

Notes on:

**Regional Stability in East Asia
and the Western Pacific**

By

**Ross Garnaut
Professor of Economics
The Australian National University**

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The East Asian economies as a whole are now growing as strongly as before the crisis. As before the crisis, the growth in output is accompanied by even more rapid expansion of trade, especially within the Western Pacific.

The maintenance of internationally-oriented growth is the key to rising living standards of the poor in East Asia, as it was before the crisis. Rising incomes of workers and villagers, in turn, provide one element of a favourable environment for the building of democratic institutions and a stable domestic political order.

The assertion that internationally-oriented growth is a path to rising incomes of the poor is not mere economic theory or rhetoric. The rising employment and real wages in Indonesia and the Philippines in the period of internationally-oriented growth before the crisis of 1997-9 have been carefully documented. Real incomes have increased strongly in coastal China, where growth has been linked to the international economies. Labour demand has increased strongly and wages have risen in rural areas surrounding the Indian cities which are centres for the new information technology industries. In Asia as elsewhere, incomes have lagged behind in communities that have weak links to the international economy.

Growth since the crisis is significantly weaker in developing Southeast than in Northeast Asia. The capacity for rapid growth and the safe speed limits are lower in Southeast Asia. Failure to heed the signs that growth was in excess of the safe

limits was one cause of the crisis. It is clearer now than before the crisis, that the large Southeast Asian economies, Indonesia, the Philippines, Vietnam and probably Thailand, will take longer to raise living standards into the ranks of the developed countries than will the developing economies of Northeast Asia.

The crisis was an episode in temporarily weakening the international links of East Asian economies. Foreign trade shrank — reversing the beneficent process of mutually reinforcing economic growth and trade expansion. Foreign capital inflows became outflows.

How robust is the renewed growth and trade expansion? Is the regional infrastructure for economic co-operation suitable to sustaining the renewed growth?

There is not much chance of a close repetition in the foreseeable future of a financial crisis on the pattern of 1997-9. The crisis has inoculated the current generation of financial leaders against the mindless optimism of the years immediately preceding the crisis.

Regulatory agencies and financial institutions have been strengthened professionally by the experience of crisis — just as the Australian banks were

strengthened by the currency crisis of the mid-1980s and the banking crisis of the early 1990s.

The IMF and national policy agencies have learned from their mistakes that deepened recession in the first year of crisis. In a repeat of the problems of 1997, there would be less zeal in fiscal and monetary contraction, and in accelerating structural reform at the height of crisis.

And some modest developments in the regional international monetary infrastructure would help to brake a downward spiral earlier than in 1997-98. The Manila Framework of regional financial surveillance, which grew out of APEC discussions and has United States participation, would provide some earlier warning and advice. Embryonic monetary co-operation among ASEAN, Japan, China and Korea — “ASEAN Plus Three” — would provide earlier and larger foreign exchange support. (Incidentally, Australia, with Japan, one of only two supporters of all three IMF-led financing packages during the crisis, is a logical member of this regional monetary grouping.)

There are two larger threats to regional stability in the period of restoration of internationally-oriented growth.

One is political instability arising from domestic problems in parts of Southeast Asia, and from possible sudden movements on the Korean Peninsula and the Taiwan Straits. I will leave that for another time.

The second is the threat to the open international trading system that underpins economic growth in East Asia. Sustained, rapid economic growth and rising living standards in East Asia, particularly in China, requires access to global markets: East Asia is too small to accommodate China's growth requirements. The loss of momentum on trade liberalisation in the WTO, with sagging United States political will further discouraged by the Battle of Seattle and now the Melbourne melee, has created a policy vacuum that may be filled by unhelpful developments.

APEC was a useful support to unilateral trade liberalisation in East Asia from 1989 until 1997, but can only operate effectively in the context of an effective WTO, with the United States supporting trade liberalisation in both APEC and the WTO.

Rushing into the policy vacuum, are a plethora of ideas for new sub-regional free trade areas. Amongst the most advanced are Korea-Japan and Singapore-New Zealand. At best, these are a serious diversion from the unilateral and non-discriminatory multi-lateral liberalisation that has supported East Asian growth in

the past. At worst, there would be a confusion, a tangle, of discriminatory sub-regional arrangements that raise everyone's transactions costs.

Such a tangle would damage, above all, the new information economy, with its requirements of low transactions costs and rapid transactions times.

To avoid this confusion and tangle, and to clear the path for a return to effective unilateral and multilateral liberalisation in the pattern of the pre-crisis years, is the main game for foreign economic diplomacy in the period ahead.

To this end, it is advisable for Australia to support new, sub-regional free trade areas that are committed to open regionalism — the removal of trade barriers on a multilateral basis within the APEC timetable — but not others; and above all to make it clear that Australia's participation in new free trade areas will be premised on the multilateralisation of its own trade liberalisation. And it is advisable for Australia to press upon its Asia Pacific partners a sense of the risks and potentially high costs of allowing the WTO vacuum after the Battle of Seattle and the Melbourne melee, and with the current conceptual vacuum within APEC, to persist beyond the United States Presidential election. The 2001 APEC Leaders' meeting in Shanghai — the first time a new United States President meets his East Asian counterparts, and the first time a Chinese President meets his Asia Pacific

counterparts after China's entry into the WTO, provides an occasion to tie down the threads that have unravelled since 1997.