existing practices rather than one that seeks fundamental political change. Muthiah said he did not think that this was a bad thing; the goals are quite realistic and expose the limits of Asean cooperation.

Muthiah tackled the issue of the non-interference principle. Some have argued that the principle is a stumbling block to Asean cooperation. He is of the view that the principle is not really the problem, it is the lack of political will. A mere change in principle will not affect regional governance.

There is better agreement on the security vision, notably the desire to live in peace. However this has not translated into a strong concrete action programme Muthiah said. There is no programme comparable to that of the creation of single market in the economic community. While there is some substantive cooperation on anti-terrorism, he did not foresee much progress in other areas such as conflict prevention, conflict settlement, post-conflict peace-building, and so forth.

Regarding taking a proactive leadership role in shaping the evolving regional architecture, Muthiah said that Asean has had some success. Asean leads the formation of the Asean Regional Forum (ARF). It played a key role in the development of Asean Plus Three (APT) and Asean Plus Six. The Asean Treaty of Amity and Cooperation has been accepted as a formal framework for international interaction in East Asia, and Asean is recognised by all the major

powers and international organisations. More recently, the US became a signatory of the Treaty of Amity and Cooperation and held the first ever summit with Asean. These were no mean achievements.

The future, Muthiah said, looked less promising. A real issue is the question of whether Asean can still retain its driver's seat role and central position. Much will hinge on how the forum for Northeast Asia, as well as the broader East Asian architecture develops.

Regionalism — the Changing Context

The context for regionalism in Asia has altered substantially. Asia is not only the core world region but increasingly, it is becoming the centre of gravity in several areas. The relationship between the region and the world has shifted. Hence, it is crucial for Asian regionalism to be globally-oriented, not only to cope with the ongoing crisis, but to position itself as driver of global affairs in the 21st century. A mindset change is required in thinking about regionalism in East Asia.

Regionalism should now be aimed at facilitating the growing global role of major Asian countries. East Asian regionalism is still in its infancy. The question of relevance is salient and this is reflected by the many ideas and initiatives that have been proposed. These include Asean Plus Three (APT), The East Asian Summit (EAS), the Hatayoma proposal for East Asian Community, Rudd's idea of a Pacific Asia Community and the efforts by some to revitalise Asia Pacific Economic Cooperation (Apec) as the primary forum for the Asia Pacific region. Muthiah argues that some of the organisations are 'solutions in search of a problem' or are in

the situation of 'putting the cart before the horse.'

In order to see what purpose East Asian regionalism can serve, one should look at the changing context in East Asia. In the late 1980s, when East Asian regionalism was first mooted, the emerging theme, globally, was the establishment of Nafta and the strengthening of 'Fortress Europe.' The challenge for the export-oriented economies of East Asia was how they should respond. This was the underlying concern behind the proposal for the East Asia Economic Group (EEG) which was later modified into the East Asia Economic Caucus (EAEC). Over time, East Asian regionalism became more acceptable. An East Asian economic arrangement was seen as necessary to manage the 1997 economic crisis – and the on-going economic crisis.

The context today is very different. East Asia, broadly defined, has three out of six of the largest economies in the world – China, Japan and India -- as well as several mid-sized ones, which are all likely to grow. Five Asian and six East Asian states are members of the G20, which is now seen as the premier global forum for global economic issues. China, India and several East Asian countries have embarked on major military modernisation programmes and Asia has the most number of nuclear weapon states. Asian countries are seeking to increase their representation, influence and roles in international governing bodies such as the International Monetary Fund (IMF), the World Bank and the UN Security Council.

Although one can argue over whether a power shift to Asia is indeed on its way, one cannot deny that Asian power and influence have increased in the global arena. Dr Muthiah said

that as Asia is increasingly becoming the centre of gravity for many issues at the global level, many Asian problems have to be addressed at the global level too. As the connection between the regional and global levels has grown dramatically in the last decade or so, the regional-global context should be the driving force in regionalism in East Asia.

Community Building?

As for the third proposition -- that regionalism should liberate itself from the mantra of community-building – Muthiah said no one has clearly defined the term community in a meaningful way, or had asked what purpose it served. He offered one definition: A community is one that can make binding decisions on authoritative allocation of values in a society.

The key goal for most Asian states is to build a community at the national level. The task is difficult, may take several decades to realise, and its success is not guaranteed. Furthermore, community-building at the national level can and does involve the use of force.

Building community at regional/international levels in states that are involved in building community at national levels is a daunting task. As these states have wide disparities in political systems, levels of development, state capacities, historical suspicions, and widely differing international positions and role quests, community-building at the regional level was not really a necessary objective for them.

Regionalism in Asia should be simple, and seen as a facilitator to realise national aspirations and goals, not reduce the state's

relevance or transcend it. More tangible goals like regional cooperation to achieve desirable outcomes like peace and security, economic growth and development, free movement of goods, capital, and services etc, will be more tangible and meaningful. And such endeavours can be pursued without the label of community-building.

The second speaker, **Ponciano Intal Jr**, examined the relevance of East Asian regionalism

... we can expect the emergence of a trend towards greater intra-regional trade beyond production networks

through an economist's perspective, more so in the context of deeper global engagement. Intal divided his presentation into two parts: first he looked at the changes in Asean and East Asia and followed then up with a discussion on whether East Asian regionalism is still relevant.

