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The Role of Asia in a Globalized Era

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This period of major change, in which the traditional system is failing to function satisfactorily while a new framework has not yet been found, is an unstable transition period fraught with danger.

—From the IIPS Founding Declaration (May 17, 1988)

I. A Look Back at the Past 25 Years

I would like to express my deep respect to the Institute for International Policy Studies (IIPS) for its continued efforts over the past 25 years to make valuable recommendations on issues confronting the international community in a broad range of fields including politics, economics, diplomacy, and security.

Included in the 1988 Founding Declaration of the IIPS is a perception of the times, quoted above. The year 1988 was when we began to see positive signs of an end to the Cold War due to progress in *détente* between the United States and the Soviet Union. On the economic front, the world was experiencing an asset value boom, with Japan at the top of the list. It was a time when optimism prevailed. And yet, even in such positive circumstances, the Founding Declaration was able to foresee an approaching era of volatility with calm prescience. I was struck by the depth of its insight. In fact, the world has ever since remained adrift in a long "transition period" without arriving at a new paradigm to replace the old, dysfunctional one.

Structural changes in the international political situation: The end of the Cold War and the rise of multipolarity

On the international political scene, the year 1989 heralded a spate of dramatic turnaround events including democratization revolutions in Eastern European countries and the fall of the Berlin Wall. Late in the year, the world welcomed the declaration of an end to the 40-year-long Cold War at the Malta Summit held by US President George H. W. Bush and Soviet leader Mikhail Gorbachev. By the close of 1991, the Soviet Union's dissolution had been finalized.

What followed, however, was not "the end of history,"[1] or the start of an era of peace and

[1] See Francis Fukuyama, *The End of History and the Last Man*, The Free Press, 1992.

stability through the triumph of democracy and liberalism, but a multipolarized world in which diverse values coexisted. The international political scene remained volatile, as ethnic problems that had been contained under the Cold War framework bubbled to the surface around the globe, with the attacks of September 11, 2001 and the subsequent war against terrorism. As the search for a new paradigm persists, a chaotic situation continues to prevail around the world, as seen most recently in the disorderly changes of government in several Arab countries following the Arab Spring and the eruption of civil wars in Mali and Syria.

Structural changes in the economic and financial environment: Strengthened interconnectedness

The structural changes that have occurred in the past 25 years in the economic and financial environment are comparable in scale to those in international politics. In particular, "strengthened interconnectedness" has been crucial in two respects.

The first is the strengthened interconnectedness of economic activities across borders. In other words, globalization of the economy has advanced significantly. Obviously, economic globalization is not a new phenomenon that has arisen only in the past 25 years. After the Age of Discovery, the arrival of Europeans in the New World served as a trigger to promote the transfer of goods (merchandise trade) and people across borders. This may be considered the dawn of the globalized age. In the nineteenth century, moves toward free-trade principles such as the abolition of the Corn Laws and the Navigation Acts in the United Kingdom, and the signing of commercial treaties among European countries—coupled with the development of transportation technologies such as freezing—triggered the dramatic increase in trade that led to significant progress in globalization.

However, the transportation of goods and people in the past 25 years has accelerated to a degree far surpassing any of the preceding trends. Progress in trade liberalization and the building of global supply chains by multinational corporations are among the factors driving this more recent and dramatic globalization.

As the Cold War came to an end, the collapse of the Iron Curtain, which divided the Eastern and Western blocs, had a substantial impact. Corporations in Western industrialized countries brought abundant capital and advanced technologies into emerging countries and former Eastern-bloc countries, setting up production bases in an optimal manner by leveraging the low-cost local labor force.

The flow of goods and people was also advanced through market integration of the European Union in the 1990s, the signing of regional trade agreements such as the North American Free Trade Agreement, and the rapidly upgraded network of free trade agreements (FTAs) and economic partnership agreements in the 2000s.

Progress in international specialization has increased both the export of product parts to production bases and the export of finished products from the production bases to markets in the industrialized nations, contributing to the rapid expansion of merchandise trade. In fact, if we set merchandise trade in real terms in 1988 at 100, the figure for 2012 exceeded 400, representing an annual growth rate of 6%. Similarly, with regard to the transfer of people, an equally dramatic rise was observed in the number of international travelers, cross-border workers, and immigrants.

