

**Keynote Speech by  
President Haruhiko Kuroda  
Asian Development Bank**

**At the  
Center for Strategic and International Studies**

***“Asian Regional Economic Integration: Fact or Fiction?”***

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**I. Introduction**

Let me first thank Mr. Katz for his kind introduction, and the Center for Strategic and International Studies (CSIS) for providing this opportunity.

It is a great pleasure for me to speak to you today about Asia's economic integration. As a key partner in Asia's development, the Asian Development Bank (ADB) has been involved with regional cooperation and economic integration initiatives for many years.

ADB's vision is an Asia and Pacific free of poverty. To pursue this vision, we provide finance and advice to borrowing member countries – development solutions to help them achieve their goals.

Regional cooperation and integration is part of that solution. Only by working together can Asian countries achieve sustained, rapid growth to reduce the still overwhelming number of people living in poverty. And only by working together can we create a future of shared prosperity, stability and peace.

So, let me turn to the question: is Asian economic integration fact or fiction?

**II. Asia and the Pacific: Status of Integration**

I will start with a few facts.

Fact number one: Intraregional trade is flourishing.

This is especially true of East Asia, where intra-regional trade has grown from less than 35% of all trade in 1980 to 54% in 2003.<sup>1</sup> This is a lower proportion than in the EU, but significantly higher than the NAFTA region, where intra-regional trade represents 46% of all trade.

Fact number two: Intraregional investment is significant.

As you know, foreign investment in the region, or FDI, picked up rapidly in the early 1980s. As large multinational firms diversified across Asia, new regional production networks and new channels for intraregional investment were created.

In the period covering 1990 to 2002, for example, Japan was the largest developed country investor in the ASEAN countries (excluding Singapore), and Hong

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<sup>1</sup> Kawai, M. 2004. *East Asian economic regionalism: progress and challenges*. Institute of Social Science, University of Tokyo. Figures include Japan.

Kong was the largest investor in China.<sup>2</sup> We have thus seen the development of an identifiable “trade-investment nexus” – a mutually reinforcing relationship between the two.

Fact number three: in less than a decade, East Asia has made significant progress in monetary and financial cooperation. This process has been led by the ASEAN+3 group in response to the 1997 financial crisis, and assisted in various ways by ADB.

A major feature is the Chiang Mai Initiative (CMI), which provides liquidity support through a network of bilateral swap agreements. In May of this year, ASEAN+3 took a major step forward by strengthening the CMI and doubling of the size of available swaps.

ASEAN+3 has also put in place a number of mechanisms to support policy dialogue and promote open discussion on financial and economic issues. And, it has implemented the Asian Bond Markets Initiative to mobilize the region’s vast pool of savings for direct, efficient use in the region’s long-term investment.

Fact number four: Many Asian countries are joining together to lay the foundations for closer trading relationships, primarily – but not exclusively – through development of shared infrastructure.

The Greater Mekong Subregion – the GMS – which includes Cambodia, Lao People’s Democratic Republic, Myanmar, Thailand, Viet Nam and China, is quite advanced in this endeavor. In 1992, with ADB’s assistance, these countries embarked on a program of regional economic cooperation to raise the standard of living for their people. Through the GMS program, three major economic corridors are in progress, which, when completed, will significantly boost trade and investment across the region.

The GMS has emerged as a strong regional entity, and one of the fastest growing regions in the world.

Based on this success, ADB is now working with South Asia and Central Asia on a strategy to connect landlocked Central Asia and seaports in South Asia via Afghanistan. The Subregional Economic Cooperation in South and Central Asia program envisages Afghanistan as a regional hub, and a critical link between South Asian and Central Asian markets.

So, those are four basic facts on trade, investment, monetary and financial cooperation, and infrastructure development.

### **III. Beyond the Facts: Issues and Challenges**

But fact number five is that the process of integration is still at a very early stage. Much more needs to be done to create a truly pan-Asian community and an Asia-wide future of hope and prosperity.

Asia is an extremely diverse region – in cultures, governments, income levels, living standards and overall socio-economic conditions.

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<sup>2</sup> Kawai, M. 2004. *East Asian economic regionalism: progress and challenges*. Institute of Social Science, University of Tokyo. Figures include Japan.

And there are many hurdles to overcome – development gaps, lack of government capacity, sensitivities about national sovereignty and geographical barriers, such as the dispersion of small island nations, to name a few.

Perhaps most importantly, unlike Europe, North America or Latin America, the region lacks a coherent and comprehensive strategy for intensifying its efforts toward integration. Yet doing so is critical to its future.

Economic and social disparities in the region are widening – due, at least in part, to unequal linkages to the global economy. Inadequate access to markets, finance and technology prevents some countries from benefiting from regional growth.

