

The Future of Asia

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Regional dynamism

Asia's ascent in the global landscape has been a long one. In 1964, Japan was accepted as a member of the Organisation for Economic Co-operation and Development. If you had gone to the Organisation for Economic Co-operation and Development at that time, you would have seen that the delegates met in a large, elegant conference room in Paris and that there were 24 countries around the table. And, when the members of the Japanese delegation found themselves in that room for the first time, they would have seen that they were the only delegation whose members were so different, so non-Caucasian. I still remember vividly the day when I went to a meeting at the Bank for International Settlements in Basel as an observer. It was the year the Cultural Revolution was sweeping China. Red Guards were rampaging there, and it was of high concern to neighboring Asian countries. But at the meeting at the Bank for International Settlements, central bankers from all the European countries were gathered, had cocktails, luncheons, and dinners, and talked endlessly about gold, the dollar, and the pound sterling, switching among English, French, and German. There was absolutely no interest in the upheavals going on at that moment in China. The Vietnam War was at a critical stage, but, apparently, the bankers had little interest in such events. I thought uneasily that, for those bankers, the world seemed still to end somewhere near the Dardanelles.

For Asians who have memories of those days, the interest in Asian issues shown today by political and business leaders in the West, the frequency of reports about Asian affairs now appearing in the Western media, and the volume of articles and books published in the West on things Asian are dazzling. This reminds me of an ancient Asian saying, "The history of man never stops flowing."

The Asian ascent started in the 1960s. Japan, defeated in World War II, had lost 70 percent of its industrial output. It made a rapid recovery from the destruction. The factors that enabled this performance were certainly not singular. Skillful economic policy management (such as the income doubling plan in the 1960s), the free access to the U.S. market, the undervalued exchange rate of ¥360 per dollar, the favorable demographic situation, and the highly motivated business leaders and workers all made important contributions. In less than three decades, after near-total destruction, the Japanese economy recovered and was the second largest economy in the world. The recovery of Japan was remarkable. But more remarkable was the fact that the success of Japan has turned out to be the harbinger of the development of the entire East Asian economy over the last four decades. An almost feverish enthusiasm for development has spread throughout the region. The East Asian dynamo of economic development has been ignited.

One unique feature of Asian economic development is that it has always been led by a forerunner. After Japan, it was the four tigers in the 1970s, that is, Hong Kong (China), the Republic of Korea, Singapore, and Taiwan (China). Each with a competent and stable government supported by a high-quality labor force, the four tigers started stalking successful development in the wake of Japan. They focused their resources on the promotion of exports.

During the 1980s, the member countries of the Association of Southeast Asian Nations

joined the race. Most of these countries had been relatively underdeveloped. Various diversities within society, the relatively low level of public education, and the inadequacy of social and economic infrastructure meant that these countries lagged behind the four tigers. But they were stimulated and inspired by the achievement of the four tigers, and they quickly recognized their economic and strategic importance within the region. They accelerated their efforts at economic development in parallel with their cooperative endeavor to strengthen their ties as a group.

In the 1990s, the world was mesmerized by the stunning economic growth rates in China. The historic ascent of the Chinese economy started in 1979 when Deng Xiaoping launched the Opening and Reform campaign. Deng's reform policy was unquestionable evidence that he was a true political genius. He succeeded in unleashing the dynamism needed to awake the sleeping lion. He proved that Napoleon's ominous prophecy 200 years earlier had been correct. ("China is a sleeping giant. Let her sleep, for, when she awakes, the world will tremble.") Deng departed from communist orthodoxy by discarding some of the fundamental principles. Yet, he managed to uphold the political legitimacy of the communist dictatorship after skillfully overcoming serious difficulties, including the protests at Tiananmen Square in 1989. The Chinese economy entered a period of tremendous growth. In a matter of only two decades, China has become a world-leading producer of many consumer goods.

At the beginning of the 21st century, it seems increasingly clear that the Asian ascent will continue. India, another sleeping giant for many centuries, is looming on the horizon. With its vast human resources of high quality and its resilient democracy, India has clear potential of becoming the next Asian economic powerhouse.

Numerous books have already been written exploring the secret of the ascent of Asia. The most intriguing feature of the phenomenon is the fact that, while Asia is admittedly a region of great diversity, there has clearly been a regional dynamism common in all the economies. One factor that exists universally in the region is the sense of strong national aspiration to development. In Asia, there is a shared target; all societies try to catch the forerunner. The catch-up mentality seems to have provided a common ground upon which the development of each economy could be established. Also important was the enlightened and motivated leadership in most economies, though not in all. Leaders succeeded in stimulating a sort of collective dynamism in their nations and in directing this dynamism toward the national goal of economic development. Equally important, many of them knew that the promise of freedom could unleash individual initiative in business activities.