Inter-regional interconnectedness achieved marked progress not only in the real economy but also in financial activities. This second form of strengthened interconnectedness—or more specifically, this advancement in "financial globalization"—is reflected clearly in the sharp increase in the transaction value of foreign exchange markets and cross-border credit limits.[2] The range of participants in cross-border transactions has likewise grown ever more diverse. Besides the traditional players such as multinational corporations and the major financial institutions of advanced countries, there is now increasing market participation by the financial institutions, hedge funds, and sovereign wealth funds of a wider range of countries. Analysis of the content of fund flows indicates that trading methods have also become progressively diversified and complex, including not only

[2] International Monetary Fund, "Understanding Financial Interconnectedness," Staff Paper, October 4, 2010 reports that the number of bilateral links between economies nearly doubled between 1985 and 2010, based on the BIS International Consolidated Banking Statistics index representing the banking sector’s cross-border financial interconnectedness.

traditional financial products such as bonds and stocks but also derivatives trading and trading involving commodity markets.

The advances in financial globalization just mentioned are also propelled by progress in information and communications technology and the development of a range of financial trading methods. Developments in technology and trading methods promoted investment and loans and risk hedging on a global scale and the sophistication of cash management by corporations, which has led in turn to an expansion in international financial transactions including international capital movement and derivatives trading. Changes in regulatory systems, such as liberalization of capital markets, have also given a big boost to these phenomena.

The increased financial globalization, however, has both a bright side and a dark side. On the bright side, the activation of global intermediary functions contributes to the growth of the world economy through more efficient distribution of resources. On the dark side, a malfunctioning system in a particular financial market or certain financial systems is transmitted instantly to other areas. The world financial crisis stemming from the subprime-loan debacle in and after 2007 is a good example of this.

II. The Growth of Asia and Recent Developments[3]

One of the most significant structural changes of the past 25 years is the rise of Asia. The 2016 Olympic Games will take place in Rio de Janeiro, the first time for the Games to be held in South America. But if we turn our attention to emerging countries in Asia, the Olympic Games were held nearly 30 years before this, in Seoul in 1988, followed by Beijing in 2008. I feel that the hosting of these two Olympic Games in Asia underscores the striking prominence of Asia's economic development among other up-and-coming regions and its increased presence in the world economy. Reflecting overall economic activity levels, the world economy in real GDP terms grew at an average annual rate of

[3] The scope of the term "Asia" can be rather extensive. For instance, the Asian member countries of the Asian Development Bank range from the Polynesian island countries of Kiribati and the Cook Islands in the east, to the countries in the Caucasus to the west. However, the discussion that follows focuses on China, India, the NIEs and the ASEAN countries whose economic influence is relatively large.

3.4% between 1988 and 2012, while the Asian economy achieved a far faster rate of growth at 7.8%. Asia has established itself unquestionably as the "factory of the world," as shown by its ability to produce nearly half of the world's automobiles and two-thirds of the world's iron and steel. It may be no exaggeration to say that Asia has gained the fullest benefit of the numerous forms of strengthened interconnectedness discussed earlier.

Strengthened inter-industry/inter-regional interconnectedness and the growth of Asia

If we look at the factors supporting Asia's rapid growth in the long term, three seem particularly significant.

The first factor is the sophistication of the supply chain. International specialization has progressed globally against a backdrop of developments in information and communications technology and inventory control technology. In Asia, the foundations for the manufacturing industry were laid as Japanese corporations set up plants in a range of industrial sectors and Asian countries strove to support industry by improving education and infrastructure. Since many Asian countries have lengthy coastlines, the availability of the lowest-cost transportation by sea helped form close ties by means of international specialization among Asian countries including Japan, and this led in turn to the establishment of close-knit supply chains. Today, not only Japanese corporations but also major US and European corporations have established a number of bases in Asia, and they export and import parts and finished products between their home countries and third countries. At the same time, domestic corporations in Asia have established their own brands and developed supply chains in the region.

