

Asia's Role in the Global Economy and the International Financial System

Abstract

By examining not only the economy of Asia in her current framework but also the sizzling economic growth associated especially with China and India, this essay argues that Asia's existing contribution to the global economy should no longer be as limited. An expansion of Asia responsibilities in the world stage is necessitated by the tilting of the economic might in Asia's favour, and reinforced by the already limited role she undertakes.

In view of this, the essay has outlined possible ways Asia can contribute to the global economy. Firstly, it pushes for an import-driven Asian market to augment her current strategy of export led growth. Such an arrangement alleviates the unhealthy accumulation of Asia's export surplus, provides an additional locomotive in place of the current hegemonic US economy and allows new production bases to be set up in developing countries; all of which are indication of a progressing economy.

Secondly, while Asia's calls for a fairer reflection of the distribution of power in the international financial system is indeed justified following her economic growth, such a scenario can only be made possible if Asia and the world community can come to a consensus with regards to unresolved outstanding issues. Meanwhile, the region should adequately prepare herself into the undertaking this additional weight by committing more enthusiastically to global economic issues.

Lastly, contrary to popular perception, this essay believes that regionalism, in the right setting, is the key towards globalization. Given the inherent difficulties in doing coupled with exacerbation by the world's opposition, such a task has so far proved to be impossible. Yet it is only by overcoming these difficulties one by one can one speaks of the East Asian Renaissance, or even the global economy.

1. Introduction

An economy is the management of resources and the distribution of wealth within a system. Given that a predefined system is the prerequisite to the workings of an economy, the term “global economy” entails the amalgamation of world economies and requires a holistic perspective to otherwise separate entities. Since collectivity is pertinent to a global economy, it is usually characterized by the liberalization of the flow of goods and services, the eroding of state boundaries and the weakening of the powers associated with the state. In the global economy, the international financial system plays a role equivalent to states in their domestic economies; a governing body enforcing financial regulations and overseeing international transfers.

Why then, does one see the need to participate in the global economy? How does one contribute to the global economy? Most importantly, should one position himself with the global economy to such an extent that his interest is compromised? This paper shall answer these questions from the angle of a dynamic economic region – Asia.

2. An Analysis into Economic Development in Asia

The ascent of Asia’s economy in the last quarter of a century is highly remarkable. From Asian Tigers¹ and ASEAN to Japan, the world has seen economies recording unprecedented, nearing double digit growth rates over the years (Fig 2). However, these economies, impressive their developments were, can only be viewed in lesser light when comparing with global heavyweights. While Japan undeniably remains as the region’s powerhouse geographically, not many will view her so when defining the Asia in political and economical context due to her alignment with Western economies (Vogel, 2002, 2004a: 1). Moreover, having peaked by the 1990s, Japan has established herself as a global leader who contributes massively to the world

¹ “Asian Tiger” refers to the Newly Industrialized Countries- Singapore, South Korea, Hong Kong and Taiwan. By 1990, these countries, with 1.4% of the world population, accounted for 8.6% of the global market (1992a:1)

finance system.² That Asia is in the limelight in the 21st century is as a result of the thrust provided by China and India, and for this reason, while still taking other Asian economies into due consideration, this paper shall study the two economies in greater depth.

Approximately two decades after the drastic pro-market reforms³ swept their economies; China and India were no longer that of the yesteryear. The massive influx of Foreign Direct Investments (FDI)⁴ and production of exports propels these economies forward at such breakneck speed that even conservatives keen to make their point on trade restrictions will attribute, to a certain degree, China and India's economic growth to their participation in the global economy. Today, China and India are the fourth and tenth largest economy in the world, and is still growing.

The potential of Asia is never disputed. Populous Asia is often linked with the economics of scale she enjoys and comparative advantage as a low wage labour market. Demographically, Asians are in their prime years and investors are hence more likely to view them as being consumption-orientated. Geographically, the mobility of factors of production and the proximity of Asian cities those factors encourages the agglomeration of production (Ottaviano, 1997).

3. World Trade

Asia's integration into the world trading system has been a win-win situation for both Asian and the global economy, By blending large quantity of capital, which originated from massive FDI and entrepreneurs, with low wage market, Asia's economy is able to generate an upward spiral in production (Fig. 1)

² Japan is a leader in many international finance institutions, most significantly being a co-founder of the Group of Seven (G7). It has consistently ranked top in the Official Donor Assistance (ODA) scheme.