The Asean and East Asian economies have opened up in the last couple of decades. Asean countries, particularly the Asean Five, had a trade to GDP ratio exceeding 100 per cent by 2006-07. Likewise the ratio of Foreign Direct Investment (FDI) to GDP also increased, especially in Brunei, Cambodia, Laos, Myanmar, Thailand and Vietnam. Southeast Asia is relatively more open than Northeast Asia – even more than Japan, the world's second largest economy. In Southeast Asia, the changes in the direction of trade have been dictated by comparative advantages, and opportunities arising from regional and global trade liberalisation. In this regard, Intal highlighted the

cases of Cambodia, Vietnam, Philippines and Singapore.

The high degree of openness in trade and investment in Southeast Asia indicated that it is possibly a main contributory factor to the high economic growth experienced by the region since the mid-1980s. Intra-Asean trade increased significantly in the last two decades, rising from about a fifth to a quarter of total trade. The increase in intra-Asean trade, said Intal, also contributed significantly to the increase in trade between Asean countries and the Plus Three countries of China, Japan and South Korea.

Is East Asia Economic Regionalism Still Relevant?

Intal said the first issue to look at in determining if economic regionalism was still relevant, was whether there was still potential for further advantage in intra-regional trade and investment in East Asia. The experiences of the European Union (EU) and North American Free Trade Agreement (Nafta) suggest that the region has ample room to grow. For example, for 23 out of 27 EU members, intra-EU trade accounts for 60 per cent or more of total trade.

The corresponding figure for Asean Plus Three was much lower, the highest being Korea-Asean intra-trade at 44 per cent while the China-Asean intra-trade figure was at a lowly 26 per cent. In short, the bigger Plus Three exports were geared more towards trade outside the Asean region.

Intal observed a rise in East Asia's share of Japan's and Korea's exports. This is linked partly to deepening production networks for East Asian demand and the rest of the world. Given

that the developing East Asian countries are expected to lead the world in growth of aggregate income and demand, we can expect the emergence of a trend towards greater intra-regional trade beyond production networks. Furthermore, the lower barriers to trade, and improved facilities for trade facilitation, such as custom and infrastructure, helped boost intra-regional trade.

Finally as per capita income rises in East Asia, it is likely that product differential will become a more important element in customer choice and product sourcing. An improved trade environment and a reduction in tariff- and non-tariff barriers would intensify competition in domestic producers over product differentiation. The demand for product differentiation from within the region would probably lead to increased intra-regional trade.

The investment climate, as well as trade facilitation play an important role in fostering East Asian regionalism, and therefore greater global engagement. East Asian regionalism for global engagement is not an oxymoron; the history of Asean regionalism is really in tandem with deeper global engagement.

According to Intal, regionalism becomes an important complement to deeper global engagement through the 'plus' element of the usual 'Free Trade Agreement (FTA) Plus'. Virtually all the countries in the region that had navigated successfully the process of trade liberalisation and globalisation owe much of their success to increased foreign investment.

Among Asean countries, it is Philippines, Laos, Myanmar and Indonesia that need to improve their investment climate the most.

Hence it is crucial for these countries to pay attention to regional integration arrangements that emphasise investment liberalisation and facilitation — such as Asean Free Trade Agreement (FTA) or Japan's Economic Partnership Agreement (EPA) — which could lead to greater regional and global engagement.

In addition to improving the investment climate, Asean countries can benefit greatly through in-trade facilitation. This involves improving infrastructure, equipment and procedures which will improve connectivity within and between the countries. In essence, to improve trade facilitation is to improve the transaction time and reduce costs of trade internationally, which in turn will support regional and global trade.

There are other factors that support East Asian regionalism and deeper global engagement. These are macroeconomic stability and capital market development in the region. The former improves the investment climate while the latter contributes to financial capability and more efficient financial intermediation across the region.

A related element is that of ensuring realistic exchange rate regimes among the countries in the region, to prevent serious current account imbalances. Another important factor that can contribute to harmonious integration is ensuring fair competition, which includes removing trade distorting subsidies.

Intal noted that to implement successfully the measures discussed earlier, regional policy consultation, coordination, agreement or cooperation is required. For some less developed countries in the region, additional

technical or development assistance along with policy reform, institutional capacity-building and infrastructure development may be warranted. Therefore, he said, the pursuit of East Asian regionalism with deeper global engagement is a significant component of technical, economic and development cooperation, as well as regional policy coordination.

In ending, Intal reiterated that East Asia regionalism was still relevant but with deeper global engagement. This meant that any East Asia 'Free Trade Agreement Plus' needed to focus more on the 'plus' component, and such focus tended to be supportive of both deeper regional integration and greater global engagement.

The third speaker, **Mr Simon Tay**, looked specifically at two words in addressing the question of whether East Asia was still relevant -- 'still' and 'relevant'. Tay conceptualised the question in broader focus by positioning East Asia in a post-crisis world. Tay felt that the crisis was far from over: its effects will still play out five to eight years from now, he said.

East Asia as we know it, its institutions and processes, have become much stronger in the wake of the 1997-98 crisis

In a way, East Asian regionalism has gone from one crisis to another, said Tay. East Asia as we know it, its institutions and processes, have become much stronger in the wake of the 1997-98 crisis. East Asia is better able to cope with the current crisis, leading the other regions in economic recovery. Tay echoed Muthiah's point on the increasing link between regionalism and

the world. In addition, Tay noted the shift in power in terms of security and political influence.