The second factor supporting Asia's growth is the advancement in trade liberalization. The Republic of Korea, for instance, worked vigorously to conclude FTAs from the mid-2000s, and has succeeded in signing agreements with trading partners whose scale of trading, including ongoing negotiations, accounts for 80% of the total value of the country's exports. Meanwhile, ASEAN members are promoting liberalization of intra-regional trade and aim to abolish tariffs by around 2015. ASEAN is also working to conclude FTAs with extra-regional countries such as Japan, China, the Republic of Korea, and India. In this way, by positioning themselves as a hub and creating close-knit trade networks, ASEAN countries are seeking to generate a synergy effect of industry accumulation and inflow of direct investment. This type of industry accumulation has created a virtuous cycle: enhancing technologies and fostering skilled human resources has contributed to a further buildup of industry.

The third factor supporting Asia's growth is that the self-sustaining domestic demand expansion mechanism has started to operate as domestic income levels have risen in line with the development of export industries. Although the wage levels of Asian countries are still relatively low, their absolute level has shown a steady increase. Led by a growing middle class, demand for consumer goods and infrastructure such as electricity and water has also expanded. In addition, rising income levels have created room for further growth through stabilization of the economy and society.

Strengthened financial architecture in Asia

Although the Asian economy has developed rapidly over the past quarter-century, the road to success was not always smooth. In the latter half of the 1990s, in particular, many Asian countries suffered the bitter experience of a currency crisis and subsequent economic crisis.

During the currency crisis, inflexible exchange rate policies became a target. At that time, many Asian countries had effectively adopted the US dollar peg system. This contributed to the stabilization of their own currencies, but on the other hand it reduced their external competitiveness due to the inability to use exchange rates to adjust high domestic inflation. This led to increased vulnerability in the economy by further aggravating the current account deficit.

Another aspect of Asia's development was its growing exposure to two vulnerabilities in its financial architecture. The first vulnerability is attributable to the dual mismatch of currency and maturity periods. Asian financial institutions borrowed short in foreign currencies and lent long in their own currencies. As a result, as soon as they encountered difficulty in foreign currency borrowing, they experienced cash-flow problems. In addition, once their own currencies depreciated in response to this situation, the burden of repaying foreign currency debt increased, and the balance sheets of financial institutions worsened, creating a vicious cycle.

The second vulnerability is associated with the excessive reliance by corporations on bank financing. Although reliance on bank loans has now decreased somewhat in some countries and regions, the financing structure of Asian corporations is characterized by a higher share of indirect financing. This reflects the underdeveloped local capital markets, which helped transmit directly the negative impact of the aggravated balance sheets of financial institutions to the corporate sector.

Based on the lessons from the currency crisis, Asian countries have shifted to a more flexible exchange rate system by abandoning the *de facto* US dollar peg system, facilitating adjustment through changes in exchange rates. Another significant change has been the adoption of what is currently called a macroprudential perspective in their macroeconomic policies.

In addition to these initiatives, Asian countries have increased their efforts to enhance robustness against financial market stress. For instance, efforts have been made to foster Asian local currency bond markets, and the buildup of short-term foreign debt is under control. The dual mismatch has been substantially improved, helped also by greater sophistication in risk management among financial institutions and corporations. To improve their resilience against a shock, Asian countries have increased their foreign currency reserves at a faster pace than other regions of the world, while this may also be considered a result of foreign exchange interventions aimed at restraining the appreciation of their own currencies. Furthermore, as a backstop in the event of a short-term liquidity shortage in an Asian nation, the Chiang Mai Initiative (CMI) was launched among the ASEAN+3 countries, and the bilateral currency swap arrangement network has been improved.

Japan has also played a major role in strengthening the Asian financial sector. For instance, the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP), conceived by the Bank of Japan and established in 1991, has launched the Asian Bond Fund (ABF) aimed at encouraging intra-regional bond investment. It is intended to foster a local currency bond market to make effective use of the abundant savings in Asia. In addition, ASEAN+3 has launched the Asian Bond Markets Initiative (ABMI) to promote efficient and highly liquid bond markets in Asia. Under the initiative, the inaugural guarantee transaction was started in April 2013, in which corporate bonds of investment-grade corporations within Asia were issued with the guarantee of the Credit Guarantee and Investment Facility (CGIF). Although some of the individual initiatives may be small in scale, the accumulated effects are expected to improve the stability of the Asian economy and its financial markets and, in the long run, support its medium- and long-term economic development.

