

# Perspectives on East Asian Development: An Introduction

*Indermit Gill, Yukon Huang and Homi Kharas*

## A diverse region

Some say this will be Asia's century. If so, its origins began more than 40 years ago with Japan's postwar revival and acceptance into the Organisation for Economic Co-operation and Development, the club of the 24 rich economies, in 1964. Japan's remarkable economic growth was quickly duplicated by other Asian economies and, most recently, by the meteoric rise of China. Terms like Asian miracle, and high-performing Asian economies became part of the lexicon of economic development (World Bank 1993). Yet, it all went wrong for a while. Japan is only now emerging from its longest period of stagnation in 50 years, and the currency and banking crisis of 1997–98 brought five major countries in the region to their knees. The region is now well on its way to recovery again, returning to historically high growth, surging trade volumes, and an unprecedented accumulation of foreign reserves. But the memories of the recent setback are fresh; there is a layer of unease concerning the extent of shared benefits, and growing dismay over the stress that the once cohesive Asian societies are facing. Policy makers are eager not to be lulled again into a false sense of complacency about the region's future.

No region is as diverse as East Asia. Not only does per capita income (excluding Japan) vary from about US\$500 to over US\$25,000, but major divisions in less quantifiable factors such as language, culture, resource endowments, and political systems also persist. Despite this or perhaps because of this diversity, East Asia is integrated as never before. Goods, money, and, increasingly, knowledge are being traded across the region. The new terminology emphasizes regional production networks rather than country policies or leaders as keys to success. In many ways, East Asia is now undergoing a renaissance: redefining itself from a collection of disparate nations that once looked mainly to export markets in the West to a more self-reliant, innovative, and networked region. In the process, countries in the region are seeking to build stronger economic and political relationships among themselves, as well as more strategic partnerships with the rest of the world.

In this complex landscape, East Asians are fiercely debating options for the region. Much is at stake, including ensuring that any new East Asian economic architecture complements the evolving global architecture. This volume provides an opportunity to understand, firsthand, how some of the most influential thinkers in East Asia view the challenges for the region.

*East Asian Visions: Perspectives on Economic Development* is a collection of essays by 17 eminent East Asians who represent a broad spectrum of backgrounds and experiences.<sup>1</sup> All are senior policy makers, statesmen, or scholars who have either had to deal with or think through some of the most critical financial and developmental issues confronting their countries and the region. Collectively, 10 of them have, at some point in their careers, been at the head of key ministries and central banks; nearly a dozen have been academics and scholars of distinction; several have served as ambassadors to the West and bring a more global strategic perspective; and many have been influential policy advisors and decision makers in governments and international financial agencies.

Table 1.1 lists the authors, where they come from, and key positions they have held. Their essays reflect individual experiences at critical economic junctures and are occasionally

quite personal, not surprising since each author selected a topic of his or her own choosing. Given their backgrounds, they have chosen to write about the highly diverse country experiences of East Asia, covering rich, middle-income, and poor countries, and they speculate on how their countries fit into a rapidly changing region and globalizing world.

**TABLE 1.1. Contributing Authors**

<i>Author</i>	<i>Country</i>	<i>Key position(s)</i>
<i>Aun Porn Moniroth</i>	Cambodia	Secretary of State, Ministry of Economy and Finance; Chairman of the Supreme National Economic Council, Cambodia
<i>Roberto F. de Ocampo</i>	Philippines	President, Asian Institute of Management; former Secretary of Finance, Philippines
<i>Toyoo Gyohten</i>	Japan	President, Institute for International Monetary Affairs; former Chairman, Bank of Tokyo; former Vice Minister of Finance, Japan
<i>Yujiro Hayami</i>	Japan	Chairman, Foundation of Advanced Studies of International Development, Japan; Former Professor, Tokyo University and Cornell University
<i>Jomo Kwame Sundaram</i>	Malaysia	United Nations Assistant Secretary-General for Economic Development; former Professor, University of Malaya, Malaysia
<i>Cao Sy Kiem</i>	Vietnam	Academy of Social Sciences; former Governor, Central Bank, Vietnam
<i>Tommy Koh</i>	Singapore	Ambassador at large, Singapore; Chairman, Institute of Policy Studies; former Ambassador of Singapore to the United Nations and to the United States
<i>Haruhiko Kuroda</i>	Japan	President, Asian Development Bank; former Vice Minister of Finance, Japan; Professor, Hitotsubashi University, Japan
<i>Long Yongtu</i>	China	Secretary-General, Boao Forum for Asia, China; former Vice Minister, China; former Chief Negotiator for China, World Trade Organization
<i>Kishore Mahbubani</i>	Singapore	Dean, Lee Kuan Yew School of Public Policy, Singapore; former Ambassador of Singapore to the United Nations
<i>Felipe Medalla</i>	Philippines	Professor, University of the Philippines; former Secretary for Planning, Philippines; former Director General, National Economic and Development Authority, Philippines
<i>Mari Pangestu</i>	Indonesia	Minister of Trade, Indonesia; Board Member, Center for International and Strategic Studies, Indonesia
<i>Minxin Pei</i>	China	Senior Associate and Director, China Program, Carnegie Endowment for International Peace, Washington, DC
<i>Andrew Sheng</i>	Malaysia	Visiting Professor, University of Malaya, Malaysia, and Tsinghua University, Beijing; former Chair, Securities Commission; Deputy Chief Executive, Hong Kong Monetary Authority, Hong Kong (China)
<i>Wu Jinglian</i>	China	Professor, Chinese Academy of Social Sciences; Senior Fellow, Development Research Center, State Council, China; Member, Standing Committee, Chinese People's Political Consultative Conference, China
<i>Joseph Yam</i>	Hong Kong, China	Chief Executive, Hong Kong Monetary Authority, Hong Kong (China)
<i>Zheng Bijian</i>	China	Chairman, China Reform Forum; Executive Vice-President, Communist Party School, China

Source: Compiled by the editors.

