INCLUSIVE, BALANCED, SUSTAINED GROWTH IN THE ASIA PACIFIC

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Preface

As the global economic crisis intensified in March 2009, the Pacific Economic Cooperation Council (PECC) organized a workshop on “Regional Responses to the Economic Crisis” hosted by the Japan Committee for Pacific Economic Cooperation in Osaka, Japan. The meeting concluded that the Asia-Pacific faced historic challenges that call for unprecedented policy responses, cooperation and analysis.

To address these challenges, the PECC created a Taskforce on the Global Economic Crisis to “assess the region’s progress in fighting recession, rebalancing economic structures, and managing sustained recoveries … [and to] anticipate the critical policy changes that will be required in the Asia Pacific to move from crisis management to stable growth.” Recognizing that the International Monetary Fund and the World Bank and other institutions were already contributing timely information on global developments, the PECC Standing Committee concluded that value could be added by providing independent analysis of policy options with particular emphasis on regional responses in the Asia-Pacific, where several key economies involved in the crisis are located. I was asked to chair the Taskforce.

Over the next few weeks we assembled a team of seven experts — an international group of leading researchers — and developed an ambitious work programme to produce results in less than six months, given the urgency of the crisis. We invited several other distinguished experts to serve as a “Panel of Advisers” (listed below). We discussed preliminary findings at a conference on “The Global Economic Crisis: Macroeconomic Issues”, hosted by the Asian Development Bank Institute in Tokyo on 28–29 July 2009 and an advanced draft at a conference on the “Economic Crisis and Recovery: Enhancing Resilience, Structural Reform, and Freer Trade in the Asia-Pacific Region”, hosted by the Singapore National Committee for Pacific Economic Cooperation and the Institute of Policy Studies in Singapore on 9–10 October 2009.

Comments at both conferences provided essential guidance for the study and helped to improve this report.

A preliminary summary of the report appeared as Chapter 1 of PECC's *State of the Region Report 2009–2010* and was presented to participants at the APEC Leaders' Meeting in November 2009. We are hopeful that work within APEC will find these recommendations useful and build on them.

The team is grateful to Drs Charles Morrison and Jusuf Wanandi, PECC Co-Chairs, and the PECC Standing Committee for encouragement and support. The Taskforce's Advisers provided highly valuable input on research plans and intermediate drafts. We hesitate to single out individuals, but Jonathan Fried, Ambassador of Canada to Japan, and his colleagues provided especially detailed and insightful comments at several stages. We are grateful to the Asian Development Bank Institute and its Dean Masahiro Kawai, Mario Lamberte, Research Director, and Peter Morgan, for hosting our planning efforts. Eduardo Pedrosa, the Secretary General of PECC and Jessica Yom of the Secretariat provided outstanding support for the project, promoted it actively and successfully, and brought this publication to fruition.

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Executive Summary

The recovery of the Asia-Pacific from the global economic crisis of 2008–09 is underway but incomplete. Despite encouraging progress, major risks remain, ranging from slow growth and persistent unemployment to reemerging global imbalances and renewed financial volatility.

The policies that stopped the economic freefall — massive stimulus and financial bailout packages — were urgent, relatively easy to sell politically, and to a large extent forced by circumstances (particularly the fall of Lehman Brothers). Sustained recovery now requires tackling different problems, including international imbalances among the United States, China, and other economies. U.S. consumers are not likely to drive world demand in the medium term, and the slack will have to be taken up in part by Asian consumption and investment. The early policy responses, successful as they were in averting a larger calamity, were not designed to address longer-term issues, and some are even counterproductive from that perspective.

INCLUSIVE, BALANCED, SUSTAINED GROWTH

This report argues that given the progress already made, inclusive, balanced, sustained growth in the region — in other words, full recovery — is feasible. But renewed growth is not assured and calls for new, difficult policy choices. These include structural reforms that change economic relationships within economies and among them. International cooperation will be essential for forging and implementing this strategy.