The enhanced resilience against shock resulting from these initiatives was made clearly evident when another financial crisis erupted, ten years after the Asian currency crisis, this time with the epicenter in the United States and Europe. This time, Asian currencies, bonds, and stocks, in certain phases, were sold intermittently against the backdrop of investors' reduced risk appetite, and Asian economies were depressed temporarily. Despite the magnitude of the shock, however, the situation never led to a recurrence of the Asian currency crisis: Asia quickly turned its economies around and stabilized its markets.

Background to the recent destabilization of financial markets

The Asian financial infrastructure has certainly enhanced its robustness through post-currency crisis initiatives. Nevertheless, some unstable movements have been observed recently in financial markets, including a sharp fall in exchange rates and stock prices in some Asian markets, including India and Indonesia. This instability was triggered by factors such as increased speculation earlier in 2013 over the anticipated scale-back of monetary easing measures in the United States.

One question that must be asked here is: why has destabilization of the markets occurred despite the enhanced robustness of the financial system?

There is an argument in some emerging countries about ascribing the destabilization of their own markets to the conduct of monetary policy in advanced countries. However, we must bear in mind that the recent instability in emerging markets has not been observed uniformly across these countries. While some countries experienced large-scale capital outflows from spring to autumn, in other countries such effects were limited. What is the significance of these increased differences among emerging economies?

A comparison by group shows that the countries whose financial markets were destabilized had relatively vulnerable economic fundamentals such as current account deficits, budget deficits, external debt, and so on. Following the 2007 financial crisis, many countries introduced large-scale economic stimulus measures in both financial and budgetary terms. Combined with heightened expectations for growth and the impact of monetary easing by the advanced countries, a massive amount of money flowed into the emerging countries. This triggered an appreciation of their currencies and restrained production activities due to reduced competitiveness in exports. On the other hand, the greater purchasing power of households has led to increased imports. These two phenomena caused a deterioration in the balance of current accounts. Furthermore, a number of governments came under pressure to introduce measures such as increased subsidies or social security payments in order to lessen public discontent with widening economic inequality. On top of this, we saw growing concern over other adverse effects such as an increase in the anticipated rate of inflation.

On the other hand, among the countries where relatively modest adjustments were observed, some implemented policies with a greater emphasis on sustainability. Such policies included strengthening taxation measures aimed at fiscal soundness during the strong recovery phase after the financial crisis, tackling labor market reforms, and relaxing regulations on foreign investment.

The manner in which financial policies are handled in advanced countries may, to some extent, have an impact on fund flows into and out of emerging economies, but—taking into account the increased differences among these economies—this should not deflect attention from the more fundamental issues. We need to look squarely at the fact that the vulnerabilities in the economic structures of particular countries are becoming a focus of concern once again, given the relative decline in the growth outlook for emerging countries that led the recovery of the global economy in the wake of the financial crisis.

This issue boils down to the question of whether or not the Asian countries will be able to sustain growth in the medium to long term.

III. Issues Confronting Asia

Outlook for the Asian economy

In regard to the long-term prospects for the Asian economy, many international organizations and private institutions predict relatively high growth. For instance, a report issued by the Asian Development Bank in 2011, titled "Asia 2050: Realizing the Asian Century,"[4] advanced a scenario in which by 2050 Asia could account for more than half of the world economy.

From a demographic perspective, the productive-age population of many Asian countries is expected to rise steadily for more than 10 years, except for countries such as China and the Republic of Korea, whose productive-age population ratios are projected to reach their peak in the next few years. This means that many Asian countries are "young" nations that can enjoy an incidental "demographic dividend." In addition to this, as modern industries continue to make inroads into Asia, an increase in production activity is expected to raise overall income levels.

As the rising income levels boost the size of the middle class, domestic demand in terms of personal consumption is also expected to grow. According to a working paper published by the OECD Development Centre, the share of Asia’s middle-class population (with daily income per capita ranging from 10 to 100 US dollars) is projected to increase from 28% as of 2009 to 54% in 2020, and to 66% in 2030.[5]

That said, these scenarios are based on the premise that the Asian countries do not get caught in the "middle-income trap," a situation in which a country—after making the transition from a low-income to a middle-income country—fails to become a high-income

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[4] See Asian Development Bank, "Asia 2050: Realizing the Asian Century," 2011.