With changing global investment trends, Asia must strengthen its comparative advantage to compete. Firms are looking less for cheap labor, and more toward economies that can offer a skilled workforce, adequate infrastructure, stable and efficient legal and financial systems, competent suppliers, and institutions that can effectively harness technology in order to attract investment. In many parts of Asia, this will best be achieved by combining forces at a regional level.

Regional integration should also serve as a stepping stone to greater integration with the global community. In this respect, the proliferation of free trade agreements in Asia poses a challenge, as well as an opportunity.

As of last year, there were more than 30 trade agreements under negotiation or under study in East Asia alone. Now is the time, as these deals are being struck, to prevent the so-called “spaghetti bowl” effect by ensuring they are consistent among themselves, and consistent with the multilateral trade liberalization under the World Trade Organization (WTO) framework. This is a pressing issue with the next Ministerial round of WTO talks set for December in Hong Kong.

Going forward, the diversity among governments, the absence of common cultural and institutional traditions, and the preference for non-binding agreements suggest that EU-style integration is unlikely to take hold in Asia – at least in the foreseeable future.

In the absence of EU-style supra-regional institutions, building a pan-Asian approach will require trust-building, particularly among leaders of the countries in the region, to pursue region-wide objectives for their mutual benefit.

It will require a willingness to tackle a whole host of delicate issues, from customs harmonization and labor laws, to greater exchange of financial and economic information, to joint policy making in critical areas. One such example is exchange rate policy, which has the potential to stabilize or destabilize economies across the region.

Above all, it will require vision, political will and a deep understanding of the long-term nature of the processes involved.

#### **IV. Poverty in Asia**

Ladies and gentlemen, these are exciting times in Asia. But they are also challenging times.

I mentioned a moment ago that economic disparities in Asia are widening. This is true not only among countries in the region, but also within countries, including those with the most dynamic economies.

The basic rationale for deeper integration of the Asian economies is its potential to drive sustained, broad and inclusive growth, thereby reducing poverty and raising living standards across the region.

While much has been made of Asia's success in reducing poverty to date, a couple of things must be kept in mind.

First, Asia is home to more of the world's poor than any other region of the world. Some 690 million Asians still struggle on less than a dollar a day. And by 2015, the region is still expected to account for half of the world's poor.

Second, by non-income standards, many subregions of Asia have an even more daunting problem than Sub-Saharan Africa.

South Asia, for example, has more undernourished people, more people without access to proper sanitation, and more people living in slums than Sub-Saharan Africa. East Asia has more people without access to safe water and sanitation, and more people living in slums than Sub-Saharan Africa. HIV/AIDS infections in South and South East Asia are projected to be nearly as high as Sub-Saharan Africa by 2015.

The task confronting Asia is therefore a huge one. And while Asia can do much on its own, the support and cooperation of the international community will be essential.

## **V. Concluding Remarks**

Let me conclude by restating my main message. Economic integration is a growing reality in Asia, and it is a fact.

If there is any "fiction" about Asia today, it is the perception that because the region is doing well, there is little to worry about. As I have said, this is certainly not the case. Deepening and broadening integration is one important way to contribute to sustained rapid growth and greater poverty reduction. The end result of integration should be greater inclusiveness among Asian countries, and Asian peoples.

While the innate characteristics of the region pose challenges, these are not insuperable. I believe that leaders across Asia share a vision of a thriving regional economy, well integrated within itself, and with the world. By working together to build on common strengths and reduce shared vulnerabilities, this vision can come to fruition, bringing profound economic and social benefits for all.

Thank you again for this opportunity. I look forward to hearing your views.

## **I. QUESTION AND ANSWER SESSION**

**President Kuroda responded to several questions following his formal remarks. The following summaries of the questions and answers were prepared by staff of the Scholl Chair in International Business, CSIS.**

### *1. Chinese Currency Revaluation. Will China move to a managed float before the end of 2005?*

President Kuroda has been arguing for a Chinese currency revaluation for several years because the current monetary regime is unsustainable and could lead to major economic dislocations. A revaluation should take place sooner rather than later. To avoid a detrimental shock to the Chinese economy, the pace of the revaluation

should be gradual. The decision of exactly when to revalue the currency, however, is inherently political and not appropriate for an economist like President Kuroda to address. China is now accumulating vast foreign exchange reserves to maintain its currency peg; the domestic economic counterpart to this accumulation is excess liquidity. In its purchases of foreign exchange, the Chinese central bank has attempted to keep money supply relatively unchanged but has been only partly successful. The result has been an overheated Chinese economy, particularly in the real estate sector. A revaluation is healthy not only for China's sustainable development, but for the global economy as well.