³ China's program of economic changes, "Socialism with Chinese characteristics" was led by Deng Xiaoping and started in 1978. The economic liberalization of India in 1991 initiated by Narasimha Rao did away with License Raj and granted automatic FDI approval in many sectors.

⁴ China attracts US\$40 billion of FDI and is the world greatest exporter in 2003. While India lags far behind, it is opening up to FDI as well.

which caters to international (as opposed to domestic) demand. This export-led strategy⁵ has so far been able to propel Asia's economy to high growth, and allowed international economies, especially developing ones, to enjoy cheaper prices for economic goods.

Although such a strategy has so far proved to be effective, global economist should still be concerned given the far reaching repercussion of an over-reliance on international imported demand. In the last 30 years, US constitutes a vast majority of the international net exported demand (Fig. 3), implying a worrying yet unnecessary dependence on trade on the United States, given the might of Asia she should be able to stand on her own.

The solution to the pessimism surrounding the dominance of US lies in an expansion of Asia's role in the global economy. Traditionally, much of Asia's resources have been directed towards creating means of production to satisfy world demand. However, as the growth of Asia's economy outpaces the growth in international demand, producers should now cater for domestic consumption instead. From the viewpoint of the global economy, Asia has outgrown her role a production base and it is now timely for her to play the global consumer instead.

But why Asia, one may ask? Firstly, producers should note that Asia accounts for over half the world population and is henceforth a massive untapped market. With Asia's economic growth, the spending power of consumers rises, and so should production catering to domestic demand. Producers should also realize that marginal consumption decreases with increased consumption, making it more viable to direct more resources to locals' consumption, rather than investment and eventually to developed world citizens whose appetites are largely satisfied. Secondly, viewing from national interest, many Asian countries, especially China, have accumulated large reserves and US securities from trading surpluses over the years. The value of these securities is based entirely on confidence towards the US economy and with

⁵ In 1995-2000, the export to GDP ratio is 41.4%, an indicator of Asia's reliance on trade strategy

accumulation, is low-yielding. It hence serves better to utilize these securities now than in the future. Thirdly, the government needs to take into account the casual relation between economic growth and economic welfare. For Asia, rising opportunity costs of economic growth has been brought about by overinvestment, the consequence being the lack of production of consumption goods, which is a better measure of economic welfare. To the global economy, Asia's shift to that of a global consumer not allow provides an alternative to US preponderance but also allow developing countries to set up their own production bases.

Fortunately, having recognized the importance of domestic consumption, both the China and India government have already introduced fiscal policies to stimulate them.⁶ Critics, however, may link expansionary policies with the controversial Keynesian economics. Contrary to these associations, one should instead view the role of the government to that of correcting market inefficiencies and safeguarding interests of citizens, whereby increased consumption is as a result. For instance, demand for economic goods will rise by cracking down on pirated goods which act as substitutes. Poverty reduction might increase the rate of increase of marginal propensity to consume, henceforth increasing production.

Supply constitutes its own demand, so says classical economist Jean-Baptiste Say. Ultimately, the onus lies in Asian producers to create supply so that demand will increase. For Asia, this demand is crucial in maintaining its growth momentum. In the global economy, Asia's role lies in rebalancing the distribution of world trade.

4. International Financial System and Global Issues

⁶ Both China and India have attempted to stimulate demand by introducing policies that encouraged the setting up more financial institutions with higher monetary loan and lower interest rate since 2004.

Following the rise of sophisticated Asian economies such as Japan⁷, and more recently, China and India, and the near saturation of the United States economy, there is a distinct distribution of economic power. Bolder economists are already questioning US status as a financial hegemon in the near future. Having established the might of Asia economy earlier in this paper, I believe that it will be inevitable that international financial institutions confer a greater role to Asia reflecting on its economic power. However, to gain approval in the international community, the Asian economy, especially China, must show a greater commitment to global issues.

Japan, China and India, with the second, fourth and tenth largest economies in the world, are clearly Asian countries which have reached a point whereby they can influence the global economy. Yet these countries, in particular China and India, hold little influence in affecting or changing financial regulations, partly because their interactions with the global economy only started during the 1990s. India, wanting to achieve self reliance, closed her door to the international finance system until recently. Similarly, China began participating in international economic groupings only recently, having joined the International Monetary Fund (IMF) in 1980 and World Trade Organization (WTO) in 2001. While Asia has maintained a good track record of cooperating with these organizations, establishing her position in these organizations takes time.

