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Discussant Note on Governor Zeti's presentation, Paper 5, Session 3

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It is a privilege, albeit a challenging one, to be offered the opportunity to discuss Governor's Zeti very insightful and comprehensive paper. I fully agree with the thrust of the paper and will only to provide some additional food for thought. In doing so, I will make use of my Chinese experience since I have been based in Beijing for the last two years.

As Governor Zeti points out, the Asian successful and rapid economic development is not the result of luck but the fruit of hard work. Several factors underlie this strong performance:
-making economic development a priority and the public support for development;
-the high propensity to save, partly possibly also a cultural phenomenon;
-an outward oriented development path; and
-finally, the fact that Asia has been able to build upon the heterogeneity and the diversity of its economies. This has led to this famous pattern of vertical trade integration.

Actually, this diversity makes it very difficult to analyse the region as a whole. Besides the question of the boundaries of the region, there is the question whether one should use means, averages or weighted averages to support the analysis since the inclusion of giant economies, at very different stages of development, such as Japan, China or India can, and, on most occasions, does change the results of the analysis.

To the list of Governor Zeti, I would add another important factor: the strong ability of Asian economies to adapt. This ability comes in my view from the dynamism of their young population and the eagerness of this youth to catch up rapidly. It also results from the willingness of the Asian governments to adjust, when needed, the economic policies. As a result the Asian tigers and dragons have been able to rebound rapidly from the 1997-98 economic crisis.

The question we are facing today is whether Asian countries can rebound again in a sustainable way and this time, possibly, without having the US and the European economies as drivers of world growth.

My answer is yes but under certain conditions. Most Asian countries have shown considerable resilience and now have many assets at their disposal.

Firstly, during the last decade, Asian policymakers have managed to fix with diligence the problems that were the causes for the 1997-98 crisis. As a result, their financial systems emerged almost unhurt from the recent crisis. Let me note, however, that, in some countries, the fact that the financial sector escaped to a large extent from the crisis is not per se a sign of strength but rather the consequence of a lack of opening up and of capital account liberalisation. This is probably one of the most important paradoxes in China: the effectiveness of the Chinese stimulus package is considerably hinging on the ability of the Chinese banks to provide extensive credit to the State Owned Enterprises. However, the Chinese banks apparent strength is mainly due to a combination of factors: they are shielded from foreign competition; they benefit from a guaranteed spread between the deposit and the lending rate; and, they can tap a huge pool of savings since Chinese households and companies have no other instruments than bank deposits to invest their ample savings. I am taking the example of China but the fact that the Asian region's savings are not reinvested in the region shows that further progress is needed in terms of financial reform and financial market developments.

Secondly, Asian policy-makers have also been very conservative in terms of fiscal policies and hence had plenty of room of manoeuvre for large stimulus packages. Most of these packages have focussed on infrastructure spending, a very effective way of spending, particularly when there are obvious needs, which is the case in most Asian countries. I would nevertheless argue here that the needs in terms of social safety net, education, health and pension are at least as blatant as the need for infrastructure in many Asian economies. Of course the result of social support policies are more felt in the medium term but social policies have more effective in boosting consumption and in reducing precautionary saving. They should become priorities for most countries in the region, particularly for those where income inequalities have been rising fast. In sum, one of the inescapable consequences of investment spending as a tool for fighting the crisis has been further increasing the unbalanced character of some Asian economies.

Thirdly, the Asian outward oriented development strategy has so far served the region well. Regional trade integration has considerably strengthened and, for ASEAN countries, China has now become a major target for exports. However, a large share of ASEAN exports are just being exported to China for assembly when final demand lies outside the region, namely in the US and in the EU. It is difficult in light of the deleveraging process that US households, US and EU banks and US and EU governments will have to face, to envisage a resumption of fast external absorption by the US and EU. This means that the additional impetus to GDP growth that Asian countries have enjoyed over the last few years will shrink importantly and new engine of growth will have to be found in the region itself. Again this calls for policies that boost real household income and for finding other engines of growth than the manufacturing sector. The services sector is an obvious choice since it remains to be fully liberalised in many Asian countries.

Fourthly, in light of the dependence of the region on external demand and the extent of regional trade, one cannot but note the diversity in exchange rate regimes in the Asian region. The fact that the region as a whole has an important external surplus seems to suggest that the exchange rate of most Asian countries is undervalued. One main stumbling block in the required adjustment process has been the fact that the Chinese authorities have fully re-pegged the RMB to a rapidly depreciating USD since July last year. This not only complicates the conduct of monetary policy; it also further reinforces the Chinese competiveness, and of those countries having a pegged USD system. Hence it forces countries with a pure or managed float to unwarranted adjustments. For China and other countries with a peg, it hinders the move away from the tradable to the non-tradable as well as the development of domestic consumption. I understand from my contact with Chinese officials that this RMB re-pegging is temporary but the longer it stays in place, the more damaging and the more difficult it will be to restart of a process leading to a fully flexible exchange rate.

I would like to mention a last challenge, probably outside of the scope of this conference, but a very important one for all of us, and in particular for Asia: fighting climate change. I am quite appalled by the implications of different scenarios on global warming. We are already seeing in low ground and heavily populated regions the effects of massive floods or typhoons. Asia has become a major factory for the world and is importing most of its energy and commodities. Energy efficiency, curbing emissions and the respect of the environment will require changes in economic policies that could be detrimental in the short run but could also become an engine of growth. Asia is a major stakeholder in this endeavour.

Let me conclude by repeating that I strongly believe that, in light of past experience and of the expertise of Asian policymakers that Asia will manage its transition to a new growth model or new growth models that will benefit the region and the global economy.

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