[5] See, for example, Homi Kharas, "The Emerging Middle Class in Developing Countries," OECD Development Centre, Working Paper No. 285, January 2010.

country with an annual income per capita of 10,000 US dollars or more. The countries and areas in Asia that have succeeded thus far in becoming high-income countries are, apart from Japan, limited essentially to the "Four Asian Tigers" (the Republic of Korea, Taiwan, Hong Kong, and Singapore). Although other countries also enjoy tremendous growth potential, each needs to overcome a range of challenges in order to transform itself into a high-income country by realizing its potential.

The key to avoiding the "middle-income trap"

One of the issues we need to address is increasing productivity in a sustained manner through the accumulation of human and physical capital to realize the potential for growth. Japan and the "Four Asian Tigers" dramatically improved productivity by upgrading social capital and education infrastructure, and by investing heavily in research and development during the course of their development into high-income countries. It is crucial for other Asian countries following in their footsteps to raise their already-high educational standards even further, and improve the work environment to maximize the use of human capital. It is also crucial that they accelerate urbanization and expand business opportunities by leveraging the merits of growth. At the same time, a favorable business environment must be created by improving infrastructure, including soft infrastructure such as legal systems.

Sustainable growth also depends on the important issue of dealing with widening economic inequality. As Asian countries have achieved rapid growth, with emerging countries becoming middle-income countries, the percentage of the population living in poverty has declined and income differences with advanced nations have also been reduced, from a macro perspective. Nevertheless, from a micro perspective, income and asset inequalities have gradually increased between city dwellers and the highly educated on the one hand—who enjoy greater access to the benefits of economic growth—and the rest of the population on the other, exacerbating the distortion of income distribution within a country.[6] If no measures are taken to deal with this situation, there is an increasing risk of mounting public dissatisfaction and social unrest. At the same time, there is a risk of economic inefficiency if budgetary support is expanded too easily.

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[6] See Asian Development Bank, "Asian Development Outlook 2012: Confronting Rising Inequality in Asia," April 2012.

It is clear that each country needs to overcome its own structural challenges to avoid getting caught in the "middle-income trap." Having said this, when we consider the balance between structural measures (which may increase economic inequality) and ensuring social stability, the key issue must be whether or not the country can catch a "tailwind" and continue its efforts for many years to come. Here "tailwind" means rising resource prices for the resource-rich countries and low-cost capital inflows from advanced nations for the emerging countries.

Macroeconomic management from a medium- to long-term perspective

In relation to this point, I would like to consider a third issue: the necessity of macroeconomic management from a medium- to long-term perspective.

Although the issues may vary from country to country, sustaining both high rates of growth and stable prices over a long period of time depends on the difficult task of macroeconomic maneuvering.

Many Asian countries seem to have been unable to rein in increasing state spending even during a period of economic expansion. Likewise with monetary policy, they find themselves caught between their exchange rate policy and monetary policy: on the one hand, they find it difficult to tighten their belts to avoid further appreciation of their currency in a period of continued capital inflow backed by a booming economy, while conversely, they find it difficult to implement monetary easing to protect their currency in a period of accelerated capital outflow. As a result, in a fairly large number of cases, macroeconomic policies are managed procyclically with the economic situation.

It goes without saying that each country has its own set of circumstances, and for this reason we must avoid oversimplification. However, the skill of macroeconomic policy management can have a major impact on efforts to ensure sustainable development. The important point here is that measures must be taken with full commitment to a medium- to long-term perspective, even when implementing flexible policies in response to changes in circumstances.

The example of Norway, although it may be exceptional, is certainly suggestive in this respect. A resource-rich country, Norway has a mechanism in place to ensure that fluctuations in resource prices do not overly affect economic trends. As a result, while many other resource-rich countries have experienced increased inflationary pressures due to abundant capital inflows driven by resource price escalations, the growth of consumer prices and property prices in Norway has remained at moderate levels. Moreover, the net government debt is negative, which is rare for an advanced country.