Developmental dictatorship

This political style is often dubbed developmental dictatorship. It cannot be denied that developmental dictatorship is not always compatible with the principles of democracy. It was, in most cases, accompanied by a certain amount of planning and control by the government. It was not a system based on the free action of market forces. Yet, it can neither be denied that developmental dictatorship did serve the purpose when social and market infrastructure was not mature enough to generate an autonomous thrust toward development. This situation represents a dilemma for many developing economies. It is almost natural for a developing economy, particularly one driven by the urge to catch up with forerunners, to consider powerful government leadership necessary in mobilizing and organizing otherwise listless forces.

However, the value of developmental dictatorship has a clear limit. If the dictatorship tries to outlive its historical usefulness, it will quickly become a detriment. The dictator must

turn over the reins to private market forces. Thus, the success of a developing economy depends on the quality of leadership. The leaders must be sufficiently wise to discern when the dictatorship is no longer needed. They must be courageous enough to relinquish power that has outlived its usefulness. Inertia, complacency, and vested interests are the worst enemies of any leader in a developing economy.

The first serious challenge for the galloping Asian economy came with the tide of globalization. The first victim of the challenge was Japan. Until the 1980s, Japan was the role model for East Asian economies in their quest for an ideal development strategy. In a sense, Japan played an exemplary role in demonstrating the value of developmental dictatorship. The enlightened and motivated government guided the economy skillfully, while the dynamic, yet well-disciplined, well-organized private business sector ran the economy. The dexterous combination of control and protection worked well in mobilizing the potent dynamism that had been stored in an economy effectively secluded from outside influence. However, the wave of globalization undermined the very foundation of the system.

The basis of globalization was to be found in a new sort of environment for economic activities. This environment was, first of all, symbolized by the free flow of information and financial resources on a global scale. As the result of the information technology revolution, the traditional monopoly on information by the government and business managers had been effectively broken. Now, every voter, taxpayer, shareholder, consumer, and employee might share the same information universally and instantaneously. This new situation made the competition for efficiency global, and it made values such as transparency and accountability the most important in governance and business management.

Unfortunately, the traditional Japanese model, which had been so successful, lacked these ingredients. Beginning in the mid-1980s, the economic bubble ballooned and then burst. The economy suffered more than a decade of stagnation. In hindsight, the whole disaster seems to have been caused by a series of mistakes in economic policy decision making that had their root in Japan's inability to adapt to the new environment of globalization. The system of control and protection by the government, the lack of awareness about global competition, and the disregard for transparency and accountability all contributed to Japan's inability to make bold changes. The sense of complacency and inertia that was the child of the experience of past successes aggravated the situation. Only after the traumatic shock of the near collapse of the financial system in 1997 did Japan finally awaken and undertake, in earnest, the structural reforms that are bearing fruit in the current impressive recovery.

Asian economies also learned painful lessons. The 1997–98 Asian financial crisis was caused by a combination of factors. Yet, the most immediate cause was a combination of the massive, volatile flow of short-term capital and a weak banking system under inadequate supervision. The fragile banking system in East Asia simply could not withstand the onslaught of speculative international capital. The tragedy occurred because, although these economies were not big or strong, they opened up their capital markets after incessant prodding by U.S. advocates of globalization. In hindsight, they should have opened their capital markets according to a properly sequenced schedule. They miscalculated the monstrous force of globalization.

Regional cooperation

In any event, East Asians realized, with a sense of remorse, that their economies were not fully prepared to join the globalizing world in spite of the remarkable physical development they

had achieved. In dealing with the aftermath of the crisis, they became convinced that the region needed to become equipped to prevent and manage crises more effectively. Their particular concerns were that there was no mechanism to facilitate emergency financing, no market for mobilizing domestic savings for the development of the region, and no arrangement to reduce exchange rate volatility. Indeed, this fresh awareness marked the start of efforts to foster Asian economic cooperation that, in the following years, gained great momentum.

Certainly, Asian economic cooperation was not a new concept. The Association of Southeast Asian Nations was created in 1967, and a variety of efforts have been undertaken to encourage intraregional trade and investment and to coordinate industrial policy. Only following the 1997 crisis, however, were concerted and conscious steps launched to promote Asian regional economic cooperation in an organized, institutionalized fashion.