The term "rebalancing" is now widely applied to policies for sustaining the recovery. This report seeks to bring greater precision to the analysis of these issues, and in particular to policies addressing global imbalances. In 2009, the short-term effects of the crisis brought the current account imbalances of the United States, China and Japan to levels that are generally considered sustainable. But as the recovery proceeds, and assuming no major policy changes, imbalances are again likely to grow. Should markets conclude that imbalances are no longer under control, currency and asset prices would become volatile again, perhaps triggering another downturn.

Avoiding market volatility is one important reason for rebalancing. Providing new drivers for demand, given the expected slow recovery of consumption in the United States and Europe, is another. This will also increase expenditures in emerging economies on consumption and social priorities, helping to make growth more inclusive and to spread more widely the benefits of the region's extraordinary economic gains.

The arithmetic of rebalancing appears manageable. In the run-up to the crisis, the "excessive" part of the U.S. current account deficit (the portion above 3 per cent of GDP) amounted to around 1 per cent of the Asia-Pacific region's GDP. These imbalances, which have exerted great stress on global financial relations, are relatively small when compared to domestic expenditures in large economies. But the arithmetic tells only part of the story; imbalances often reflect deeper distortions within national economies and are therefore politically difficult to solve.

STRUCTURAL POLICIES

The transition to sustained growth will require economies to exit their stimulus programmes and to replace them with structural reforms that drive growth through the recovery and beyond. Although the common effect of these policies will be to generate adequate, balanced, sustainable demand, their details depend on the structural weaknesses of different economies. For example:

- U.S. policies could impose new disciplines on consumer and government spending by reining in excessive borrowing and by increasing taxes.
- China's policies could stimulate domestic demand by improving social safety nets, freeing labour markets in order to raise wages, and opening capital markets to smaller firms.
- Japan and other advanced Asian economies could free up service sectors and refocus technological capabilities on growth markets such as aging populations and energy conservation.
- Southeast Asia and South America could accelerate investment through measures that improve productivity and the conditions for doing business.

If these changes in demand are achieved, they will need to be accompanied by parallel changes in supply. Exchange rate flexibility (the appreciation of the currencies of China and other Asian exporters and depreciation of the U.S. dollar) is the least disruptive way to provide incentives for the required resource transfers.

GROWTH ENGINES

Demand and supply shifts could be further accelerated with high profile Asia-Pacific "growth engines" that address key social and environmental priorities. These could provide a focal point for government investments and incentives, and for support from international institutions such as the Asian Development Bank and the World Bank. Four important areas for such projects are:

- Economic integration: investments in connectivity and trade agreements that strengthen Asia-Pacific markets.
- Green economy: investments in energy conservation, research and development, efficient irrigation, and energy-saving vehicles and transport systems.
- Social priorities: investments in education, health care, pensions and social safety nets.
- Knowledge and productivity: investments in research and development and technology, and reforms to drive productivity.

Such regional initiatives could stimulate Asian demand, create markets for Asia's manufactures, engage American resources and technology, and put Asia's savings to productive use.

A ROLE FOR ASIA-PACIFIC INSTITUTIONS

International cooperation will be essential for inclusive, balanced, sustained growth. The G-20 now provides a "board of directors" for the global system, with substantial Asia-Pacific membership. But the plans of the G-20 will need to be translated into pragmatic initiatives. Asia-Pacific institutions could play a central role in implementing these, for example by orchestrating the realignment of Asian exchange rates (ASEAN+3), by encouraging economic integration and stimulating productivity growth, and by launching engines of growth focused on social and environmental priorities (APEC, ASEAN+6 and others).

Interdependence in the Asia-Pacific is now often viewed as a source of risk, but it connects the most powerful technological, financial, and productive resources ever assembled. The region's institutions should not miss the opportunity to exploit these connections to address the crisis. By working together, Asia-Pacific governments can signal to markets that they are committed to cooperation and will keep growth on track.