In response to a comment from a member of the Chinese Embassy in Washington, President Kuroda agreed that current East Asian supply chains include Japan as the supplier of technology and capital goods, and China as the main hub for manufacturing. This is the result of globalization and is generally positive in economic terms. From an economic perspective, concern over specific bilateral trade imbalances is misplaced.

## *2. ADB Policy Towards North Korea and Myanmar*

Because North Korea is not a member of ADB, no financial or technical assistance can be given. Moreover, there is no consensus among the members of ADB at this time regarding North Korean membership. Myanmar is an original member of ADB and is therefore theoretically eligible for assistance. However, it is also in arrears on its ADB contribution and, per ADB rules governing members whose contributions are in arrears, may not be given assistance until their accounts are up to date. Myanmar's poor record on human rights provides further grounds for denying ADB technical or financial assistance. Even if Myanmar took care of its arrears, its human rights record would remain as a significant obstacle to instituting any aid projects. The ADB has remained in limited contact with Myanmar through the Greater Mekong Sub-region (GMS) meetings.

## *3. Energy Policy in Asia*

ADB's Asia economic forecasts have been significantly affected by the rise in oil prices. Many Asian economies are fast growing importers of oil that are unfortunately inefficient energy consumers. Through cooperative efforts among technologically advanced countries, ADB and the International Monetary Fund (IMF), energy efficiency can improve in the region. However, lack of funds and experienced personnel will make this a difficult task.

## *4. Financial Reforms in Asia Since the Financial Crisis*

The macroeconomic situation in Asia has improved dramatically since 1997. East Asian economies now have large current account surpluses, low external liabilities, and large accumulations of foreign exchange. From an analysis of the external sector in these economies, a short-term currency crisis is unlikely. The financial sectors of the East Asian economies have made significant progress as well. However, continued vigilance on potential risk factors is a prudent way to move forward, and safety nets such as the Chiang Mai Initiative currency swap arrangements are very positive. In the long term, the creation of a regional bond

market as a way to minimize reliance on the banking sector is extremely important for future financial stability.

#### *5. Open Regionalism as a Model for Asian Integration*

Although ASEAN+3 is a “natural group,” Open Regionalism is the preferred model for Asian integration because Asian countries are heavily reliant on the global economy. In the future, Australia and India will most likely be included in the ASEAN+3 free trade framework. Other structures may also be useful in pursuing regionalism, including Asian-Pacific Economic Cooperation (APEC).

#### *6. Need for an Institutional Framework for Regionalism*

East Asia regional integration has been largely a market driven phenomenon. The Asian Financial Crisis showed that although there are many positives to integration, the risks must also be addressed. ADB recently established an office for regional integration at its headquarters, which will address: 1) ASEAN+3 financial cooperation; 2) free trade agreements; and 3) regional infrastructure cooperation. ADB will be more active in analyzing the effects of new Free Trade Agreements (FTAs) and commenting on the contents of individual agreements, particularly when trade diversion is a consequence. Asia has a dearth of regional institutions that can foster integration but ADB has a fundamental obligation to do so and will play an important role in future economic cooperation in Asia.

#### *7. A Future “True” ASEAN FTA*

The proposed elimination of ASEAN tariffs by 2015 is a positive step towards regional integration. Although many hurdles remain, an FTA is important so that ASEAN can compete with China and other large economies and forestall being marginalized in Asia.

#### *8. G8 and the Need for Assistance to ADB*

The recent focus on aid to Africa is natural because of the scope of that continent’s problems, but the international community must not overlook the size of the poverty problem in Asia. The most recent Asian Development Fund (ADF) agreement on replenishment was successful, but the increase in aid to Asia was noticeably smaller than that for Africa. The danger is that ADF will be overlooked in the competition for international aid. The key to keeping the focus on Asia will be maintaining a positive environment for foreign direct investment.

#### *9. Regionalism in the Pacific Islands*

The fourteen Pacific Island nations in ADB face serious geographic and labor challenges. Average growth rates among these countries are less than 2% when compared to 5% GDP growth for the rest of Asia. ADB’s plan for assisting Pacific Island nations is set forth in the Country Strategy & Program (CSP). Although CSP is a positive step in focusing on the difficulties faced by Pacific Island countries, political instability in the region remains as a huge problem.

#### *10. U.S. Role in Asian Regionalism*

The U.S. will and should play a key role in Asia, not only through the ADB where the U.S. and Japan are the largest shareholders, but also through APEC and bilateral relationships in the region. However, it is the sheer size of the U.S. economy and its technological superiority that will ensure continued U.S. participation in Asia. Increased U.S. involvement in Asian regionalism will benefit both the U.S. and Asia. U.S. businesses are already heavily involved in China, India, Korea and other Asian countries. Political leaders should take the lead from the business community but should pay more attention to countries like Pakistan, Vietnam, and the Philippines in addition to China.