Since the development of the North Sea oilfields in the 1970s, Norway has enjoyed a continuous and high level of income through the export of oil and natural gas. Government revenue from oil and natural gas operations is transferred to the Government Pension Fund Global, the nation's sovereign wealth fund, which is invested exclusively in foreign bonds and stocks. The fund balance has reached 130% of GDP, or 140,000 US dollars per capita. This is a mechanism for stocking up while the economy is booming, and preparing for the future depletion of oil resources and an expansion of fiscal needs in line with an aging population. At the same time, it functions as a way to prevent an increase in income caused by resource price escalation from leading to an expansion of fiscal spending or overheated economic activities triggered by credit expansion.

Obviously, there is no guarantee that Norway's sovereign wealth fund will be a permanent solution. In fact, the fund was set up as the oil revenue reserve fund and then merged with the pension fund. Discussion continues regarding the improvement of its organization, operating methods, and the ideal use of the capital.

The example of Norway should, however, give Asian countries food for thought in two respects. First, Norway has steered its economy by adopting a long-term perspective while the domestic economy still has the wind at its back, at the expense of sacrificing short-term profits to some extent. Second, even such a policy as this must undergo constant reexamination in response to changes in circumstances.

IV. Asia's Contribution to International Economic Management

A continued and sustainable high rate of growth in Asia will be a great contributor to the expansion of the global economy as a whole. In an increasingly interconnected world, the benefits are expected to spread around the globe. Nevertheless, the role of Asia is not limited to being a leading force in the world economy in the sense merely of wealth creation.

As pointed out at the beginning, interconnectedness is currently evolving in the financial and economic fronts beyond the framework of the nation state. Nevertheless, the role of financial and economic institutions has not changed fundamentally from their original nation state-based framework. The significance of the issue of how we should overcome the conflict between globalized financial economic activity and the nation state-based governance system is increasingly pressing.[7]

Although Asia is composed of diverse countries whose stage of economic development and political and cultural backgrounds vary greatly, it also shares the experience of having overcome many differences, achieving regional integration and strengthening collaboration. This accumulation of experience will continue into the future. While leveraging such experience-based knowledge, Asia—whose presence in the world economic arena will continue to grow—is also being called on to participate in the establishment of a global governance framework. From this viewpoint, I would like to discuss two items on the agenda.

Participation in the establishment of a new international economic order

First, Asia is being called on to contribute more actively to the establishment of international economic rules.

If we look back to the days before the 2007 financial crisis, the United States and Europe were the major players in establishing international economic rules, and Asian countries were basically obliged to accept them. After the recent financial crisis, the G20 came under the spotlight in establishing international economic rules. Besides Japan, the G20

[7] See Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy*, W. W. Norton & Company, Inc., 2011. In his book, Dr. Rodrik formulates a hypothesis about a "political trilemma of the world economy," arguing that (1) hyper-globalization, (2) nation states, and (3) democratic politics are mutually irreconcilable.

includes five countries from the Asia-Pacific region: Australia, China, India, Indonesia, and the Republic of Korea. The Asian countries are gaining a greater voice in the discussions regarding global economic recovery and the subsequent discussions on the correction of global imbalances. Asian countries are also expected to be more active in providing information to the world on their experience of growth through free trade activities and the establishment of global supply chains.

Having Asia's voices heard is of great significance in the financial sector as well. Investment and loan activities have expanded in Asia to a great extent, attracted by the dynamism of its growth. Singapore and Hong Kong have developed into hubs for international financial transactions. As sophisticated financial activities accumulate, Asia's opinions are gaining importance in discussions regarding financial regulation. In general, financial institutions' business models differ greatly between Asia and the United States and Europe. In the United States in particular, financial institutions and corporations depend fairly heavily on fully developed capital markets for financing, while in Asia traditional bank lending continues to play a leading intermediary role in many countries. In addition, Asia has a number of priority areas of its own, such as fostering small and medium-sized businesses and microfinancing, as it continues to emphasize the improvement of income levels. These differences can be important when drawing up financial rules and regulations in terms of what should be emphasized and which risks should be anticipated.