Political insecurities may also account for the reluctance of the international community to accept Asia's place in the international financial system. The collapse of the Soviet Union might have taken place long ago, but the policy of containment still remained deeply rooted in Western democracies, explaining for the lukewarm reactions to the rise of countries affiliated with communism, examples being Vietnam, China and Myanmar. For example, the tying up of trade with human rights resulted in widespread resentment in

⁷ Gilpin argued in the late 1980s that Japan was already the financial hegemony in Asia. Strange (1990) claimed that while US holds power to shape financial structure to its end, Japan now wields a certain amount of power

China, in what was perceived to be a hidden political agenda to impose Western values on non-Western countries (Moore, 2000).

To rectify such problems, Asia must continue to prove herself in the world stage. China's participation in organizations such as the G-20 is no doubt laudable (Yu, 2005), but Asia cannot afford to limit herself to mere participation, but should advocate issues to the benefit of the international community, and respond to their concerns.

One issue which concerns the world community will be the impact of economic growth in Asia to the environment. While critics of indicators of uneconomic growth maintain that environmental well-being should be left to individual's pursuit, the negative externalities of ecological damage and pollution are heavy. On the other hand, the world community could not expect Asia, a developing economy, to adhere to the 3% growth rate that ecologies could sustain without damage (Suzuki, 1998). Whereas concessions are usually given to developing economies, the magnitude of Asia both in economic growth and size amplifies this negative externality and might cause discontentment amongst the world community. In fact, it is worthwhile to note that more than three-quarter of the world's ten most polluted cities are from Asia. In this aspect, Asia should proactively seek to reach a consensus with the world community.

The abidance by international trade laws has been another controversial issue of Asia surrounding the global economy. The fact that Asia, especially China, have large economies running on massive trade surpluses place her as a world competitor, and hence exacerbates the reaction of her flouting international laws. Asia's failure to crack down on intellectual property rights (IPR) violations has, for instance, been a source of tension between herself and the world community. China's alleged manipulation of the yuan has been another. Yet critics should be reminded that, with the development of Asian economies, it is of Asia's best interest to set up intellectual property laws. Instead of pushing for an immediate adoption of a free market exchange rate, the world community should also respect China's need to contain ill effects of

massive speculation and instead encourage first a partial floating system, the direction she is heading towards.

Already, the IMF has echoed Asia's concern with regards to her lack of clout in the financial system relative to its economic power and urges the international community to look into this matter in order to fulfill IMF's mandate of a greater global economic stability (2005:a). Meanwhile, Asia should adequately prepare herself to undertake the responsibility attached to greater power.

5. Regionalism and Globalization

That the term 'regionalism' is linked with 'globalization' in the first place might be puzzling to many. How does regionalism advances globalization when it reinforces the very geographical boundaries that globalization seeks to eliminate? In what way does the apparent definition of Asia not conflict with its integration? Consequently, the world community, unsettled by these rhetorical questions, is diametrically opposed to any attempts by Asian countries to regionalize⁸. Yet in doing so the world community is instead destroying the link between Asia and the world.

The world's reaction, albeit inappropriate, can be easily understood. The concept of regionalism has long been associated with negative protectionism, where countries in the region form trading blocs, accorded preferential treatment only to one another and closed their doors to the global economy. Surely it is in the world's interest to prevent this outcome at all cost?

The lack of regionalism might worsen the anti-globalization stance already adopted by certain Asian countries. It is precisely regionalization, or the lack of it, that saw China and India not opening their doors to foreign trade in the earlier decade. In contrast, Singapore, having reaped the benefits of

⁸ Japan's proposal for an Asian Monetary Fund (AMF) to be set up is rejected unanimously by both the United States and the International Monetary Fund (IMF) twice in 1998 and 2000. Initiatives for private meetings between Asia Pacific countries have also been blocked by the United States.

regionalization, later moved on to become one of the freest economies in the world. No longer is the assumption that regionalization will result in a tendency for the world to shut its door to the global economy accurate. Regionalization today should instead be viewed as a stepping stone which provides conservative states with an option to open up their economies on a smaller, regional basis. Given the risk that globalization itself carries when it forces the economic door open, for example when in the wake of the 1997 Asian Financial Crisis, it is pertinent that states cooperate with one another, with regionalism being a good avenue to do so. Having recognized the inherent benefits of regionalism, states will then be encouraged to open up to a larger platform, and ultimately, the global economy.

