The financial crisis and East Asia

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East Asian economies were relatively well insulated against the financial impacts of the global financial crisis but their dependence on trade through regional production networks and export-led growth strategies made them vulnerable to the sharp contraction of demand from the North American and European economies. The International Monetary Fund projects sharp real GDP declines in 2009, with Japan's economy shrinking by -6.2 per cent, Taiwan's by -7.5 per cent, South Korea's by -4 per cent and Singapore's by -10 per cent; China is the outlier, with positive growth expected to be 6.5 per cent. Even so, China has experienced a huge growth contraction from 13 per cent in 2007. Japan was hardest hit by the contraction of export markets: its current account surplus is expected to shrink from 4.8 per cent of GDP in 2007 to 1.5 per cent in 2009. China's will shrink slightly but Korea's and Taiwan's will expand.

There is a strong reaction in the region to this revealed vulnerability. Governments are asking how they can reduce their dependence on exports to the advanced industrial economies and rely more on regional and domestic demand. This reasoning leads to an emphasis on alternative growth engines in the region (such as potentially large demand in China and India) and on ways to deepen the linkages among the region's economies. Unexpectedly, the G20 leaders' summits organized on an ad hoc basis to manage the financial crisis may turn out to be the catalyst for a sharper focus on deeper regional integration. Six Asian economies are members, the three Northeast Asians plus Australia, India and Indonesia, and each is an equal at the global table. This new 'definition' of the six as equals in global strategy could be the basis for a more strategic approach to trade and finance in the region that replaces current ad hoc arrangements.

Northeast Asia gets high marks for promoting and maintaining economic openness, peace and stability in the region with some exceptions. Although Northeast Asian governments like other G20 governments took some protectionist measures during the crisis, leaders at the first Japan-China-ROK Trilateral Summit in December 2008 expressed their determination to avoid protectionist actions. Openness to trade and FDI is pursued through ad hoc regional trade agreements but the impacts are mixed when they are riddled with exceptions and when inconsistent rules of origin raise transaction costs. Efforts are also underway to create an emergency financing mechanism through the Chiang Mai Initiative and to increase the depth and liquidity of regional financial markets through the Asian Bond Market Initiative and the Asian Bond Fund but progress on governance frameworks is slow.

Some prominent East Asian thinkers see the region at a crossroads. Asia is unique: by 2030 three of the world's four largest economies will be located there and the world's two largest populations live side by side. By 2020 China will produce 44 per cent of Asia's economic output and India and Japan will account for 17 and 15 per cent, respectively, as estimated by the Asian Development Bank in its 2008 study Emerging Asian Regionalism [1]. Together the three will be 20 per cent larger than the US economy. As China and India emerge as economic powerhouses they will compete with Japan and each other for influence and leadership of the region – unless a serious commitment to community building creates common goals and channels for closer cooperation. Evolving regional institutions have ASEAN at the core and other countries joining extensions depending on the purposes of the group. This ASEAN-Plus architecture expanded after the Asian crisis when the heads of the ASEAN economies, Japan, China and South Korea formed ASEAN + 3 to draw lessons and prevent such a calamity from happening again. Since then ASEAN + 3 has taken both finance and trade initiatives, most of which are bilateral in scope. The East Asian Summit expands the group to include Australia, New Zealand and India, a logical extension based on jurisdictional criteria but also one that dilutes China's influence.

The absence of an acknowledged leader, however, constrains the scope and speed of deeper integration in East Asia. Without an accepted champion to provide focus and set priorities governments have to be content with incremental change. For some time ASEAN has been regarded as the core, particularly by China which assumes any initiative it might take would be highly suspect by the smaller countries. Cooperative regional institutions serve China's objective of developing closer friendly relationships in the neighborhood and its desire to counter-balance US influence but the impetus must be provided by others. Good relationships with its neighbors also allow China to concentrate on its many distractions at home. Regional leadership is further complicated by the relative absence of the United States which is not part of the ASEAN-Plus institutions and participates mainly on a bilateral basis and through APEC.

The long term prospects for Asia's nascent economic institutions will depend on support from the large players, on consistency with global institutions – and on results. The G20 meetings were both a missed opportunity for regional responses to the crisis and a catalyst for future action. They were a missed opportunity in that governments acted on their own. The Chiang Mai Initiative swap mechanism was inactive; some even assert that if the common fund arrangements are not finalized by mid-2009 the initiative will be abandoned. National treasuries and central banks responded in uncoordinated fashion. There was no collective Asian strategy that pulled together the domestic, regional and global impacts of the large stimulus packages in China, India and Japan and other members. No prescriptions were forthcoming from the group and no targets for their own cooperation. Indeed, one reason the Chiang Mai Initiative mechanism was not drawn upon during the crisis may be because most economies have more confidence in unilateral actions to 'self-insure' against financial crises by running current account surpluses and managing their exchange rates to build foreign exchange reserves. At the end of 2008 according to IMF statistics, the combined reserves of China, Japan, Singapore, India and Hong Kong totaled almost $4 trillion which is far in excess of any guidelines for protecting against balance of payments shortfalls.

Yet the G20 was also a catalyst in addressing the leadership 'deficit' in regional cooperation. The membership of the 'Asian 6' countries confers an expectation that they will think and act in the global interest. This expectation could translate into this or a sub-group providing strategic leadership to replace the ad hoc initiatives of the past. A more strategic approach would serve the objective of rebalancing the dependence on export-led growth by Asian economies with more regional and domestic demand. But there was little talk about allowing exchange rates to be market-determined or to reduce self-insurance. Instead they looked to exploit the vast potential demand in China and India, arguing that more of the region's savings should be intermediated within the region and that intra-regional production networks could be deepened by investing in regional infrastructure to speed up intra-regional shipments, by promoting trade in green technologies and by greater reliance on trade in services.

In conclusion, the G20 opened a new channel for both regional and global cooperation and may serve as a catalyst for strategic leadership within the region. This catalytic role is still playing out since there was no coordinated regional response to the global crisis in 2008-09. The G20 is a convenient and timely band wagon which, while still led by the Americans and Europeans, is also a vehicle for initiative and leadership from its Northeast Asian members and the Asian 6.

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