

## Regional cooperation in East Asia amid global economic turmoil

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### Elements of the global economic problems

Barely 10 years after the 1997 Asian financial crisis, the global economy is once again experiencing turmoil.

This year alone, international oil prices have risen by more than 50 percent (Figure 1). High fuel and food prices have led to soaring inflation in many developing countries. In 2007, inflation among nine of the larger ASEAN+3 countries<sup>1</sup> averaged only 2.4 percent (Table 1). For the first six months of 2008, though, inflation for these same countries has already averaged 4.4 percent.

It is hardly imaginable that only last December, economies in East Asia were grappling with the issue of rapidly appreciating currencies. The latter helped reduce inflation in

2007 but at the same time, strong domestic currencies have adversely affected the competitiveness of exports and import-substituting industries.

These regional economic problems are occurring against a backdrop of the US subprime mortgage crisis—the full impact of which has not yet been manifested—and a looming US recession. Indeed, the global economic situation is not encouraging at all.

<sup>1</sup> China, Japan, Korea, Indonesia, Malaysia, the Philippines, Singapore, Thailand, Viet Nam. Inflation data for Brunei, Cambodia, Lao PDR, and Myanmar are not available for the second quarter of 2008.

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Figure 1. Brent crude oil prices (US\$/barrel), January 2000 – July 2008

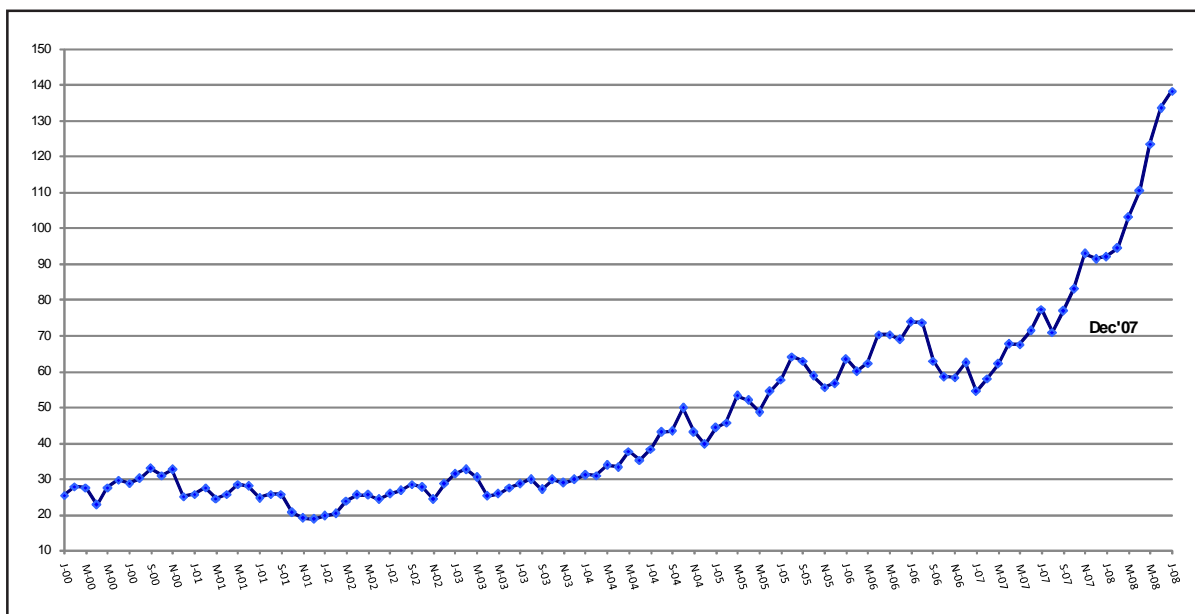


Table 1. Inflation increase in East Asia

	2007	1 <sup>ST</sup> HALF 2008
JAPAN	0.03	1.0
CHINA	4.8	7.8
KOREA	2.5	4.1
INDONESIA	6.4	8.7
MALAYSIA	2.0	2.8
PHILIPPINES	2.8	7.7
SINGAPORE	2.1	7.1
THAILAND	2.3	5.9
VIET NAM	8.3	19.9
WTD. AVERAGE	2.4	4.4

There are two important questions that arise from these recent events. One is whether the issues are somehow interrelated. And two is how regional cooperation in East Asia, in general, and in the Pan-Beibu Gulf region, in

particular, can help countries in this part of the world cope with the unfavorable effects of these events.