If the regionalism of Asia were to take place, however, we should see it differently from the conventional paradigm which we viewed from the regionalism of entities such as the European Union (EU). The economies of Asia are intertwined naturally in the first place; without the “teamwork” in place the Asian development would never have been that impressive. Indeed, Okita (1996) likens the pattern of development in Asia to the “flying geese”, where less developed economies, having access to others’ capital and technology, bypass essential developmental steps and grow rapidly.

However, the existence of such “teamwork” is yet to be recognized. In fact, there has yet to be a single organization representing Asia economically, with the membership of the Asia Pacific Economic Cooperation (APEC) being too diverse⁹ to promote Asia’s interest, and former Malaysian Prime Minister Mahatir’s proposal for the East Asia Economic Grouping (EAEG) fading away in the 1990s. Failure of regionalism has been largely due to reluctance for a country to lead financially, with separate blocs in Asia pushing for their own interest. Asia itself is politically, economically and culturally diverse, and the large differences between each state are undeniable. The political rivalries and tensions between China and Japan are also significant, given that those states have the two largest Asian economies. The world’s opposition towards

⁹ More than a third of the 21 APEC members are not from Asia

any move with bearings of regionalism makes it all the more daunting. The result is an awkward and unreliable style of “teamwork”, falling short of regionalism, which Asian countries cannot rely upon.

Optimists, however, point out to the East Asian Renaissance, the resurgence of the mighty ancient historical civilization and great political empire that Asia once was. Leading the quest of Asia’s return to power would be China and India, the growth engines of today. Yet this empire does not foolishly close her trade routes, but instead, builds more of them. This is the new regionalism, an empire built on the basis of a multipolar world order.

Indeed, the establishment of ASEAN Plus Three (APT), a dialogue between Asian countries, can already be viewed as the catalyst for this progress. ASEAN, already an established grouping, can serve to bridge the divide between Sino-Japan relations, insofar the limiting reagent to the growth of Asia’s economy. Economic heavyweights Japan and China can work towards developing a financial mechanism, helping developing economies in the process. Moreover, the transfers of trade, investments and technologies have already been a parcel of the workings of the Asia economy and APT can serve to provide an institutional framework to it, thereby enhancing the process (Alatas, 2001).

Already, significant achievements have been made by APT. The Chiang Mai Initiative provides a safety rope for Asian economies to cling to in the event of a crisis. If a Free Trade Agreement, currently in negotiation, is to be set up, Asian countries will only stand to gain collectively, the percentage of welfare gain illustrated by Figure 4. But APT is neither about numbers nor selfish personal gains of Asia. APT forwards regionalism, a concept in sync with globalization.

Critics, of course, will not fail to point out the shortcomings of APT and doom it to failure. But are other regional organizations, such as European Union, then completely flawless? The journey of a thousand miles starts with a single step,

so goes a Chinese proverb. If APT can prove to be the first step, Asia is not far away from being a pure integrand of the global economy.

6. Conclusion

The global economy needs Asia, as much as Asia needs the global economy. Being mutually dependant, it serves Asia to contribute to her best of the abilities so that both parties can benefit as much as possible. Given the spirited growth associated with Asia, so should her contributions. In terms of trade, Asia can expand her role via a gradual shift of emphasis from production to consumption. The international financial system is also a direct platform whereby Asia can play her role as an emerging power, instead of the silent participant that she usually is. Yet in order to work with the world, Asian countries must first be able work with each other.

Both Asia and the world community are concerned about the global economy, but when taking their different approaches towards their concerns, there bound to be friction among them. In the face of this, both parties should bear in mind that the improvement of the global economy is not a strictly competitive game, whereby Asia's gain is equated with the world's loss. Instead, such a game is strictly cooperative, and only by working hand in hand, with the presence of mutual accommodation and compromise, can the concept of the global economy be a reality.