Prior to the current crisis, and in the wake of the Iraq, Afghanistan and other issues, Americans themselves were already talking about a post-American world scenario in which America, while still powerful, would have to depend on multipolar diplomacy. Clearly, said Tay, the multipolar world depended on Asia. Looking at how East Asia has emerged from one crisis after another, it was clear that the region was still relevant, although the nature of regionalism was changing. East Asia has to think more globally and to consider the role of America in Asia.

East Asian regionalism projects, pre-crisis, have continued to this day. Tay said it was apt that the EAC meeting took place in Kuala Lumpur, because it was in Kuala Lumpur that the seed of Apec's decline was sown, courtesy of then US Vice President Al Gore's unfortunate speech. Kuala Lumpur also saw the birth of the Asean Plus Three process followed by the inaugural East Asian Summit. Tay said he felt there was a need to continue with East Asian regionalism processes but cautioned on these processes reaching their limit. The limit, Tay argued, is primarily because of Asean.

'To Love Asean is to Criticise it!'

While acknowledging Asean's weaknesses Tay stressed that it was still the hub of East Asian processes of regionalism. Moving the East Asian process forward however, will be constrained by questions such as how to provide the agenda, the energy and the direction for the process. Tay felt that on the other hand, if, as mooted by some, you displace Asean, the outcome would be

worse. Asean is the ultimate limit of the East Asian regionalism process.

If the process is pushed too hard and fast, the region might end up being more disunited than united. There is evidence of friction among emerging East Asian powers and there is concern that this could lead to a halt in the regionalism process. Combine this fact with America's declining power and influence, there is a sense emerging that Asia might want to go it alone. America would also be more isolated and withdrawn and less able to reach across to engage meaningfully with Asia.

Tay sees a couple of scenarios in the future: one is of Asia disunited, and the other, the increasing emergence of Chinese domination. It looks as if Asia will emerge as the relative winner from the current crisis, with China at the head of the group. Chinese diplomacy in the last ten years has been one of cautious and gentle power. The question facing the region is whether there is a change or emerging change in China's attitude. Will Asia have a new tributary system emerging? Tay said he thought it was unlikely.

To avoid a disunited or a Chinese-dominated Asia, the region had to think of what Tay described as the power of 'and.' East Asia should be able to build regionalism, 'and' think globally, 'and' keep America fully engaged in the region.

Tay hoped for Apec's revival through the combined efforts of Japan and the US. He hoped to see it focus on trade and investment issues as well as on political-economic engagement. He preferred to see 'East Asian regionalism and Apec,' emphasising that both organisations made up the best solution for the region. East Asia

regionalism is a way to socialise emerging powers in the region, specifically China. Its also serves as the East Asian way of asking India to link up with the region and to be introduced to the East Asian norms and ways of cooperation. It is also an important vehicle to help re-socialise Japan, particularly with its new pro-Asia government.

Tay also spoke about the recent emergence of ideas and proposals, some of which he felt could be dangerous and distracting. Among these were Australian Prime Minister Paul Rudd's idea of an Asia Pacific Community (APC) and Japanese Prime Minister Hatoyama's proposal of an East Asia Community.

Tay thought that the Japanese idea aimed at fostering fraternity within the region was a vague proposal. While the sentiment of fraternity was welcome, it is not very clear how the idea can be implemented.

As for Kevin Rudd's idea of Asia Pacific community, while Tay was not against new ideas, he felt that there was the danger of Rudd's community proposal being more about power than about norms. Also, its members focused more on small, select groupings of major powers rather than on inclusiveness and equality, qualities that are norms for East Asian groupings.

For all its limitations, East Asian regionalism, Tay said, was an effort to create 'norms', and an effort that allowed small and mid-sized countries to be as important as their larger counterparts. It was also an effort to unite economically, but at the same time, maintain interdependence with the West and the global system. And lastly it was an effort to create a security community but also to realise the bilateral hard security issues – linkages that

remain vital to solving or handling every hard issue. Is East Asia regionalism still relevant? It is, Tay claimed, and so are many other things.

The fourth speaker, **He Baogang**, discussed in detail Australian Prime Minister Kevin Rudd's proposal of an Asia Pacific Community. He also looked at the responses to and criticisms of the proposal, particularly those coming from Australia itself.

One of the reasons behind the proposal was the lack of or relative lack of progress in pre-existing regional institutions such as Asean Plus Three and Asean Plus Six. Moreover, He said, Kevin Rudd, upon assuming power, desired to distinguish and distance himself from the previous administration of John Howard. At the same time, Mr Rudd wished to uphold an important labour party tradition regarding Australia's place in the region.

It was in response to these concerns that Rudd proposed in 2007 the idea of establishing an Asia Pacific community, which in a sense said He, was a political community. The aim was to transform the Asia Pacific, by 2020, into an organisation similar to the European Union. There are two factions within the labour party in Australia: one that regards Australia as belonging to the East Asia semi-hemisphere and has consistently pushed for enhancing Australia's engagement with Asia, and the other which saw Australia as a Pacific power.

Mr Kevin Rudd's idea of an Asia Pacific Community is more representative of the faction which favours Pacific-centric regionalism. Hence it is not surprising that the East-Asian-centric faction within the labour party is more inclined to support the Asean Plus Six regional

organisation processes than the one proposed by Rudd.

