

## **Development of Globalization, Dynamic Economic Development and Emerging Challenges in the Asia-Pacific Region**

Key Note Speech on “Sustainable Economic Growth in the Asia-Pacific Region,”  
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### **I. Introduction**

Our time is characterized by rapid changes of which the globalization of economic activity is one of the most important factors that can be attributed to these changes. Economic globalization has brought about the expansion of markets and deepening of economic interdependence beyond state-borders. Recently, bilateral FTAs and RTAs have aimed for “deeper integration,” which involves additional elements for harmonizing national policies and reduces options for government intervention. This trend is referred to as “new regionalism,” which is characterized as a high level of liberalization on trade in goods and services, and harmonization across a broad range of policies. Since this new idea is based on “competitive liberalization,” it argues that the proliferation of FTAs and RTAs would put multilateral negotiations back on track, facilitating globalization processes throughout the world.

Globalization has brought about a tremendous impact on the Asia-Pacific region. Based on geographical proximity and advances in transportation technology, the Asia-Pacific region has emerged as an integrated economic actor in the world economy. Even though there is no formal agreement on regional integration among the countries in the region, expansion of intra-regional trade and deepening of supply chain structures have boosted mutual interdependence in the region.

This forum will provide a great opportunity to discuss the development of globalization and emerging challenges in the Asia-Pacific region.

### **II. Development of Regional Integration**

Economic regionalism is taking root in the Asia-Pacific region. The region is becoming highly integrated through market-driven trade and FDI activities: the share of exports from East Asia in total world exports rose from 14% in 1980 to 27% in 2006 and its share of imports expanded from 15% to 24% during the same period. FDI inflows into East Asia increased more than three times, from 5% of world total FDI inflow in 1980 to 16% in 2005.

Along with expansion in trade and FDI activities, the volume and share of intra-regional trade and FDI inflow have also strengthened. The volume of intra-regional trade among APEC Member countries increased from US\$ 1.4 trillion in 1994 to US\$ 3.3 trillion in 2005. In the case of ASEAN+6 (ASEAN, China, Japan, Korea, New Zealand, Australia and India), intra-regional trade shares rose from 34.6% in 1980 to 42.6% in 2005. When we include Hong Kong and Taiwan, intra-regional trade shares reach 57.6% for 2005. Comparing other major economic blocs, the intra-regional trade shares among ASEAN+6, Hong Kong and Taiwan are slightly lower than that of the old EU 15 (59.7% in 2005), but is higher than NAFTA (44.3% in 2005). In terms of FDI, intra-regional FDI inflows among Asian Newly Industrializing Economies (NIEs) comprise 34.9% of total inflows into East Asia during 1995

to 2005.<sup>1</sup>

Bilateral or unilateral liberalization in trade and investment would be an important contributing factor for such rapid increases in economic interdependence. According to the APEC report “Busan Roadmap to Bogor Goals”, average applied tariffs levied by APEC economies had fallen from 16.9% in 1989 to 6.8% in 2005. The proliferation of bilateral Free Trade Agreements among intra-regional countries in Asia-Pacific region has increased economic ties in the region: 55 FTAs have been concluded within ASEAN+3 countries and 21 additional FTAs are under negotiation.<sup>2</sup> The number of FTAs either concluded or under negotiation among ASEAN+3 countries outscored FTAs which ASEAN+3 countries have with outside ASEAN+3 countries.<sup>3</sup>

The Asia-Pacific region is virtually headed for an integrated economic bloc. Lively discussion has been exchanged regarding institutionalizing regional integration; however, no concrete vision or roadmap has been produced yet. ASEAN+3 and ASEAN+6 are one of the proposed ideas toward economic integration in the Asia-Pacific region. Also, long-term idea of forming a Free Trade Area of the Asia Pacific (FTAAP), which was proposed at the 2004 APEC Business Advisory Council (ABAC) meeting and discussed at the Hanoi APEC meeting in 2006 by the Leaders, can be another example of recent developments in regional integration. Whether or not there is a consented roadmap for regional integration, increased economic interdependence in the Asia-Pacific region will be unavoidable.