#### Primary cause of the problems

Perhaps the word “unbalanced” is an appropriate term to describe the current global economic problems. For one, it calls to mind the issue of the trans-Pacific macroeconomic imbalance, which dominated economic headlines just three years ago. The more appropriate concept is that of global macroeconomic imbalances, which basically juxtaposes the US as an economy running a large current account deficit with other parts of the world—particularly East Asia—running external surpluses or very small deficits. As a point of reference, the US deficit was \$738.6 billion in 2007 or 5.3 percent of its GDP.

Indeed, the global macroeconomic imbalance, the weakening US dollar, rising commodity prices—including rice and oil—can be viewed as part of the same phenomenon. In a recent editorial, Paul Craig Roberts, a former Assistant Secretary of the US Treasury and former associate editor of the Wall Street Journal, wrote that “the two biggest factors in oil’s high price are the weakness in the US dollar’s exchange value and the liquidity that the Federal Reserve is pumping out.”<sup>2</sup>

The weakness of the dollar—which has depreciated by 50 percent against the euro since 2003—was triggered by the persistent US current account deficits. Mr. Roberts argues that “as abuse wears out the US dollar’s reserve currency role, sellers demand more dollars as a hedge against its declining exchange value and ultimate loss of reserve currency status.” This would be true of sellers of commodities, international trading of which is conducted in US dollars.

Meanwhile, in an effort to forestall a serious recession and further crises in derivative instruments, Mr. Roberts asserts “that the Federal Reserve is pouring out liquidity that is financing speculation in oil future contracts. Hedge funds and investment banks are

<sup>2</sup> See “Why oil prices are so high?” <http://www.globalresearch.ca/index.php?context=va&aid=9300>.

<sup>3</sup> Agarwala, R. 2004. Reserve Bank of Asia: an institutional framework for regional and monetary cooperation in Asia. In *Towards an Asian economic community: Vision of a new Asia*, edited by Nagesh Kumar. Singapore: Institute of Southeast Asian Studies.

*...Many of the global economic problems in the past half-century have been caused by the unipolar global financial system, the main features of which are that most of the international trade is denominated in US dollars, most of the international reserves are held in US dollars, and the US can pay for its external deficits by printing dollars which it does not expect to be redeemed in the foreseeable future.*

restoring their impaired capital structures with profits made by speculating in highly leveraged oil future contracts, just as real estate speculators flipping contracts pushed up home prices.”

While I do not fully agree with this line of analysis, what has emerged is that many of the global economic problems in the past half-century have been caused by what has been described by Professor Ramgopal Agarwala as the unipolar global financial system,<sup>3</sup> the main features of which are that most of the international trade is denominated in US dollars, most of the international reserves are held in US dollars, and the US can pay for its external deficits by printing dollars which it does not expect to be redeemed in the foreseeable future.

Just to give an idea of the extent of the problem, I would like to cite an eminent economist who said:

“A fundamental reform of the international monetary system has long been overdue. Its necessity and urgency are

further highlighted today by the imminent threat to the once mighty U.S. dollar.”

This statement was made by Robert Triffin in November 1960, nearly 50 years ago.<sup>4</sup>

What would be the role of regional cooperation in this context? In particular, what would be the role of the Pan-Beibu Gulf Economic Cooperation (PBGEC)?

### Regional responses to the problem

One manifestation of the global macroeconomic imbalance is that a large part of Asian savings is being intermediated outside the region. In particular, Asia recycles its capital inflows by purchasing US dollar-denominated investment products such as US Treasuries, and the funds return to Asia through US direct and portfolio investment.

Regional cooperation in East Asia can promote the development of domestic financial markets and regional financial integration in order to facilitate the intermediation of Asian savings *within* the region as well as attract foreign investment in instruments denominated in the *domestic currency*. Such alterna-

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tive sources of funding would reduce Asia’s reliance on foreign currency borrowing and concomitantly, the risk exposure of the region to maturity and currency mismatches.

This type of regional financial cooperation has already been initiated in the form of the Asian Bond Markets Initiative (ABMI) which was endorsed by the ASEAN+3 finance ministers in August 2003 and the Asian Bond Fund (ABF) initiative which was launched by the Executives’ Meeting of East Asia-Pacific Central Banks (EMEAP) in June 2003.