What then is the motivation behind Kevin Rudd's proposal? He said that one of the main motivations was to secure a seat at the

Kevin Rudd's idea of an Asia Pacific Community is more representative of the faction which favours Pacific-centric regionalism

table for Australia. Australia has a great fear of being excluded from the Asian regionalisation processes. So Kevin Rudd was trying to take pro-active measures. In essence he put out the 'big idea,' to be discussed among East Asian nations, so that whatever the outcome, Australia was almost guaranteed a place in the group. In that respect, He contended, Kevin Rudd had succeeded, so to speak, in securing a seat for Australia at the East Asian table.

Another important motivation is the effort to manage a large rising power, namely China. China is Australia's biggest trading partner. Chinese imports of raw material from Australia contributed to 2-3 per cent of Australia's GDP.

While China played a significant role in Australia's economy, the US simultaneously played a big role in Australia's security. Managing and balancing the interests of both China and the US was a difficult task for Australia. And an organisation like the Asia Pacific Community would bring both powers in.

Response to the proposal has been mixed in Asia. Academics voiced their criticisms. One critic said that the idea was vague and ill-conceived and predicted that it was doomed to fail. Another critic said that the APC is a distraction from the most urgent problems in the region; there are more important issues such as the monetary safety net. Thus it was better to focus on fixing concrete issues in the region. Another critic suggested relating the APC idea to Apec. East Asia strategists basically said Australia should not start a new institution; focusing on existing institutions was a more feasible and pragmatic endeavour.

Institutional critics recognised that the Rudd proposal did have its merits. In a sense, he has solved the problem of existing regional institutions which are perceived to be weak, passive, and fragmented. There were some criticisms too; one was that Kevin Rudd was not clear on what his proposed APC should look like. A couple of critics suggested that the best way forward was not to create a new institution, but instead to expand and strengthen existing ones, particularly the East Asia Summit.

Cultural critics, said He, tended to look deeper; they looked at the idea itself. They claimed the idea of an APC itself was a mistake for three reasons. First, the Pacific-centric idea was originally promoted by the United States and adopted by Australia. Australia's Labour Party traditionally has tried to define the region in Pacific terms. It fitted Australia's interest well because as long as Australia is talking about the Pacific, America is naturally included. At the same time Australia is engaged with Asia. Hence, Australia prefers large institutions to avoid facing the tough choice of choosing between Asia and the United States.

Another tough question is Australia's identity issue. The idea violates the first law of region which is the physical law. To build a community you need a continent, a proximate land mass. There is no way you can build a community in the middle of the Pacific Ocean. He pointed out that in Europe's regionalism process there has never been mention of an Europe Atlantic community!

The second issue is the idea of trying to accommodate the United States without dealing with tough issues with regards to the US. While

... critics suggested that the best way forward was not to create a new institution, but instead to expand and strengthen existing ones

the US plays a significant role in Asian regionalisation, it should not be a member of an East Asian community.

The third criticism is that APC does not address the issue of Australia's identity. The idea of the East Asian Community has a long history dating centuries back. It included former Malaysian Prime Minister Dr Mahathir's proposal of an East Asian Economic Group of the late 1980s, to Japanese Prime Minister Hatoyama's East Asia Community proposal. In short, the East Asian community idea has indigenous roots. Recently, when South Korea proposed a monetary security net, it excluded Australia from its discussions. Such exclusions happen frequently as East Asia in general does not regard Australia as part of the region.

Interestingly, for its part, the Australian general public does not think of Australia as part of Asia. Some even consider it an insult to think of Australia as part of Asia! The crux of the problem is that if Australia does not feel that it is part of Asia, then why does it talk of being a part of the community? If Australia does not consider itself part of East Asia, then it has no part in the East Asian regionalism processes and in any event, clearly, neither does the US. This is part of Australia's dilemma, and why Australia tries to avoid tackling its identity issue.

Finally, the critics discuss the level of power. Kevin Rudd's idea mismatches power politics. Australia, a middle power, is trying to set the agenda in bringing superpowers China and US together. He said that neither China nor America seem to be thrilled about this. In both cases, it was pointed out that the channel for discussion already existed and there was no need to create a regional organisation whose aim was, in He's own words, 'to try and bring both in to check each other. No point, waste of time and energy.'

In 1995, Australian commentator Greg Sheridan called the Asianisation of Australia as a revolution in Australia. He said if the process has been occurring then it is incomplete. Recently Kevin Rudd shared his dreams, in which Australia's next generation must regard Asia not as foreign but as familiar. Here He pointed out that Rudd does not use the word 'family,' instead he used the word 'familiar.' This highlights the fundamental limit of Kevin Rudd's proposal. He does not have a strong sense of community. Kevin Rudd may be the first Australian Prime Minister that can converse in Mandarin, but he is yet to produce Australia's best China or Asia policy!