Many different vectors are operating in the region; all are moving toward some sort of regional economic cooperation. There are several tracks. However, I think we can group the efforts into two broad categories. One is government led, and the other is market driven. The first category of cooperation includes a network of free trade agreements. Indeed, during the last decade, bilateral and intraregional free trade agreements have mushroomed. These agreements will probably contribute to increasing the aggregate volume of trade within the region. There is some concern over these flourishing arrangements, however. First, at present, with few exceptions, the arrangements are designed only to reduce tariffs bilaterally. They are not intended to liberalize and stimulate broader economic activities in the region. Second, because tariff reduction is carried out by discriminating against outsiders, the proliferation of such arrangements may not support the overall balanced development of intraregional trade.

Other types of cooperation are practiced mostly in the area of finance. Cooperative projects have been initiated directly following on the lessons of the Asian financial crisis of 1997–98. After the crisis, many Asian economies suffered severe shortages of foreign currency. Many Asians felt that the International Monetary Fund was not forthcoming in providing adequate financing. They felt they had been discriminated against relative to other regions such as Latin America. Many Asians became convinced they needed their own regional financing facility.

As a first step toward financial and monetary cooperation, central banks in the region have established a network of currency swap agreements. Already, 18 such agreements have been concluded, at a total of US\$40 billion equivalent. Central banks are expected to try to develop the network into a centralized pool of reserves that may function as a regional monetary fund. For success, such a facility must have an appropriate degree of conditionality and sufficient authority over policy surveillance.

A second step is the development of capital markets to receive investments of the region's internal savings through instruments of obligation issued by public and private borrowers in the region. The idea of a regional bond market has been prompted by the fact that, so far, most of the region's excess savings have been invested in nonregional instruments, particularly U.S. Treasury obligations, and then have detoured back into the region through nonregional investors. Asia was not the master of its own savings.

A regional bond market will succeed only if a standard, dependable market infrastructure is in place, including settlement, accounting, auditing, rating, and so on. An adequate degree of liquidity and appropriate arrangements for credit enhancement will also be required.

The third step in financial and monetary cooperation is the creation of some sort of common Asian currency. This idea arose because, although East Asian countries have around

US\$3 trillion in official reserves, international economic activities in the region are conducted predominantly in nonregional currencies, particularly the U.S. dollar, and the Asian economy is still susceptible to fluctuations in the dollar exchange rate. All these irregularities might be solved, in theory at least, through the creation of a common reserve currency in Asia. The creation of a common currency is a project for the long haul. Even in Europe, where conditions are much more favourable, it took 50 years to issue the first euro. Still, if Asia wants to establish itself as an integral economic power in the world, Asia needs its own currency. Theoretical studies on the desirable shape of the common currency and the proper sequence of preparatory stages have been flourishing. On a more practical level, the Asian Development Bank is reported to be working on the idea of a notional composite currency unit that would be a representative indicator of Asian currencies.

Thus, there are several schemes for Asian financial and monetary cooperation proceeding at different speeds. The enthusiasm for and momentum of financial and monetary cooperation will continue to mount in coming years. As the integration of the real economy progresses, it will provide increasing support for the need to integrate the superstructure. In the process, the most serious challenge will be securing a consensus among all governments in the region that they should surrender national sovereignty as soon as possible and as much as possible. Without a surrender of national sovereignty, no surveillance mechanism will work effectively, and no common currency will be feasible.

In addition to government-led cooperation, there has been a strong movement toward market-driven economic cooperation in Asia. The rapid development of the Asian economy was supported in the 1960s primarily by exports. All Asian countries, taking advantage of their cheap labor and imported foreign technology and techniques, were racing against each other to produce competitive products and export them outside the region, notably, to the United States. There was not so much intraregional trade and investment. Then, in the middle of the 1980s, there emerged a fundamental change in the picture. The change was triggered by the surge in Japanese direct investment in the region. Motivated by the sharp appreciation of the yen following the Plaza Accord in October 1985, Japanese manufacturing industries moved their factories into neighboring Asian countries. This set off new flows of goods and capital within the region. Japanese industries exported parts and components to their overseas factories and shipped finished products back to Japan and to other Asian countries. This pattern of operation was replicated by other relatively developed economies such as Hong Kong, Korea, Singapore, and Taiwan. In this respect, the overseas Chinese capitalists who are scattered all around Southeast Asia have played an important role. Apparently, the new pattern in the movement of production factors stimulated indigenous economic development in all countries in the region, and a beneficial regional chain reaction had started.