Note: The names in italics are the last names. "Country" refers to place of birth or residence during the bulk of the individual's career.

Four themes permeate these essays (see table 1.2):

- What explains East Asia's growth and developmental success: Will it continue? Can all countries in the region benefit from China's success or will some be crowded out and left behind?
- Will the powerful forces of regional integration build efficiency or become a source of vulnerability? What if there is a disruption in China?
- Can East Asia avoid domestic disintegration given growing public intolerance of increasing

inequities, pollution, and corruption?

- From where will East Asia find its next generation of leaders? Are meritocratic elites and bureaucracies in decline? Can national sovereignty be partially set aside in favor of more effective regional associations?

None of these questions draws a ready answer. But by writing reflective essays, rather than technical pieces, the authors have the freedom to move between politics, economics, culture, physics, and ethics. What is lost in formality of approach is more than made up for by breadth of reasoning. Not surprisingly, the authors have a keen sense of the need to get the politics right: within countries, within the region among countries competing for leadership, and between the region and the West. And, because politics is rooted in history and culture and because East Asia has a long tradition in these areas, many authors start by looking backward. De Ocampo goes the furthest in this historical approach by noting, in the first paragraph of the first essay, an early episode of regional cooperation: “Southeast Asian economies were trading with each other as early as the seventh century, when the Sumatra-centered Srivijaya Empire controlled both the spice route between India and China and local trade along the coasts of Southeast Asia.”

**TABLE 1.2. A Roadmap to the Essays**

<i>Themes</i>	<i>Approach</i>	<i>Key questions</i>
Growth and development strategies	Historical perspectives Postwar performance  Future prospects and country differences	What are the lessons of history? Was the crisis indicative of some deep-rooted weaknesses or simply a pause in the miracle saga? Is China an opportunity or a threat? Can laggards thrive in the new Asia?
Networks and regional integration	Trade-production sharing network  Financial network Old regionalism versus new regionalism	Will the production-sharing network still drive regional growth and trade? Can East Asia create a viable regional financial network? Will East Asia move beyond market-based (old) regionalism to more politically driven (new) regionalism? What is the region: the Association of Southeast Asian Nations (ASEAN), ASEAN+3 (plus China, Japan, and Rep. of Korea), the East Asian Community, Asia-Pacific Economic Cooperation? Is regionalization or globalization driving East Asia?
Globalization and avoiding domestic disintegration	Social justice Sustainable development Ethics and corruption	Does increasing domestic or regional inequality matter? Do East Asians still believe in growth at any cost? Is corruption an ethical or a developmental concern?
Leadership and change agents	National: senior leadership, bureaucrats  Regional: ASEAN, China, Japan, Rep. of Korea, others  Global: United States and the West	Does leadership matter? Is there still a role for meritocratic elites and dedicated bureaucracies? Is ASEAN up to the task? Will China or Japan play a more active leadership role? Can Japan-China work it out? Is the West still relevant for East Asia?

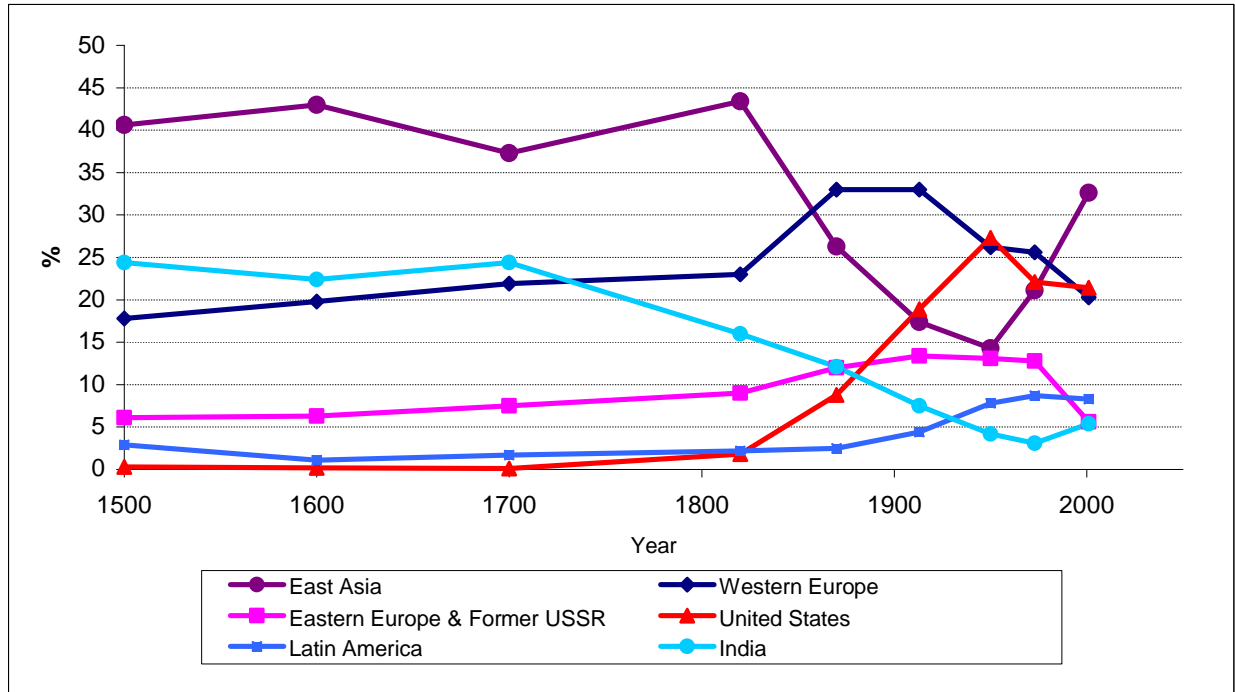
*Source:* Compiled by the editors.