However, the ABMI and ABF initiatives consider only the financial side of the issue. Regional cooperation can also be useful in identifying infrastructure projects to be funded. Recently, the Network of East Asian Think Tanks (NEAT) proposed the establishment of the Asia Investment Infrastructure Fund which is a mechanism by which infrastructure projects in the region can be prioritized and funded. By considering the “real” side of the issue, more substance will be given to regional financial cooperation. Of course, the structure and configuration of the Asia Investment Infrastructure Fund still has to be threshed out, particularly on how it will relate to the Asian Development Bank.

The PBGEC and the Asia Investment Infrastructure Fund can collaborate and comple-

<sup>4</sup> Source: [http://www.imf.org/external/np/exr/center/mm/eng/mm\\_sc\\_03.htm](http://www.imf.org/external/np/exr/center/mm/eng/mm_sc_03.htm).

ment each other in identifying critical infrastructure projects in East Asia. PBGEC can work with other subregional groupings like the Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA) and Greater Mekong Subregion in order to come up with an effective bottom-up strategy in prioritizing projects. This will address the other problem implied by the term “unbalanced” which refers to the large disparity in economic development in East Asia. Presently, the infrastructure projects under consideration by the PBGEC are the highway connecting the southwestern part of China with the northern part of Viet Nam under the concept of “Two Corridors-One Ring,” and the construction of the Nanning-Singapore Economic Corridor.<sup>5</sup>

Other regional financial cooperation mechanisms have been established or proposed in order to protect the region against volatile capital flows and other forms of financial turbulence. The more elaborate financial cooperation mechanisms such as exchange rate coordination and the Chiang-Mai initiative can be addressed at the macrolevel by ASEAN, ASEAN+3, and the East Asia Summit. These larger regional groups should also consider the case for a global currency as advocated by Professor Robert Mundell.

<sup>5</sup> These proposals including the one on regional bank cooperation are taken from the “Research Report on Pan-Beibu Gulf Economic Cooperation” published by the China-ASEAN Business Council, July 2007.

Figure 2



The PBGEC has made its own modest proposals which can complement the aforementioned mechanisms. One example is the proposal to set up a regional bank cooperation organization that complies with the development features of the Pan-Beibu area.

With the help of constant dialogue and forums like the PBGEC, regional cooperation can be pushed forward. This will also ensure that the various efforts—referring to PBGEC, ASEAN, ASEAN+3, and the forthcoming Comprehensive Economic Partnership for East Asia (CEPEA)—are all consistent with each other (Figure 2). If we work together, the vision of a peaceful and prosperous East Asia will definitely be realized. 📄

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## New Publications

**Human capital and development in the Philippines: a festschrift in honor of Alejandro N. Herrin**  
*edited by Joseph J. Capuno and Aniceto C. Orbeta, Jr.*



After many policies have been put in place over the years to uplift the welfare of the Filipinos, the overall human development in the country has not reached its maximum potential. Undoubtedly, much remains to be done especially in improving the quality of human capital in the Philippines. Policy reforms are needed to improve the access to basic education, provide sufficient work opportunities, strengthen health systems especially in the rural areas, promote child and maternal health and nutrition, and encourage people to practice responsible sexuality and parenthood.

This volume reviews these issues with academic rigor and with an eye toward providing practical policy recommendations. It is a fitting honor to Dr. Alejandro N. Herrin for his vast research works and institutional capacity-building efforts especially on population management and health issues that have led to many policy initiatives in the country.

**Rice and Philippine politics (RPS No. 2008-01)**  
*Ponciano S. Intal, Jr. and Marissa C. Garcia*



Using a political economy perspective, this paper establishes the strong relationship between rice and politics and explains recent developments in the Philippine rice landscape. Results of the analysis show that the price of rice has been a significant determinant in election results since the 1950s, with the exception of 1998, where despite stable prices, the presidential candidate from the incumbent administration failed to win the elections. In addition, reliance by the Philippine government primarily on price instruments to achieve its rice objectives and to protect farmer and consumer interests has not resulted in any substantial improvements in rice production. In fact, the shift to rice protection since the 1980s has failed to stabilize domestic rice prices and has penalized the poor.

If the Philippines is to achieve sustained, stable rice supply at low prices and, at the same time, promote rice consumer and producer welfare, the adoption of a private-focused, market-based regulatory regime without a rice trading parastatal (but with rice emergency reserves, not for price stabilization) remains a long-term objective.