Positioning East Asia in the Post Crisis World

At the seventh and final session of the Seventh East Asia Congress the panel speakers were Ambassador Yoshiji Nogami, President of the Japan Institute of International Affairs, Japan, Ambassador Wiryono Sastrohandoyo, Senior Fellow, Centre for Strategic and International Studies, Dr Nguyen Vu Tung, Deputy Director-General of Institute of Strategic Studies and Foreign Policy, Diplomatic Academy of Vietnam and Dr Wang YuZhu of the Institute of Asia-Pacific Studies at the Chinese Academy of Social Sciences. The session was moderated by Dayangku Dr Hajah Norulazidah Pengiran Haji Omar Ali, Lecturer, Faculty of Business Economics and Policy Studies, University of Brunei Darussalam, and Dr Kim Chulsu, Chairman of Institute for Trade and Investment, Korea. **Veena Loh**, Senior Fellow at ISIS, reports.

Ambassador Yoshiji Nogami said the centre of gravity was shifting from the West towards Asia, particularly after the global financial crisis. Will this still be the case after the crisis? Economies in East Asia are growing relatively faster, notably China, India and Indonesia. China will post eight per cent growth next year, but with substantive fiscal stimulus in place and massive bank lending. Is this process sustainable for the next few years? While advanced countries appear to move towards recovery, many governments are still hesitant to move towards exit strategies.

In China, private consumption is increasing, especially that of cars and consumer durables, because the Chinese government has subsidized these sectors as part of its stimulus package. However, Nogami said, consumption of daily necessities in the sectors which are not subsidized are not increasing. Can imports from the US and Europe be resuscitated? The US is saving more than the Japanese and thus there cannot be a huge consumer demand from the US. There is a need globally, for a renewed, more balanced growth strategy. The main theme of the Pittsburg Summit was to take steps to ensure a strong, sustainable and balanced economic

growth. Export-oriented models are considered less applicable after the crisis and nations are shifting towards domestic demand growth.

Nogami went on to say that in China, while there has been a massive boost in fixed capital formation targeted at replacing export demand, the share of consumption to total GDP is declining. There appears to be untapped resources. Economists have argued that private consumption can be increased by strengthening social safety nets, thereby decreasing the high level of precautionary savings. Some economists argue that this boost to private household consumption can also apply to East Asian nations as private consumption comprises one-third of the GDP of most of these nations.

Many East Asian countries have either a weak pension scheme or none at all. Benefits are low. In some newly emerging economies, there are no pension schemes. In other economies, only locational or sectoral pension schemes exist. Benefits are so low that the citizens may opt not to pay for a national health insurance benefit scheme. In many countries, health insurance schemes are linked to employment. National

unemployment insurance schemes may not exist in most countries. There is a dire need for strengthening or introducing social safety nets. While this may not necessarily lead to higher consumption, it may psychologically lower the need for precautionary savings.

Labour's share of income has been steadily declining in Asia, including in Japan. This is to maintain export competitiveness. As companies globalize, their cash position and balance sheets must improve, and reducing labour has been one of the means to achieve these corporate ends.

With strengthened social safety nets and careful examination of root causes of declining share of labour income, nations can seek to increase levels of private consumption to rebalance growth strategy by restoring or increasing the people's confidence. When incomes of people are steadily decreasing, or there is uncertainty about social safety nets, people spend less. The confidence of the people must be restored before nations embark on the subject of free trade and free movement of people.

Asia faces an ageing population. Japan is ahead of the queue followed by China. The problem is doubly difficult for policy choices. Policy-makers must first reassure the people by removing their concerns and returning their confidence before proceeding to consider new growth strategies. Nogami wondered whether Asia can be the centre of gravity if these issues are not addressed?

Ambassador S Wiryono gave an Indonesian perspective on the topic, 'Post-Crisis: East Asia to position itself?' At a time when the

world is still suffering from the economic downturn and the solution is seen to be in the hands of the economies of Asia, it is only logical that the question is asked: *How should East Asia position itself in the post-crisis world?* When the global crisis is over, how should East Asia strategically position itself, economically and politically?

Shifting Centre of Gravity

There is a strong view that today the world's economic centre of gravity is shifting from the Atlantic to the Pacific, specifically from Western powers to Asian ones, most of which are in East Asia. A new world order is in the making and the emerging economies of East Asia as a collective whole could be the dominant force in that new world order. But the realities are that East Asia does not act as a single unit. The region comprises individual economies, notably Japan, China, South Korea and also Indonesia (the region's foremost proponent of regional integration) and they are still driven by nationalism and narrow self-interest.

There are ongoing attempts to unite East Asia through Asean-driven processes -- the Asean Plus Three process and the East Asia Summit, which includes India, Australia and New Zealand. Also covering the East Asian region are two processes: the Asean Regional Forum and the Asia Pacific Economic Cooperation Forum. All these processes form a multilayered, multifunctional regional architecture.

The nature of the post-crisis world depends largely on how the current crisis is resolved. While the downturn seems to have hit rock bottom and some green shoots of hope are appearing, recovery is excruciatingly slow and is

dependent primarily on both the G-8 and the giant emerging economies. However, it has become clear that the G-8 cannot do the job alone: the G-8 plus the emerging economies must play the role of rescuers. Thus the G-20 was elevated to the Summit level and became the world's premier forum for economic decision-making.

An economically integrated and politically coherent East Asia could be the dominant force in the G-20, but because the East Asian regional architecture is multilayered and multifunctional, its borders are not well defined and its interests are many.