## **Growth: Asia in the world**

For 300 years, East Asia contributed about two-fifths of global output (measured at purchasing power parity), while India added another quarter of total output until 1700. Asia’s long decline started with India and then spread. By the end of World War II, East Asia only

accounted for 15 percent of world output, and India for another 5 percent (see figure 1.1). East Asia’s rebound since then has been more rapid, relative to the rest of the world, than the Western European expansion during the industrial revolution or the expansion of the United States after the California Gold Rush.

**FIGURE 1.1. East Asia Rebounds: Share of World Gross Domestic Product**



Source: Maddison 2003.

Note: The percent shares are calculated at purchasing power parity in constant 1990 international dollars.

The essays in this volume address East Asia’s recent success against the backdrop of the region’s performance relative to the rest of the world. At the broadest level, some interpret East Asia’s rise as an inevitable rebound back toward the major presence it once had in the world, not only in terms of wealth, but also in creativity and culture. By one calculation, if East Asia continues to grow at the same speed relative to the rest of the world, it will regain its peak global importance by 2030 (Gill and Kharas 2006). This notion of catch-up, driven by an intense desire to compete with the West, reverberates through many essays.

*Competition with the West has bred success*

Sheng, drawing on his stints in key policy positions and long research tradition, refutes the idea that Confucian values are at the heart of the region’s success by noting that this did not prevent Asia’s demise centuries ago. That fall from grace, he feels, emanated from a failure to embrace the importance of markets and technological advancement in shaping society, as well as the inward-looking, self-satisfied complacency of Asian bureaucracies. He notes that “the concept of the market as a social mechanism that is more efficient than other forms of social governance is decidedly a Western invention,” and only when Asia began to embrace the concept of markets as a positive factor in defining society could it move forward.

Mahbubani, a former United Nations Ambassador and a noted author on Asian and Western political and social perspectives, shares similar views in pointing to the Japanese Meiji revolution and the postwar humiliations as key factors that forced Asia to seek out the best the West could offer in reshaping their societies. He notes that “this willingness to learn Western best practices and to adapt and apply them may thus be the key distinguishing feature of East Asian elites.” His pithy title, “From Confucius to Kennedy,” conveys the notion that it was Western-educated East Asian elites, returning home with a “boundless optimism,” who brought from America the idea that “a ‘great society’ could be created by human intervention.” This was the driving motivation behind the great Asian leaders, such as Deng Xiaoping, Lee Kuan Yew, Park Chung Hee, and the Meiji reformers, who modernized their countries at critical junctures.

In the same manner, Gyohten, one of Japan’s most influential international monetary policy figures in a career spanning over three decades, expresses astonishment at the lack of concern about Asia, because of its small economic size, when he first attended meetings at the Bank for International Settlements, in Basel, in 1967. He recalls, “I thought uneasily that, for those bankers, the world seemed still to end somewhere near the Dardanelles.” He pinpoints a catch-up mentality in Asia as the common ground upon which the successive development of Japan, the four tigers, the Association of Southeast Asian Nations (ASEAN), and now China has been established. He also notes that successful countries benefited from enlightened leadership, or, to put it more bluntly, “developmental dictatorship,” but cautions that collective dynamism, which a benevolent dictator may mobilize, may conflict with individual initiative in business activity. The trick is to find the right moment to shift between these two forces.

Not all the contributors feel the same sense of historical inevitability. While the miracle experience spawned a search for unique success factors in East Asia, the financial crisis of 1997–98 vindicated those who were skeptical about the origins and sustainability of the miracle, including some who characterized the achievements as simply the result of massive increases in investment and Asians working harder, but not necessarily smarter (Stiglitz and Yusuf 2001). The scars left on policy makers by the crisis may be seen in several essays that call for vigilance to avoid complacency and to accelerate reforms now when times are good.