Appendices

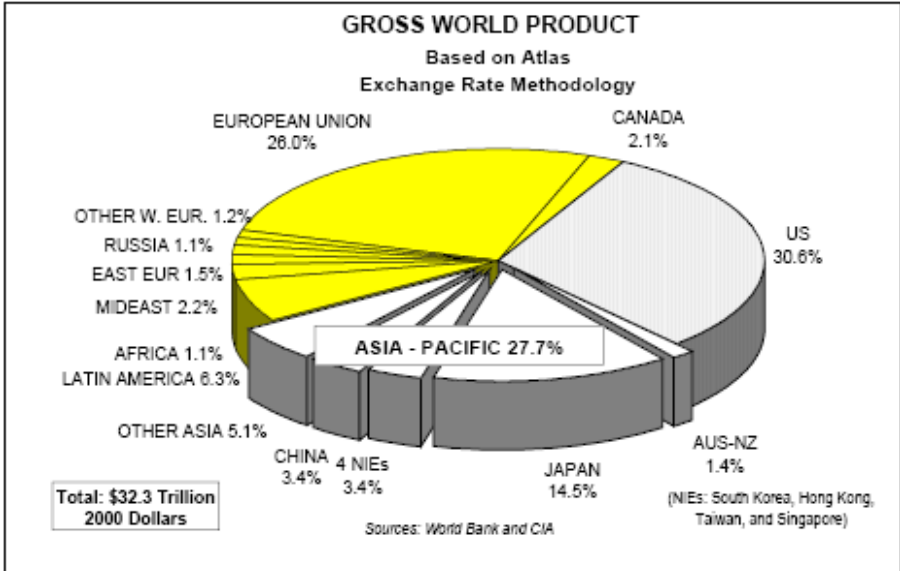


Figure 1

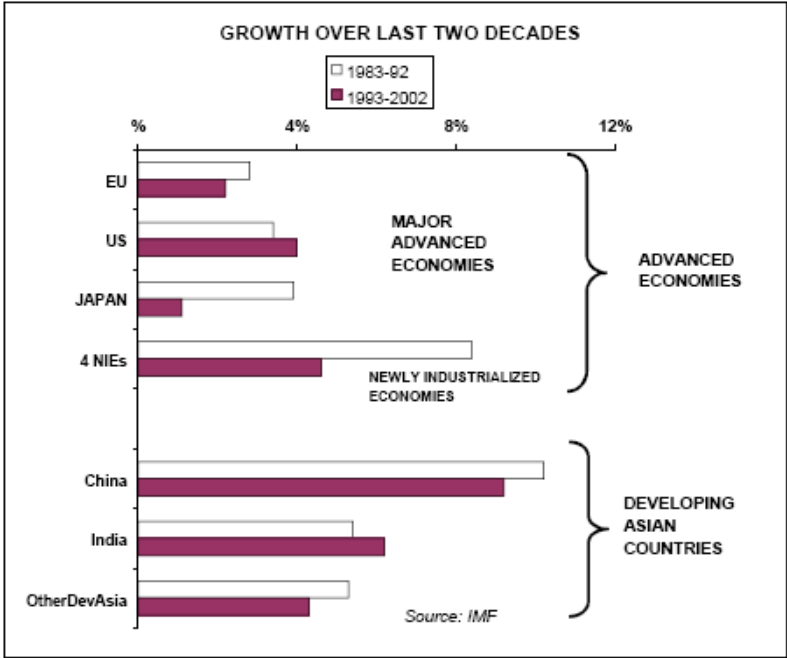


Figure 2

Country or Region	Percentage of Increase in World Aggregate Demand		Percentage of Increase in Aggregate Demand Satisfied by Domestic Sources	
	1990-1997	1997-2004	1990-1997	1997-2004
US	35.6	46.6	97.6	81.7
EU (15)	15.5	23.3	120.0	95.3
Japan	10.4	2.7	108.8	148.4
Other Developed Countries	5.3	6.4	112.9	111.1
Western Hemisphere	7.6	2.0	86.5	162.2
East Asia (inc. SE Asia)	18.2	11.0	99.5	123.3
South Asia	2.3	3.0	102.4	102.3
Other Developing Countries	5.1	5.0	95.7	127.8
Memo Items:				
China	5.6	6.5	104.6	105.0
India	1.9	2.5	102.7	102.4

Note: Local currencies are converted to dollars using the 14-year average nominal exchange rate. Other developed countries consist of Australia, Canada, Cyprus, Iceland, Israel, New Zealand, Norway, and Switzerland. Other developing countries consist of 13 African countries, 4 Central or Eastern European countries, and 13 Middle Eastern countries.

Source: World Economic Outlook.

Figure 3

	North Asia Three	ASEAN Plus Three (APT)	APT-ANZCER
Singapore	-0.87	4.12	0.92
Malaysia	-0.70	1.24	1.74
Indonesia	-0.15	0.89	0.71
Australia	-0.05	-0.11	1.05
Japan	0.25	0.34	0.57
China	2.09	1.96	1.94
South Korea	0.80	1.18	1.20

Source: Robert Scollay and John P. Gilbert, *New Regional Trading Arrangements in the Asia Pacific?*, Source: Robert Scollay and John P. Gilbert, *New Regional Trading Arrangements in the Asia Pacific?*, Institute for International Economics 2001, pp. 68.

Figure 4

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