Now, the level of intraregional trade and investment in East Asia is comparable to that in the European Union and the North American Free Trade Agreement. The complementarity of exports and imports is also high. The interprocess division of labor among regional countries has likewise risen markedly. East Asia has grown into a huge integrated manufacturing plant. Energy resources and raw materials are imported from outside the region. Within the plant, Honk Kong, Japan, Korea, Taiwan, Singapore, and others produce high-grade industrial materials, parts, and components and ship them to China, Indonesia, Thailand, and Vietnam, where they are processed into final products and exported outside the region. It is intriguing that such a large-scale transformation of industrial structure has occurred with virtually no government support. The entire process has been accomplished through market-driven private initiative.

What implications might this have for the global economy? The world economy today depends on the robust growth of the U.S. economy, which, in turn, is supported by strong growth in household consumption. The problem is that the import component of U.S. consumption is high. This reflects the eroding manufacturing base for many consumer goods. The bulk of the soaring U.S. trade deficit since the beginning of the 21st century is attributable to the increase in imports of various consumer goods. The large trade deficit is financed by capital inflows from surplus countries, aggravating the debtor position of the United States. The debt servicing cost is increasing. In 2005, the U.S. current account deficit reached US\$800 billion, about 7 percent of the gross domestic product of the United States. Roughly half the deficit is with East Asia. I said East Asia is now an integrated manufacturing plant. It is true that many U.S. multinational companies have set up operations in the plant. They are an important part of the production process. However, as a national economy, the United States is not integrated in the plant. It is an end-buyer of products made in the plant. The situation implies that the imbalance between the United States and East Asia has become almost structural; it has become less elastic to shifts in prices and incomes. Indeed, the success of Asian economic cooperation seems to have added a new problem to the issue of global imbalances.

There is also the other important aspect of the large imbalance between the United States and East Asia. East Asian governments have amassed US\$3 trillion in official reserves, most of which is invested in U.S. Treasury obligations. The huge national assets of East Asia are exposed to exchange rate risk and interest rate risk. At the same time, any major shift in portfolio will trigger a fluctuation in the U.S. dollar rate and the U.S. long-term rate. In a sense, East Asian governments are overloaded with double-edged swords. The relationship between the United States and East Asia is at the core of the issue of global imbalances.

In many respects, the achievements in Asian cooperation and Asian integration have been impressive. However, one has to admit that, so far, most of the progress has been made at the functional level, but not at the institutional level. Many people argue that this is inevitable considering the vast diversity in the region. They believe that Asia should continue to expand the scope for functional cooperation in whatever areas regional consensus may be secured. Environmental protection, human security, cultural and personal exchanges, energy conservation, research and education, and so on are cited as possible areas for functional integration. I am ready to recognize that these areas are indeed of great importance for the region as a whole, and progress in these areas will contribute greatly to the welfare of all people in the region.

A trilateral relationship and three bilateral relationships

If Asians dream of truly accomplishing any substantive integration in the region following the example of the European Union, no matter how long it may take, then they must consider seriously whether their dream has any chance of realization. What are the obstacles they face? In my view, the fundamental problem facing Asian integration is the lack of a stable leadership structure. More concretely, it is the instability in the trilateral relationship between China, Japan, and the United States. In this respect, Asia is totally different from the European Union and the North American Free Trade Agreement.

For Asia, the trilateral relationship can be decomposed into three bilateral relationships, that is, China-Japan, China-United States, and Japan-United States. Naturally, all three bilateral relationships are affected by developments in the other two. It is not possible to discuss any one of the bilateral relationships to the exclusion of the other two.

I would not consider the Japan–United States relationship the easiest; yet, it is at least more predictable than the others. The Japan–United States relationship since the end of World War II has had phases. On the whole, it has become more natural and more mature. They know each other better, their respective strengths and weaknesses, the opportunities, and the risks. Their economies are reasonably intertwined. Although there is still a large trade imbalance, this does not create serious trade disputes. Above all, Japan is committed to being a solid member of the democracies on the Pacific Rim. Between Japan and the United States is a relationship between two countries with well-established democracies and open, mature markets.

The challenge for Japan and the United States in coming years will be to identify common objectives and other areas of cooperation. One objective should certainly be to establish and maintain markets of the highest quality, markets that ensure dynamism, openness, fairness, self-discipline, and efficiency. If this is done, the influence of this success, as an exemplar, will penetrate throughout Asia and well into Eurasia. A second objective should be to cooperate so as to awake the world to the need for a multilateral effort in addressing the problem of global imbalances. The problem of global imbalances cannot be solved unilaterally or even bilaterally. It needs to be addressed through economic policy coordination at a multilateral level. Japan and the United States should cooperate to take the lead so as to move the world. The core of the problem of global imbalances is the disequilibriums in savings ratios and exchange rates. All countries must recognize the need to join in the process of adjustment in their respective ways. Mutual-blaming will never work.