So does the crisis indicate some deep-rooted weaknesses in East Asia or merely a pause in the miracle saga? As observed by de Ocampo, who was the chair of the Asia-Pacific Economic Cooperation Finance Ministers at the time, the crisis exposed glaring faults in the regulatory regimes and governance structures for financial institutions and corporations. It called into question the viability of family- and relationship-based conglomerates and their links with governments. And it tested the mettle of meritocratic bureaucracies in coping with complex and rapidly changing market conditions. The institutional weaknesses revealed by the crisis will surely take time to be fully resolved. Yet, East Asia has recovered speedily, surprising even the most ardent proponents of strong East Asian fundamentals. Expectations of a long stagnation have now totally changed. The growth of the emerging economies in East Asia since 1998 has been remarkable; gross domestic product (GDP) almost doubled by 2005. Concerns have shifted from broad regional weaknesses to questions such as whether China is growing too rapidly or how might an economy find the right balance between the quality and the speed of growth.

### *Competition with China is a concern*

China’s rise has undoubtedly changed the dynamics of regional economic relations. With its economies of scale and other advantages, it has leapfrogged up the technological ladder. No

other country in East Asia has the capacity to produce at all points between the lower and the upper ends of the technology spectrum. China now represents one-half of emerging East Asia's GDP and one-third of its exports. Its import-to-GDP share is now 34 percent, roughly triple the corresponding share of Japan and the United States. Although, in absolute terms, Japan's GDP is still much larger than China's at current market prices, China imports more from the world and significantly more from East Asia and so has shaped changes in regional trade volumes and commodity prices. Over the past decade, China (including Hong Kong) has accounted for as much as 40–60 percent of the growth of exports from neighboring countries, even in a major economy such as Japan.

Pangestu, a distinguished intellectual and minister of trade in the new Indonesian government, suggests that “the rest of the world, including developed countries, will have to make adjustments. In the interim, there may yet be greater tensions because of more protectionism as countries seek to cope with the fresh competition.” For many countries, there is a real preoccupation with whether China is an opportunity or a threat in the medium term, notwithstanding the short-term benefits to the region from China's huge imports. Gyohnten refers to Napoleon, who said, it is claimed, “China is a sleeping giant. Let her sleep, for, when she awakes, the world will tremble.”

These concerns are frankly expressed by Kiem, former governor of the Central Bank of Vietnam, and Medalla, from his perspective as a former secretary for planning in the Philippines. They elaborate on the past pattern of country growth during the Asian miracle and nostalgically recall the model of the flying geese formation, with Japan at the tip of the formation, and the four tigers next, followed by middle-income countries and then low-income countries producing at lower technology levels. This model provided a structure within which all economies could operate. There was a clear path for laggards to move up the production chain. China's emergence has changed this orderly progression.

But, if truth be told, there is more to it than simply China's emergence. Jomo, one of Malaysia's most noted and frank commentators on political economy matters, never bought into the flying geese model and sharply contrasts the less-than-stellar growth experiences of Southeast Asia relative to Northeast Asia. He views the latter's strengths as a reflection of domestic entrepreneurship and financing, as well as attention to social equity rather than to following Japanese technology.

Bearing in mind the prevalence of such concerns, Zheng, a prominent strategist in the Communist Party of China and the originator of the concept of “China's peaceful rise,” acknowledges the widespread apprehension over the so-called China threat. He offers reassurances that China seeks to manage its development in ways that would foster regional benefits and reduce frictions. Yet, at the same time, he is steadfast in affirming that the time has come for China to take its place as a global economic power. The coming years will be China's “golden age of development” leading to a great “renaissance of the Chinese nation” and confirming Mao Zedong's prediction in the 1950s that “China would become a big, powerful, yet approachable country.”

Most countries have, in fact, found a niche in which they may retain competitiveness relative to China. In the last few years, all countries in the region have been growing rapidly, and the gap between the richest and the poorest has been shrinking, the reverse of the global trend of relatively poor performance among middle-income countries (Garrett 2004). Kiem notes that countries have the choice of (1) investing in China and selling to China or world markets; (2) exporting components to China and making it the assembly plant for exports to others; or

(3) exporting raw materials to China. The United States and the European Union are focusing on the first channel. The four tigers and the more industrialized countries within ASEAN are focusing on the second. The less-developed countries that possess natural resources are focusing on the third.

Kiem's concern is whether the third path is a viable long-term option for low-income countries. Aun, the leader of Cambodia's young reformists, acknowledges that future growth in Cambodia will depend on exports, but worries about the social inequalities this may bring. Medalla argues that the Philippines did not gain as much as its more dynamic neighbors and "has the worst of both worlds: slow economic growth that is overly concentrated in and around Metro-Manila." He points out that many Philippine stakeholders are not convinced about the benefits of globalization or their ability to tap Chinese markets, especially because their nation's contributions appear largely to take the form of exporting labor rather than goods.

Pangestu also cautions that, without major internal reforms, the prospects for countries such as Indonesia may be grim. Given the current production-sharing system driven by economies of scale, relatively small changes in cost can cause significant changes in the volume of trade flows. Thus, competitive pressures may be brutal. Low-income countries with natural resources may come out well if improvements in global terms of trade hold up, but, unlike the newly industrialized countries, they have not been fully integrated into the production chain and fear being left out of the transition to the second path. Pangestu therefore argues that the prospects for many countries might be enhanced by collective action within ASEAN so as to supplement domestic reforms in individual countries.