Attempts to Remedy the Situation

Attempts to remedy the situation remain inconclusive. In June 2009, Australian Prime Minister Kevin Rudd proposed a process of consultation leading toward an Asia Pacific Community, an overarching forum that would include the United States. At the Apec Economic Leaders' Meeting in Singapore in November 2009, Japan's new Prime Minister, Yukio Hatoyama, proposed an East Asia Community that also included the United States. Neither proponent gave sufficient details about the exact features of the overarching regional forums each was proposing, leaving that for future discussions.

Meanwhile, President Obama is reportedly interested in joining the East Asia Summit. If that happens, then it will be almost impossible to keep Russia out of the Summit: it has been knocking at the door of this Summit since the time it was formed.

New developments compounding the situation are the global crisis that has erupted at

a time when many countries in the region are grappling with disintegrative forces that are willing to resort to violence, the terrorist movement in Southeast Asia, aimed at establishing a Muslim Caliphate in this part of the world, and in Northeast Asia, the phenomenon of a bellicose North Korea that is cause for anxiety for the whole region.

The regional countries have to deal with domestic economic volatility as a result of the impact of the global economic downturn. Many of them have barely recovered from the recent food security crisis and the energy security crisis. In a few years, they will begin to feel increasingly the impact of climate change.

While it is being claimed that the downturn is over, there is no denying that the recovery will take a long time, being fragile and fraught with uncertainty.

Every economy in the world today is a stakeholder whose voice must be heard

At any rate, the formation of a new international economic order must not be left to chance. Everyone must get on board because it is now very clear that there can be no decoupling from the global economy. Every economy in the world today is a stakeholder whose voice must be heard. Some of the emerging East Asian economies are already in the G-20. But those still outside feel that they have been left out and have accused the G-20 of not being inclusive enough. That is why Indonesia has proposed that Asean, through its rotating chairmanship, should be a permanent fixture in the G-20 forum and not just an occasional guest.

It is well and good that the G-20 is now developing rules to govern the international economic and financial system. 'The objective,' according to US Treasury Secretary Timothy Geithner, 'is to design an economic framework where we're going to have a more balanced pattern of growth globally, less reliant on a build-up of unsustainable borrowing... and not just here (in the US), but around the world.'

It is usually in a crisis like this that nations are more willing to take bold joint initiatives that create durable international institutions and arrangements. The UN and the Bretton Woods institutions were built in the course of the global crisis of the Second World War. Asean was born during the last stages of the war in Indochina in the late 1960s, amidst other regional disputes and tensions. Similarly, either the Bretton Woods institutions have to be reformed, or new arrangements more responsive to the needs and aspirations of the region have to be formed. This will entail the shaping of a firmer geopolitical architecture in the region, with the role of the United States and Russia more clearly defined, at least in the minds of regional nations.

Economically, the Northeast Asian nations are more mature. The combined economies of Japan, China and South Korea are several times bigger than the combined economies of Asean. Although Asean economies have done creditably in the face of the 2008 global meltdown, they have yet to recover fully from the debilitating effects of the Asian Crisis of 1998 and the economic debacle caused by international terrorism. Asean also remains uneasy over the rise of China as a world power, since there is no way of predicting whether China will remain a benign power in the coming decades.

There are tensions across the Taiwan Straits. The Korean peninsula continues to be a major flashpoint. The projected national and theatre missile defence system still raises the concern of regional nations. The unspoken rivalry between China and Japan is real and can make the region dysfunctional. Japan's relationship with the rest of the region will remain an uneasy one as long as it does not cast off the burden of history and fully acknowledge its responsibility for the Pacific Ocean theatre of World War II.

East Asia is Changing

At the same time, East Asia is changing. The global crisis is compelling East Asia to become less dependent on exports for growth. The region is also looking for, or developing, new export markets, apart from the traditional ones. Economies like those of China, India and Indonesia -- the countries with big populations -- have continued to grow in the face of the global crisis because of their huge consumer markets.

Meanwhile, the American consumer has rediscovered thrift. It is now China and other East Asian countries that have the purchasing power and the capital. In this, they are joined by the oil-exporting countries of the Middle East. So, while the burden of saving the global economy and nursing it back to health still falls largely on the shoulders of the major industrial countries, the emerging market-nations, especially those in East Asia, must do their part too. They should therefore welcome US President Obama's initiative to forge a more effective framework in the Asia Pacific and to work with East Asian countries to promote future stability and prosperity.

But before this can happen, three vital

and urgent steps must be taken:

First, the formulation and implementation of a coordinated response to the ongoing global economic and financial crisis, that will restore the confidence of people everywhere in the global financial architecture. At the same time, a judicious financial expansion must be carried out to prevent the atrophy of the real sector, thereby sustaining production and trade.

Second, the implementation of effective measures to address the tensions in the Korean peninsula. The United States must now attend to this issue more vigorously and consistently than it has ever done, while regional powers must prepare themselves for a worst-case scenario should North Korea suddenly implode following a messy and bloody succession struggle.

Third, both the United States and East Asia, especially the Asean sub-region, must devise a common strategy to match the shifting strategies and tactics of international terrorists. That terrorists are still capable of inflicting carnage in this part of the world is poignantly underscored by the terrorist attacks in Jakarta in July 2009.

The only reason Asean is not inconsequential is because without Asean, the Northeast Asian nations of China, Japan and South Korea cannot work together. But Asean must now start earning the centrality that it is so insistent on by abandoning rigidities and becoming more flexible, especially with regard to the principle of non-interference. This is the only way it can move faster — and it must move faster — or it will never be competitive.