The China-Japan relationship has many unique features. It currently seems to be characterized by a dichotomy, that is, a close economic relationship and a somewhat strained political relationship. We should take a long-term historic view, and we should not forget that there will always be some competition and rivalry. China and Japan have a bilateral relationship spanning over 2,000 years. There have been wars, but we have also enjoyed the richest interaction in culture, religion, human exchanges, trade, and so on.

The balance of power between the two countries has shown major shifts since the middle of the 19th century. Then, China suffered a major setback and humiliation. The incompetence and corruption of the Qing Dynasty hurt the country badly. This invited colonization by Western powers, defeat in a war with Japan in 1895, ongoing internal conflicts, and the Japanese invasion from 1931 to 1945. Since 1949, however, under communist rule, China has made a spectacular resurgence. At the beginning of the 21st century, China is ascending toward the apex of an historical cycle of power. Its national pride has fully recovered.

Meanwhile, Japan was emerging as the first Asian country to fend off the wave of Western colonization and become an important world power. However, overblown ambition resulted in a traumatic defeat in 1945 that forced Japan to give up its illusion of becoming the hegemon of Asia. Still, in the 60 years since the end of the war, Japan has also rebuilt itself as a democratic country and a world economic power.

Against this backdrop, shouldn't it even seem natural that these two countries feel they are in competition with each other in the quest for leadership in the region?

On the economic front, China and Japan are now functioning as two important partners supporting the Asian manufacturing plant. At present, 35,000 Japanese companies are operating in China, paying \$800 billion in taxes to the Chinese government, and 100,000 Japanese are working in China. Almost 10 million Chinese are employed by Japanese firms.

How may we establish a stable, nonhostile relationship? Given the complexity of the geopolitical issues and all the other issues, one should not expect a quick, permanent solution.

The element of competition is deeply embedded. It is quite possible for both of us to become convinced that the maintenance of a stable, nonhostile relationship will serve the best interests of others as well. We should deepen and broaden our cooperation in all noncontroversial areas, and these exist in abundance. We should also establish a constant, frank dialogue between leaders so that they can gradually build a relationship of mutual trust and free of unnecessary suspicion. We should continue to take these doable steps. Beyond that, we must be content to ask history.

The China–United States relationship has, no doubt, global implications. Both sides have many issues to take into strategic consideration. For the time being, the relationship is being conducted as if it were a bargaining game. What pattern of development will China follow? Will it develop into a country that embraces the same value standards as Western democracies, thus vindicating the hopeful American dictum that “democracy is inevitable”? Or, will China develop into an economic and military superpower that is ruled by a communist dictatorship? Or, will there be some sort of hybrid? If we look back over the 4,000 years of Chinese history, with 15 or so dynasties that rose and fell, we discover that China prospered best when the country was ruled by an enlightened, benevolent, but ruthless emperor, the Child of Heaven. It should not seem too far from the truth to affirm that the Communist Party of China is playing the same role as the Child of Heaven. This means the basic framework of China as a country has not departed far from its historical legacy. Will China change? That is the question. If China does not change, we may see, in the long run, a competition between two sets of ideologies: if I may paraphrase, the competition between individual democracy and collective democracy. The United States has triumphed over fascism and communism and is now engaged in a deadly battle against Islamic fundamentalism. It may turn out that the United States will fight another ideological war sometime during the 21st century.

If the surrender of national sovereignty is a prerequisite for Asian integration, then Asian integration in the style of Europe will not happen in the foreseeable future. Three major powers that have big stakes in the region have too much national interest involved. As long as the trilateral relationship lacks enduring stability, they have no compelling reason to sacrifice national sovereignty. Other Asian countries, particularly those in the Association of Southeast Asian Nations, have a strong sense of ambivalence toward each of the three powers. They are eager to act as a balancing counterweight lest they become submerged in the trilateral power game. There will be ample opportunity for them to play that role.

Regional cooperation will surely continue to progress. Everybody is firmly convinced that regional economic cooperation, be it market driven or government led, brings benefits to the majority. Here is a big hope. If regional economic cooperation, in alliance with significant public and private effort, succeeds in promoting economic development and enhancing the living standards in every country in the region, this will accelerate structural change in society, which, in turn, will prompt political reform. A political structure based on the divisions between the ruler and the ruled may remain viable only as long as the majority of people have time to think of nothing else but how to improve their daily lives. When people become sufficiently affluent, they will carefully consider issues about political systems. Some may prefer collective democracy to individual democracy, but the important point is that the choice will be a choice by the people themselves.