In 2012 the Financial Stability Board, in collaboration with the IMF and World Bank, submitted a report to the G20 finance ministers and central bank governors. The report examined whether or not the financial regulation reviews carried out after the 2007 financial crisis had unintended consequences for emerging and developing countries.[8] Although it was submitted after the broad direction of the regulation reviews had been determined, the main message of the report was clearly reflected in the detailed study work for subsequent practical application. The opening of new channels for consideration and adoption of the views and experience of Asia and other emerging economies will be a big step toward

[8] See Financial Stability Board, "Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences, Report to the G20 Finance Ministers and Central Bank Governors," Staff Paper, June 19, 2012.

enhancing the effectiveness of new international regulations and institutions, as well as achieving fair application of the system.

Asian countries will need to ensure that their opinions are heard whenever necessary, while contributing to the smooth operation of the global economy as a whole by accepting a reasonable share of responsibility in accordance with the expanded scale of the region's economy and influence.

Contributions aimed at improving global risk management

The second item on the agenda that I wish to discuss is the need for Asia to contribute to establishing a framework for risk monitoring to prevent the next crisis in the global economy.

The experience of the recent financial crisis shows clearly that imbalances accumulated through financial activities can have a major global influence through the intricately interconnected world of economy and finance.

It is of course impossible to predict the form that the next crisis will take. Ironically, the sense of relief that one crisis has been overcome, and measures taken to prevent a future crisis, could generate the conditions for the next one. The fundamental role of risk management is to identify any risk and determine its nature both quantitatively and qualitatively. To do this, we must watch patiently for signs of potential risks, both on a global and a regional basis.

To strengthen risk monitoring, we might begin by considering a global initiative to enhance our understanding of the current status of the economy through statistics. As economic and financial activities grow increasingly complex, it becomes more and more difficult for the statistics prepared by states and international organizations to accurately reflect the rapidly changing reality. One such example is the issue of shadow banking. Concerning financial intermediary activities, the supervisory and regulatory authorities seek to clarify their current status within the regulatory framework as best they can. However, once financial intermediary activities expand through loopholes in financial regulations, an enormous amount of work is required to understand their development and scope.

Efforts are underway internationally to clarify the nature of domestic and cross-border capital flows to identify financial imbalances at an early stage. Now that the intensified economic activity in Asian countries is having a greater impact on the world economy, Asia is also required to contribute actively to information gathering and disclosure.

In addition, Asian countries will be required to boost efforts to work together as a region. As globalization has intensified, the strength of intra-regional linkage has grown increasingly important in regard to business cycle linkage.[9] In this sense, it is recognized that the risk of a shock in one country spreading to other countries in Asia is considerable due to the region's strong intra-regional linkage.

If a financial or economic crisis were to erupt in Asia, there is a risk that it could spread throughout the world via interconnectedness with other regions. To prevent a crisis originating in Asia, the ASEAN+3 countries established the ASEAN+3 Macroeconomic Research Office (AMRO) in 2011 to strengthen regional surveillance of economic conditions. In spring 2013, a basic agreement was reached with the aim of making AMRO an international organization to expand its independence and enable it to carry out more effective analysis and make recommendations.

Asia as a whole is expected to assume a prominent role in stepping up further efforts to prevent crisis, thereby seeking to stabilize both the region itself and the entire global economy.

V. Conclusion

The citation from the IIPS Founding Declaration that I presented at the beginning continues as follows:

> *In order to successfully weather this dangerous transition period and build a*

[9] See Hideaki Hirata, M. Ayhan Kose, and Christopher Otrok, "Regionalization vs. Globalization," IMF Working Paper No. 13/19, January 2013.

peaceful and prosperous world, it is of the utmost importance that we develop the insight and ability to accurately predict situational changes, identify problems, and devise methods for solving those problems.

Five years have passed since the financial crisis erupted. The world has not yet fully recovered from the aftereffects and has yet to settle into a new paradigm. Given such uncertainty, it is all the more important for us to consolidate the richness of our cumulative wisdom and continue our efforts to establish a better world. If we trace the history of the word "Asia," it is thought to have originally meant "sunrise." I conclude my message, therefore, with the most sincere hope that Asia can combine all the wisdom it has gathered and hold aloft a beacon of light to herald a new and prosperous dawn for our world in the years to come.