### **III. Emerging Challenges in the Asia-Pacific Region**

Globalization is a market-driven reality, but it is a reality we want to manage. It brings both benefits and challenges: there is no doubt that globalization and regional integration will allow us to realize economies of scale and efficient resource allocation and production, which will result in an increase in welfare. It also conveys the basis of a better understanding among different cultures and religions, which could reduce militant competition and tension. On the other hand, globalization and regional integration will bring new challenges that we have to handle to move a step forward. Narrowing regional imbalances, facilitating structural reform and resolving the possible spaghetti bowl effect in the region should be properly handled and we should strengthen regional cooperation in energy security, financial stability and climate change. These are concerns that I am going to raise as new challenges in the Asia-Pacific region.

#### **1. Global Imbalances**

“Global imbalances” are currently one of the most frequently cited buzzwords in policy and financial circles. Many official forecasts point out these huge imbalances as a key risk to the global outlook. While these imbalances are certainly a global issue, a tremendous portion of them occurs in the Asia-Pacific region. According to the 2007 UNCTAD Trade and Development Report, the US current account deficit has risen steadily from 1.6 percent of

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<sup>1</sup> In this statistical data, East Asia includes Asian NIEs, ASEAN 9 (ASEAN Member States excluding Singapore) and China.

<sup>2</sup> The number has increased to 60 FTAs that have been concluded and 49 FTAs which are under negotiation between ASEAN+3 and ASEAN+6 countries.

<sup>3</sup> There are 12 FTAs by ASEAN+3 countries outside ASEAN+6 countries that have been concluded and 22 FTAs are under negotiation.

GDP in 1996 to a record deficit of 6.6 percent in 2006, in other words more than 850 billion dollars. This rising US current account deficit is juxtaposed with the current account surpluses of Asian and Latin American countries, most notably China, whose current account surplus has increased from 0.8 percent of GDP in 1996 to 10.3 percent in 2006, or almost 240 billion dollars.<sup>4</sup> Meanwhile, the invisible hand of the market system does not seem to be functioned well so far: from a balance-of-payments point of view, exchange rates have moved in the wrong direction as indicated by the paradox of “false pricing” and there are speculative international capital flows induced by “carry trade.” If these imbalances in international trade and investment are large and persistent, they will likely bring about major structural shifts in the distribution of global resources.

Challenges ahead of us on this issue are how to find appropriate adjustment mechanisms to the current fundamental imbalances. Some questions need to be addressed in this regard like, “What would be most appropriate exchange rate arrangement in the Asia-Pacific region?” And: “If these large imbalances are not indefinitely sustainable, what policy options can create a soft landing without drastic disruption in the international financial system?” A clue can be found in the multilateral trading system. As with multilateral trade rules, one long-term solution for this issue can be to establish a multilateral financial system in the region. By institutionalizing the financial system together with cooperative efforts, economic integration in the Asia-Pacific region can move participating economies towards sustainable economic growth. However, more serious research and constructive discussions in this area are in order.

## **2. Spaghetti Bowl Effect**

The worldwide proliferation of preferential trade has been one of the most prominent features in the world economy since the 1990s. In the Asia-Pacific region, both inter-regional and intra-regional preferential trade agreements have been developed. A total of 73 intra-regional and inter-regional FTAs in which ASEAN+3 countries are involved have been concluded. The ASEAN Free Trade Agreement (AFTA) among ASEAN Member States, the Asia-Pacific Trade Agreement (APTA) led by UNESCAP, and the China-ASEAN FTA are all examples of intra-regional FTAs. On the other hand, the KORUS (Korea-US) FTA, the Singapore-Jordan FTA and the Japan-Mexico EPA are preferential trade agreements that ASEAN+3 countries have established with outside ASEAN+3 countries.

FTAs lower tariff rates only for the partner country (or countries) that signs the agreement. It causes an incentive for a third country who does not participate in the FTA to cheat the importing country by disguising their exporting goods to look as if they are being exported from the partner country. To prevent such tariff fraud or problem of free riding, the importing country establishes a way to distinguish goods originated from the partner country from non-participating countries and such rules and regulations are called rules of origin.