Between now and 2015, the deadline for

its transformation into an Asean Community, there is a window of opportunity for Asean to get its act together. If it fails to achieve that, it will remain in a lopsided relationship with its neighbours to the Northeast. The East Asian regional architecture will continue to be messy, and the region's contribution to global stability and prosperity -- even in the G-20 process -- will be much less than it potentially could be.

On the other hand, a well-integrated East Asia that boasts an Asean Community that has found its stride, can play a very significant and constructive role in the G-20. It can be a major partner of the United States in addressing global problems, and will be a blessing to all humankind.

Dr Nguyen Vu Tung said that in the post-crisis world, East Asia will emerge more visibly, on an upward trend, with greater economic and strategic importance, and with greater weight on economic cooperation. The post-crisis era opened up new opportunities for East Asia to deepen the process of economic integration. It is widely believed that there has been more cooperation among East Asian countries after the Asian Financial Crisis of 1997/98, and the signing of the Asian Pacific Trade Agreement.

The nature of the development strategy of many of the East Asian economies has been export-oriented growth; the region was therefore vulnerable to the global crisis. East Asia is still dependent on exports to other regions, namely the US and Europe. International Monetary Fund (IMF) estimations of real GDP contractions in 2009 are 6.2 per cent for Japan, 7.5 per cent for Taiwan, 4.0 per cent for Korea and 10.0 per cent for Singapore.

To minimise the impact on these regional

economies, the strategy is to forge closer relationships, so as to reduce dependence on external regional markets. There is a move towards deepening economic integration and trading more with each other, while not becoming inward-looking or protectionist. In this context, East Asian economies will continue export-led growth, but increase trade with each other.

Revised East Asian Model

The classic East Asian model should be replaced with a newer version in which regional exports and investments will be of higher importance. These nations are also attempting to boost domestic consumption, such as through stimulus packages, to stimulate growth in trade and investment in the region. Since 2000, trade with China, Japan, Taiwan and Australia has increased significantly.

There have been concerted efforts to open up East Asian economic cooperation, improve economic regional governance and provide a new boost to economic integration schemes such as the Chiangmai initiative. Japan, China and South Korea have committed to working together more closely, and also with Asean, for economic cooperation. These coordinated actions have wide-ranging implications for regional cooperation arrangements in East Asia.

Regional cooperation towards boosting trade and deepening integration, together with the vitality and resilience of individual economies, have contributed to the quick recovery of East Asian economies. While individual economies have been badly affected by the crisis, they have been coping relatively well. This has led to East

Asia being considered the leading centre of global recovery. With new efforts at boosting regional economic efforts, East Asia will further show growth improvement.

Economic interactions between and among East Asian economies will continue to produce spillover effects on the process of constructing East Asian regionalism and community. Economic boundaries will be more clearly defined. Within these boundaries, more activities will take place. Based on a higher level of economic interaction and higher states of increased interdependence, the process of community-building will have a stronger impetus on the social, political and security spheres during this global crisis.

As East Asia accounts for 20 per cent of G-20 members, East Asian economies are possibly capable of forming a caucus within G-20. These economies are showing greater economic and strategic weight. East Asia's strategic participation in G-20 is aimed not only at securing its role in global economic governance, but also at increasing its effectiveness in projecting the region's strategic efforts towards global economic recovery. In the post-crisis world, East Asia will emerge stronger because of the relevance of its export-led growth strategy, with a new focus on economic cooperation and integration among regional economies.

Dr Wang YuZhu spoke on the topic of economic integration as a way out for the post-crisis East Asia.