### **Production-sharing networks and financial networks**

Many authors comment on the significance of the transformation of East Asian production and finance into a complex of intraregional networks. East Asia's share of world trade has increased from 10 percent in the 1970s to more than 25 percent today. Intraregional trade, which is increasingly based on components, has increased from 35 percent to 55 percent of the total and provided the biggest stimulus to the shifts taking place in the composition of trade. With such a wide range of factors at play, no single country within East Asia can dominate the production chain, but much of the activity is centered on China as the "assembly plant of the world."

#### *A new mode of production: regional networks*

By 1990, foreign affiliates already accounted for 30 to 90 percent of the total manufactured exports from China and other middle-income countries in East Asia. Japanese multinational companies now send more than 80 percent of their exports from Asian affiliates to other Asian countries and obtain 95 percent of their imports from Asian plants. Firm-level surveys suggest that outsourcing is almost 40 percent more prevalent in this region than in the rest of the world. The technological basis of product lines, however, is shifting rapidly. Low-skill, labor-intensive products such as garments and toys are becoming less important even for China and now account for only 15 percent of total exports. Improved logistics, supply-chain management, and specialization among countries have inspired a dynamic, but still largely uncharted process regarding the future location of production.

There is a strong link between much of this production-sharing-related trade and foreign

direct investment. Since 1980, inflows of foreign direct investment into East Asia have more than quadrupled, reaching 31 percent of the world inflows in 2004. Two-thirds of the regional inflows are going to China, which is now the premier destination for foreign investment globally.

The numbers suggest that, thus far, the production-sharing network has been a boon for the region. It has fostered efficiencies and lifted the competitive position of East Asia relative to the rest of the world. But much of this depends on what happens in China. Initially, China's role was constrained by its lack of secure market access and inability to join the World Trade Organization (WTO), while the state still dominated production. Long, who played a key role as China's chief WTO negotiator, traces the country's 15-year struggle to join WTO and reveals the extent to which integrating with the global economy has been part of a longer-term strategy of transition from plan to market. He now feels that the WTO-membership process has been as important as the outcome in helping to convince millions of domestic stakeholders about the virtues of globalization. Despite fears that WTO membership might initially impact negatively on the domestic economy, it clearly reinforced the already existing incentives for investment and exports and put aside any doubts about the merits of liberalizing trade in goods and services.

The worry today is no longer that China might be isolated, but that it will consolidate production networks inside its own borders. Kiem frets that production processes in China are likely to be interlinked more with its own hinterland than with low-income countries in Southeast Asia, and, if so, these countries may continue to lag behind. But such fears are dismissed by Wu, the dean of China's first generation of reform-minded economists. Wu elaborates on the long-standing debate among Chinese policy makers on industrial strategies and the country's past dependence on heavy industries. He sounds confident that China will rely more on services, resource sustainability, and technology-based activities in the future, moving up the value added ladder and leaving more room for industrialization in low-income countries.

Kuroda, as president of the Asian Development Bank, is well placed to survey how market-based trade and financial activities have transformed the region. He emphasizes the ability of crossborder infrastructure cooperation to reduce transaction and logistics costs, as well as stepped-up regional cooperation and integration in trade, investment, finance, and the prevention of regional public bads. He points to the need to design this cooperation in a way that gives preferential treatment to the least developed countries and helps to close development gaps.

### *Regional financial networks: topology and vulnerability*

If Asia's production-sharing network has been a source of strength thus far, then, as many authors note, the region's financial network was its Achilles heel in the past. As discussed in Sheng's essay, the rise of Asia's production network revolutionized industrial processes, but the concept was not new and evolved naturally from historically similar networks in Japan and Korea. Patterns of foreign direct investment and related financing helped shape the nature of supply chains, but depended on the strength of the Japanese financial system, which extended dollar-denominated credit for goods ultimately being sold in the United States.

Sheng describes how the political decision to allow the yen to depreciate against the U.S. dollar after 1995 boosted the yen value of these outstanding dollar assets of Japanese banks. At the same time, the falling Nikkei stock market index and a need to provision against bad domestic loans decreased the equity base of Japanese banks. This combination proved to be a recipe for a major credit retrenchment from East Asia. Both Sheng and de Ocampo highlight the contagion effects of the regional credit crunch. In the year and a half preceding the financial

crisis, nearly US\$90 billion flowed into Indonesia, Korea, the Philippines, and Thailand, but in the subsequent year and a half, nearly US\$80 billion flowed out, mostly back to Japanese banks.

Sheng frames his discussion in topological terms, calling the centralized financial network efficient, but describing it as lacking in robustness when the node came under pressure. He goes on to advocate the development of a distributed network for production and finance,<sup>2</sup> a combination which he believes would deliver both efficiency and robustness and which has become familiar in the region as the Toyota way of doing business. His assessment camouflages a warning: if the failure of the centralized node in Japan caused the financial crisis, does this imply that regional production networks, with centralized nodes in China, are similarly brittle?

For many of the authors, the trauma of the financial crisis has clearly not disappeared from the Asian psyche, causing them to ask whether the region is prepared to join together and reap the benefits of more integrated financial systems. Yam, who, as head of the Hong Kong Monetary Authority, sits at the crossroads of East Asian financial flows, is pushing for regional financial integration to increase market size and thereby reduce vulnerability to financial instability. But he cautions about any rush toward deeper monetary cooperation, noting the “intensely political” nature of any decision to yield power to a single common central bank in the region. He also notes the very different approaches taken in the region toward monetary policy independence, free capital mobility, and fixed exchange rates, approaches that would need to be harmonized if regional monetary cooperation is to progress.