The problem of having rules to confer originating country is that each country has different criteria on determining rules of origin. Different rules of origin cause complexities and incompatibilities: the growth of overlapping and intersecting preference trade deals and specific rules of origin in each FTA cause what Jagdish Bhagwati has referred to as the

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<sup>4</sup> UNCTAD (2007), Trade and Development Report (Table I.6).

“spaghetti bowl” problem. Bhagwati states that “preferences like noodles crisscrossing all over the place” would distort world trade and it would make multilateral liberalization more difficult to achieve. To overcome such a problem, there has been great demand for harmonized rules of origin and international organizations, such as the World Customs Organization (WCO) and World Trade Organization (WTO), are striving to derive harmonized multilateral rules that determine the country of origin of goods in international commerce. However, their endeavor of reaching harmonized rules of origin is far from being accomplished.

Region-wide efforts should be cast on resolving the problems of complexity and incompatibility of rules of origin in the region. Particularly, given so many intra-regional FTAs in the Asia-Pacific region, it would be quite likely that rules of origin become a huge barrier to facilitating trade and FDI flows in the region. Proper consideration and action should be taken to resolve the problem.

### **3. Financial Cooperation**

The financial crisis of 1997-98 highlighted the importance of regional financial cooperation in the region. Observing massive reversals of capital flows and contagion in the region, the financial crisis in East Asia alerted many in the region that greater attention needs to be paid to managing the force of financial globalization and many measures to strengthen the international financial system have been introduced by international institutions, such as the IMF, as well as by the private sector.

Strong regional interdependence is the most important rationale for regional financial cooperation; regional spillover effects, contagious proliferation and externalities due to economic interdependence call for regional economic cooperation in the financial sector.

Several mechanisms for regional financial cooperation have been established to share information and exchange policy dialogue. The ASEAN Surveillance Process, ASEAN+3 Economic Review and Policy Dialogue (ERPD), and a proposal for establishing an Asian Monetary Fund (AMF) are major regional financial cooperation mechanisms that have been established or proposed after the financial crisis in East Asia.

Even though we have a better mechanism to handle financial issues in the region, especially among East Asian countries who suffered most from the financial crisis in the late 1990s, we cannot say that it is sufficient to prevent the reoccurrence of a financial crisis in the region. A lack of political leadership and diversity and heterogeneousness in per capita incomes, differing stages of economic development and economic structures among countries in the region make it hard to institutionalize a strong mechanism that effectively monitors, prevents and manages financial risks in the region.

It has been recently reported that some economists have observed signs foreshadowing the outbreak of another financial crisis in East Asia.<sup>5</sup> Building closer financial cooperation in the region poses a great challenge, but also an unavoidable necessity in the Asia-Pacific region.

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<sup>5</sup> In a keynote speech to the “Conference on Ten Years After the Asian Financial Crisis: Vulnerabilities of East Asia,” Mr. Kim Hak-Su, the former UN Under-Secretary-General and UNESCAP Executive Secretary (February 2007)

#### **4. Energy Cooperation**

As the world economy grows at a fast pace, demand for energy resources has also soared. Given the emergence of rapidly developing countries, such as China, India and Vietnam in the Asia-Pacific region, the question of ‘how to produce with what resources’ must be considered prior to ‘what to produce.’

Energy determines the quality of our daily lives and is essential for sustainable economic growth in the region. Also, affordable energy and accessibility to adequate supply are necessary for eradicating poverty, improving human welfare and increasing living standards. The lack of access to modern and sustainable energy is a major cause of environmental degradation in vast areas of the developing world and a major impediment to sustainable development.

Asia-Pacific’s high dependency on oil from the Middle East exposes the region to greater sensitivity. The high dependency on oil and growing demand for energy resources push the region to diversify energy resources and improve self-sufficiency rates in the region. New investments in energy production and infrastructural development should receive high priority in order to secure an adequate and stable supply of energy; investments in energy resource exploration and infrastructure, such as the interconnection of national gas pipelines and ports should be encouraged. Also, sharing knowledge on the safe and efficient use of energy, cooperation in developing bio-fuels and utilization of renewable energy resources will help to economize the use of energy leading to an improvement in energy security in the region.