Relations Between East Asia and World Economy

The global crisis has called for a rebalancing of

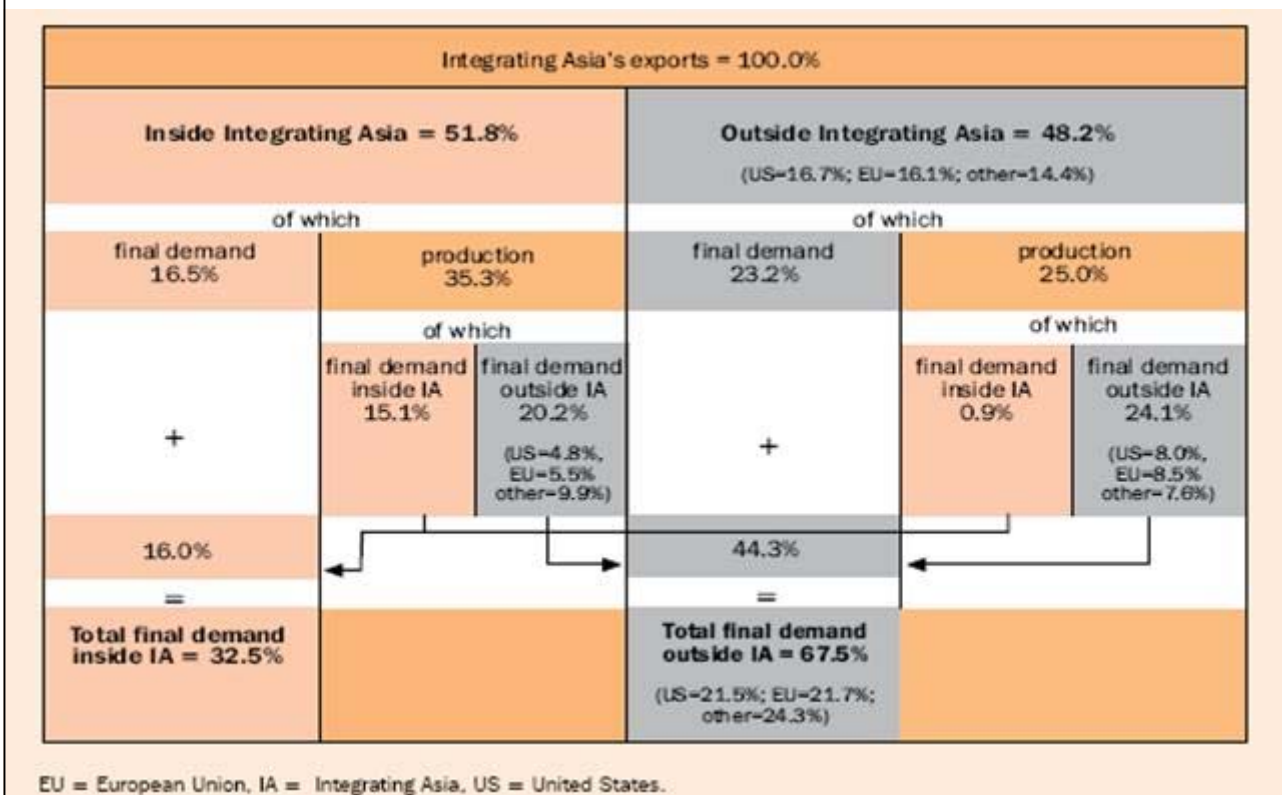
the world economy, starting from regional cooperation. The problem is, there are too many initiatives, most of them competitive and overlapping. Research by the Asian Development Bank (ADB) has shown that although intra-Asian exports are over 50 per cent, the final demand inside an integrated Asia was only 32.5 per cent in 2006 (see Fig. 1). Over the last decade, East Asia has been dependent on external markets for economic growth and therefore has been singled out as the cause of world imbalance.

surplus. At the same time, high unemployment levels will lead to a build-up of internal pressure within the US. The US may resort to protectionist measures and this may lead to an abrupt decline in imports.

Can Asia decouple from the world?

Scholars have suggested that Asia can perhaps decouple and grow independently without depending on the rest of the world. While Asia

**Figure 1. Asia’s exports depend significantly on non-Asian final demand
Direct and indirect links, 2006**

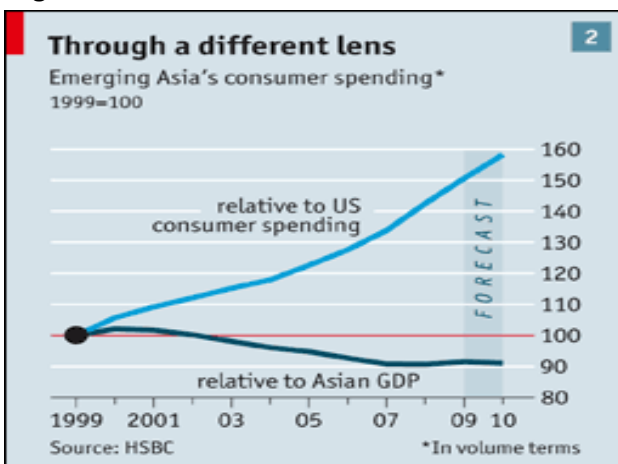


Second, the crisis has led to a decline in demand, especially from the US. The US cannot change its consumption habits drastically, though recent figures show that the US has learned to save more. Professor Ting, a former director of the Institute of World Economy and Politics, has argued that the US is unlikely to achieve a trade

can develop further by deepening economic integration in the regional market, for this to work, regional consumption in Asia must rise. However, Fig. 2 on page 33 shows that Asia’s consumer spending relative to Asian GDP has been declining for the past decade.

Secondly, can China play a role in the process of decoupling? A study shows that about 58 per cent of China's output fluctuations can be explained by a significant common world factor. This relationship holds true for the financial sector. China cannot decouple and grow by itself. Hence, there is a need for China and East Asia to undertake an integrated regional market approach.

Figure 2



regional arrangement have been overlooked. Dr Wang proposed that integration should begin with 10+3, with the major East Asian countries as the main channel, as this process has evolved over 10 years. It has its own institutionalization and leaders' meeting, and is supported by 10+1. While economically a bigger initiative is preferred, evidence from GATT, WTO and Apec show that the bigger the initiative, the more difficult it is to achieve results; smaller ones are more efficient.

There also has been joint research work to find ways to reach agreements and these have resulted in FTAs between Asean, China, Japan and South Korea.

Asean's Role in the Process

Asean's role is very important. A driver is needed to lead regional cooperation and only Asean has the licence to take that seat. East Asian cooperation cannot go forward if Asean does not take the driver's seat.

Competing Initiatives

Currently, there are too many initiatives, given the existence of 10+1, 10+3, 10+6, APC and EAC (proposed by the new government of Japan). Many interests compete behind diversified initiatives and as a result, even though we recognise that deepening regional cooperation is the future, we are far from making headway.

'10+3' should be the main channel

Regional cooperation has been crisis-driven. Different crises have led to different dialogues and responses. Because of the many initiatives and rival interests, the real benefits of the



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