The discussion of the crisis inevitably centers around the controversial role played by global institutions. For Sheng, it was only fitting that Japan initiated a number of proposals to provide more financing for the region, as he believes that Japanese banks were indirectly the culprit that triggered the collapse. But Japan also had to balance its interests with the West, and, as Jomo notes, the first proposal for an independent regional financing mechanism was thwarted by Western opposition, especially in the United States. At that time, the prevalent view throughout the region was that “vulnerability had been greatly increased by ill-considered economic liberalization policies, especially financial liberalization . . . By early 1998, . . . it was clear that [International Monetary Fund] solutions were part of the problem.”

Understandably, what permeates many essays is the sense that East Asia needs to be more self-reliant, mirroring the subtle shift toward regionalization rather than globalization as the focus of attention among policy makers. But Yam recognizes that the other side of the regionalization coin is the greater role that must be played by Asian governments in the international financial architecture. Because much of East Asia’s huge savings are invested in debt instruments in industrialized countries, while its investments are being financed by capital from those very same countries, the region is becoming more globally integrated at the same time that it becomes more regionally integrated. The policy implication is to strengthen regional capital markets so that East Asia’s surpluses can be intermediated within East Asia to meet the needs for major infrastructure and other capital investments. If successful, such reforms might transform a past vulnerability into a future advantage.

### *Regionalism and regionalization*

The center of economic gravity in East Asia has shifted toward China and Northeast Asia. Regionalism, which is based on formal economic and trade agreements, and regionalization, which is steered by market processes, are shaping the production and financial networks that are driving growth and innovation. Are these trends compatible with globalization?

The most obvious indicator of growing regionalism is the proliferation of free trade agreements, usually between two countries, but increasingly also between ASEAN and other countries, including some outside the region. In the last 10 years, 24 such agreements involving at least one East Asian country have come into effect, and another 34 are being negotiated. Most authors feel that trade issues are being appropriately addressed in these discussions and do not see them as conflicting with global approaches such as the WTO Doha Development Round (for example, Kuroda, Long, and Pangestu). Moreover, in light of the recent breakdown in the Doha round, many will likely continue to push for bilateral or regionally oriented processes despite warnings that this so-called noodle bowl approach will eventually turn out to be too complex or fraught with contradictions. Bilateralism seems to have gained the upper hand as a pragmatic alternative, but it is hope rather than experience that says this will work out as intended.

Free trade agreements are being negotiated almost as a matter of course, and most authors see making progress on regional financial integration as the near-term challenge. Following through on the Chiang Mai Initiative and the Asian Bond Markets Initiative, creating regional surveillance mechanisms, harmonizing standards, facilitating crossborder transactions, and establishing the framework for an eventual common currency are addressed in depth in many essays (Aun, de Ocampo, Gyohten, Jomo, Kuroda, and Yam). Asian bankers also defend their huge buildup of external reserves (now US\$1.6 trillion, excluding Japan) as necessary to establish a comfortable buffer against unexpected future swings in capital flows, much to the chagrin of the G-7, which sees this buildup as contributing to global macro imbalances.

The degree of enthusiasm for integration clearly varies. At the same time, the debate has also shifted to discussions about the identity of the region. Is it ASEAN, plus Northeast Asia? Does it include India because of the allure of the software strengths? Or the Pacific Rim, with its valued natural resources? Or should it be still broader so as to include the direct participation of the United States and other Western countries? There is no consensus, and it is therefore not surprising that leadership to promote further regionalization is fragmented. Gyohten believes categorically that Asian integration in the European style is not possible in the foreseeable future, but ASEAN will continue to be an important balancing power in the region.

Lagging countries in Asia have ambivalent attitudes toward greater regional economic integration, in stark contrast to China, for example (Long). But, as Medalla notes, “perhaps the best argument for economic integration is that it will make the fact more obvious that some countries are ahead and that some are behind. And the peoples of the lagging countries will start asking their governments the reason why.”

### **Avoiding domestic disintegration**

If Asia is to avoid social disintegration, it needs to deal with the challenges of the conflicts within civil society, the increasingly overwhelmed and polluted cities, and the sometimes unresponsive and corrupt bureaucracies. Most Asians are optimistic about their future, which includes more than simply economic growth or high incomes. Koh, whose distinguished career is particularly notable for the diversity of his interests, is most forceful in his belief in the need to broaden the debate beyond narrow economics. Asia, he says, should aspire to be admired “not only for its prosperity . . . , but also for its good governance, social equity, cohesive families, cultural achievements, care for the environment, and quality of life.” He sets forth three specific challenges: corruption, social equity, and environmental neglect and mismanagement.

Pei, representing the new generation of political economists whose work seeks to bridge

sharply contrasting perspectives between China and the West, warns that “behind the region’s increasing prosperity . . . lurk dangers and risks . . . But the mostly likely and most potent source of disruption is rising discontent with political leadership, lack of government integrity, and misguided public policies.” Thus, Asia “must not allow strong economic fundamentals to obscure the political risks inherent in . . . rapid economic modernization.”