#### **5. Climate Change**

Climate change is one of the major international challenges that could affect both environments and the world economy. It has been reported that we are moving closer to several tipping points that could make it impossible for us to avoid irrevocable damage to the planet’s habitability for human civilization. There are arguments that the increased frequency and intensity of natural disasters, such as typhoons and tsunamis, may be related to climate change.

The Asia-Pacific region has a major stake in the global response to the challenges of climate change and clean development. At the 2007 APEC meeting in Sydney, Leaders agree to work through bilateral, regional and global partnerships to promote clean development and adopt the APEC Action Agenda, which includes an APEC-wide reduction in energy consumption intensity of at least 25% by 2030 and an increase in forest coverage in the region by at least 20 million hectares by 2020.

Achieving stable and sustainable economic growth is a major concern for individual economies; however, increasing attention needs to be cast on finding out new pathways for “clean and sustainable” development. Climate change is not a problem, which an individual country’s efforts can completely resolve. It requires region-wide or world-wide cooperation and the scale of these challenges demands new and innovative forms of international cooperation.

#### **IV. Conclusion**

The rapid expansion of intra-regional trade and investment has increased the level of interdependence in the Asia-Pacific region. Liberalization on trade and investment, more so than any other factor, has encouraged the increase in flow of goods and FDI among regional economies and will continue to be a powerful instrument for realizing enhanced regional economic integration.

While the interdependence among countries in the region has been rapidly increasing, the institutional process of regional integration is still in its infancy. Discussions regarding regional integration in East Asia and the Asia-Pacific region have continued in lively manner; however, no solid or concrete results have been produced yet.<sup>6</sup>

The absence of powerful leadership or a strong institutional setup, like that in the EU, could be the most serious problem in the Asia-Pacific region. That is, the region is vulnerable to economic shocks because it lacks an institutionalized mechanism that can properly manage and protect it from the negative impacts brought about by unexpected economic shocks. In an emergency situation like the financial crisis of 1997-1998, it would be hard to expect facilitated cooperation to occur among countries in the region in minimizing the impact of the financial crisis on the regional economy since each country would have a different point-of-view. Increased interdependence in the region could bring disastrous results as the shock could contagiously spillover to other countries in the region, resulting in an inexorable chain reaction.

In order to properly prevent, manage and monitor crisis situations, regional information sharing, policy dialogue, consultation and surveillance are critical. A strong institutional mechanism that can handle these situations appropriately is required. However, it will not be an easy task especially in the Asia-Pacific region, where countries have diversified cultural backgrounds, different stages of economic development and various economic systems and structures. The question of how to put all these differences together under one umbrella will be the most urgent and important challenge that we must resolve.

Also, the promotion and strengthening of structural reform is an essential prerequisite for achieving sustainable economic growth and development in the Asia-Pacific region. Structural reform could be considered a process of economic adaptation which responds to changes in the economic environment. When an economy (or economies) falls behind a necessary reform process, it could deliver destructive consequences, which we already witnessed during the financial crisis.

Recognizing the importance of structural reforms in the APEC region, Leaders and Ministers from APEC Member States endorsed the "APEC Structural Reform Initiative" in 2003. This initiative is to achieve durable, non-inflationary growth and employment and consists of the two components: "APEC Leaders' Commitment on Structural Reform" and "APEC Structural Reform Action Plan." Encouraging structural reform-related activities in each economy and APEC as a whole, it emphasizes the importance of intra-regional

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<sup>6</sup> APEC is considered as an institutional mechanism that comprehensively covers Asia Pacific region. However, the fact that it is based on voluntary, non-binding nature limits its ability to handle and harmonize different economic policies among countries in the region.

cooperation in structural reform, as well as that of individual economies.

However, structural reform is a long and painstaking process. A well-planned guideline and appropriate implementation in a timely manner will guarantee a successful reform process that adequately handles new and emerging challenges resulting from rapid economic changes.