In every East Asian country, rising inequality is one of the most politically sensitive issues. But does widening inequality matter? Clearly, for Koh, this is an ethical, as well as economic, matter: “a globalized world has become, for many people, a more unjust world.” Despite major achievements in poverty reduction (some 250 million people in East Asia have risen out of poverty since the financial crisis), inequality has increased in almost all countries and not only in income levels, but also in access to basic social services. What we now know is that the increase in inequality is driven less today by differences across countries than by differences within countries. So, the solutions are to be found in domestic integration, not regional or global integration (Gill and Kharas 2006). Hayami refers to experiences in Meiji Japan (1868–1912) and in Taiwan, China, after World War II to debunk the idea that a worsening of rural-urban disparities is an inevitable consequence of globalization.

Widening gaps between rural and urban incomes and between skilled and unskilled labor are the prime causes of growing inequality in East Asia. If, indeed, East Asia is benefiting from economies of scale through efficient production networks, then it is not surprising that those who are directly engaged in these networks are gaining the most. Networks operate in cities, where they thrive on the proximity of firms to each other, and they require skilled labor to manage the complex logistics and business processes. So, the opportunities for high pay are greatest for the skilled, urban workforce.

East Asia’s new production mode may thus have a tendency to worsen inequality, unlike the labor-intensive export-led strategy that made growth with equity famous. Agglomeration effects are a powerful force for urbanization within countries and for the concentration of activity across countries, but they do reward those who first understand how to exploit them. There is no doubt that income distribution is being profoundly affected by such factors. If appropriate mitigating policies are not put in place, pressures may emerge for dramatic distributive measures and higher taxes, which could reduce investment and eventually lead to slower growth. This has been the unhappy experience in some Latin American countries. East Asian policy makers have to respond proactively to address inequality, but, because this is a recent phenomenon, there is not much practical experience to build on.

An alternative to government redistribution is offered by Hayami, Japan’s most distinguished international rural development economist. In his view, the case being made that scale economies and agglomeration are unique to industrialization and urbanization is overdone. Drawing on experiences in rural development dating back to Meiji Japan, he notes that rural sectors, too, may benefit from economies of scale. He describes several cases where there is potential to form rural, community-based production and trade networks that rely on informal relationships and self-monitoring to reduce costs and that can link the domestic hinterland with international markets. If these could be developed with better internal infrastructure so as to reduce farm-to-market costs and increase the speed of delivery of perishables, it would help narrow rural-urban income differences and reduce pressures on Asia’s sprawling megacities, which are increasingly less able to deal with their social and environmental problems.

Asia’s environmental concerns flow largely from the rapid urbanization already under way, which, by global standards, is unprecedented. Air and water pollution, loss of biodiversity,

and deforestation: all have crossborder consequences (Hayami, Koh, and Kuroda), but such outcomes also reflect the resource-intensive and historically excessive focus on growth and industrialization in countries such as China (Wu and Zheng). Given East Asia's substantial achievements in recent years, will the growth-at-any-cost strategy continue? China's senior leadership has clearly signaled its concerns over the prospects for more sustainability and more balanced development, and, everywhere across the region, leaders are talking about the need for more balanced growth, more well-rounded societies, and sustainable development. Yet, how many of them really mean it when faced with stiff competitive pressures and a preoccupation with employment generation? So far, environmental sustainability in most of the region is still sadly lagging.

Aun believes that globalization inevitably draws attention to issues of weak governance and corruption. He voices concern over the developmental aspects. Koh and Pei go further, stressing the ethical issues as well. Some authors argue that there is an Asian paradox, that corruption coexists with rapid growth. The nature of corruption in East Asia does not seem to be as damaging to efficiency as is the case elsewhere in the world. Yet, others argue, corruption, if unchecked, can bring down governments and reverse decades of economic progress, as evidenced by regime changes in Indonesia and the Philippines. There is no evidence that East Asians are more tolerant of corruption than citizens of Western democracies. They demand that their political systems address the corrosive effects of corruption. Thus, East Asians appear to have the foresight to realize that governance is likely to be increasingly important in the future, especially as globalization exerts pressures for more transparency and the rule of law (Pangestu, Long). But the challenge of building sound institutions has been complicated by the political choice to decentralize most public spending to the local level. The speed of decentralization has run ahead of the speed of building accountability and transparency into local public systems.

### **Leadership: finding change agents nationally, regionally, and globally**

The citizens of some East Asian countries, frustrated over inadequate social services, inequality, urban decay, and weak governance structures, are increasingly holding their leaders accountable and demanding that bureaucracies shape up. In moving forward, are Asian institutions now sufficiently robust that the emergence of a heroic leader no longer matters? Some feel strongly that East Asia's future will depend on the quality of its top leadership (de Ocampo, Gyohten, Mahbubani, Pangestu, Pei, and Sheng). In the absence of inspired leadership, weak reform coalitions are the rule. Medalla wryly notes that the need is greatest where leadership is in shortest supply: "protectionist development strategies require much better governments than those the lagging countries have (and may, in fact, be the reason why they are lagging in the first place)."

Others argue that the challenge is to reestablish accountable, technocratic bureaucracies. They emphasize the need for a high-quality administrative system to manage a globalized and more complex environment. Over time, talent has tended to gravitate away from the public sector to the private sector (except perhaps in Singapore), but only at considerable cost. Sheng stresses that Asian bureaucracies "must make the important transition from a paternalistic top-down governance structure to a pluralistic market economy structure" since "a small elite can no longer manage large complex market economies open to wide public choice."

Pei notes that two of the institutional pillars for maintaining growth and mobilizing public support—the rule of law and the creation of political mechanisms for government

accountability and integrity—were often not established during past periods of reform. “Crises also provide new elites with a fresh political mandate,” but, in many cases, such as the financial crisis, the duration of crisis may be too short to inspire durable changes in governance structures. Mahbubani sees superior performance among the elites as one of Singapore’s distinctive achievements. Pangestu notes that effective governance is now the paramount issue everywhere. Most authors, however, do not equate good governance with the concept of democracy as defined in the West. Rather, they would argue that Asia needs to find its own way in determining what is effective and acceptable in light of history and social and cultural distinctions.

National leadership is only one part of the puzzle in the age of regionalism and globalization. Many authors also see the need for stronger regional associations. Perhaps more out of expediency than proven effectiveness, ASEAN is now at the center of an energized search to link regional interests in institutional ways that can deflect concerns about the primacy of particular countries or coalitions. Through overlapping and more inclusive geopolitical groupings such as ASEAN+3, the East Asian Community, and Asia-Pacific Economic Cooperation and reinforced by the proliferation of bilateral and multilateral free trade agreements and financial arrangements, regional cooperation is now a must-have topic for discussion whenever Asian policy makers come together.

Yet, many bemoan the lack of substantive progress because ASEAN has chosen to operate by consensus and to adhere to the principle of noninterference in the affairs of member states. No single country or grouping has stepped forward to help bridge differences and drive the process of forging purposeful direction, unlike the case during the formation of the European Union. Not surprisingly, these essays often wonder whether ASEAN is up to the task (Kiem).

The focus on regional leadership extends well beyond ASEAN to more geopolitical questions. What role will China and Japan play in the broader East Asian context? Is the West still a factor? Inevitably, such questions cannot be answered without considering the influence of Europe and the United States. Countries in the region are trying to balance all these relationships and hedge their bets. Gyohten elaborates on three trilateral relationships that will likely shape Asia’s future: China-Japan, China–United States, and Japan–United States. Each has its own complexities, and all are potentially intractable. All authors would probably therefore agree that, whether the goal is to promote accountability within democratic-type frameworks or move toward real integration within East Asia and in its relationships with the rest of the world, progress will require fresh thinking and more visionary leadership.

In conclusion, perhaps it is worth reflecting on what was lost during the centuries that Asia was in decline. The current Asian renaissance is about more than simply revived prosperity. It is also about creativity, cohesion, and civilization. In reflecting on Asia’s future and the challenges ahead, Koh raises the bar by suggesting that “we have to solve these and other shortcomings if we want the West to treat us as equals and if we want the rest of the non-Western world to look to Asia for inspiration.”

## A summary table on the coverage by the authors of the four main themes

**TABLE 1.3. Major Themes, by Author**

<i>Author</i>	<i>Country</i>	<i>Themes</i>			<i>An illustrative insight</i>
		<i>Growth</i>	<i>Networks</i>	<i>Disintegration</i> <i>Leadership</i>	
<i>Aun</i>	Cambodia		•	•	Low-income countries will need stronger regional leadership
<i>de Ocampo</i>	Philippines		•		Lessons of the financial crisis and implications for leadership
<i>Gyohten</i>	Japan	•	•		Resolving key bilateral relations: China, Japan, United States and ASEAN
<i>Hayami</i>	Japan		•	•	Rural supply links can be brought into the regional production chain
<i>Jomo</i>	Malaysia	•	•		Asia must be more self-reliant and learn from the past
<i>Kiem</i>	Vietnam		•	•	Low-income countries are in danger of being left behind
<i>Koh</i>	Singapore			•	Nonincome development challenges must not be forgotten
<i>Kuroda</i>	Japan		•	•	Regionalization is central to Asia's future
<i>Long</i>	China		•		Globalization can be used to build a domestic reform constituency
<i>Mahubani</i>	Singapore	•			Leadership and the role of elites are key to development
<i>Medalla</i>	Philippines	•	•	•	Citizens in lagging countries must demand better government
<i>Pangestu</i>	Indonesia		•	•	Good governance is even more important than good policies
<i>Pei</i>	China			•	Economic success can be derailed by social and political vulnerabilities
<i>Sheng</i>	Malaysia	•	•		Economic networks have particular strengths and vulnerabilities
<i>Wu</i>	China	•		•	China's industries must become more resource efficient
<i>Yam</i>	Hong Kong, China		•		Regional financial integration is the most pressing challenge
<i>Zheng</i>	China	•		•	China's peaceful rise is not a threat, but it is inevitable

*Source:* Compiled by the editors.

### Notes

<sup>1</sup> This volume is a companion piece to Gill and Kharas (2006). That volume analyzes the drivers of growth in the new East Asian environment. It looks at how recent economic thought can be used to provide a rich analytical framework for many of the critical policy issues discussed in these essays.

<sup>2</sup> A distributed network is like a net in which each node is connected to several other nodes. There are therefore many pathways to connect nodes in the net. The further the nodes from each other, the more the number of potential connecting pathways. This differs from a centralized network that describes a hub-and-spoke arrangement wherein the nodes connect to each other only through a central hub.

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