

## Asian Economic Integration and Common Asian Currency\*

*Eisuke Sakakibara*

Today I'd like to talk about the Asian economic integration and currency cooperation. As you know, the Asian economic integration is proceeding very rapidly, driven by markets and private corporations. This is in contrast to the European integration. The European integration is driven by policy, by institution building. And it has come to the stage of having created a common currency. In terms of the institution building, Asian countries are lagging far behind the European countries.

But that does not imply that the economic integration is not proceeding. It is proceeding by private corporations. If you take statistics such as intra-regional trade, among East Asian countries it has now become 55% of the total. This is compared to 40% in 1990. So within the matter of the last 15 years, the inter-regional trade among East Asian countries (by East Asian countries, I'm now referring to ASEAN Plus Three) has increased by 15% and this trend is now accelerating. So if this trend continues, we expect the regional trade among East Asian countries to increase above 60% within the next four to five years. And the European Union's intra-regional trade at this moment is now 65%. And this 65% has been very stable for the last 15-20 years. So probably within a matter of the next ten years or so, intra-regional among East Asian countries trade will reach the level of the European Union, which means a virtual integration of trade and direct investment relationships among our countries.

So when people compare the East Asian integration with the European integration, people tend to have the perception that we are lagging quite significantly behind Europe. That is not true. Asian integration has already exceeded the level of NAFTA quite significantly. We are now approaching the level of the European Union.

People talk about diversity within Asia: differences in the developing stages, diversity in terms of the religions, races, values, and so on. But you have to look at the Asian integration from a different context from the European integration. With regard to the developmental stage, Asian integration is essentially a vertical integration, as compared to a horizontal integration among European countries. Of course, with the entry of Central- and Eastern European countries, the

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European Union is entering the stage of vertical integration to some extent. It started as a horizontal integration among the countries with similar developmental states. However, in the Asian integration, China and some of the Asian countries have vastly different stages of development. But because of that, the Vertical integration has gone fairly well. While both in Korea and Japan, maybe about 5-10 years ago there was a fear of China. There was talk about the hollowing out of the economy; there was talk about the loss of jobs in Korea and Japan, because of the competition with China. But it has not happened.

What has happened in this area is what you could call a win-win situation. Both Korea and Japan benefited enormously by integrating our economies with China. And the same thing could be said about China. What has happened in this area is that we have created a production network throughout the East Asian countries. This is sometimes called supply chain network. East Asia as a whole has become a giant factory. What is called the production process division of labor has taking place within this region. That is, the Korean companies or Japanese companies produce parts and components, say, in Bangkok, Thailand and then export those parts to China, then assemble all those parts and components in China. Then assemble the parts in China and then export that to the United States and Europe. I often jokingly remark to my American friends when they talk about the necessity to appreciate the RMB. When they complain about the huge Chinese surpluses in regard to the United States. And I tell them, well, maybe 30-40% of those Chinese products are made in Japan. Some of those parts and components of High-tech Chinese products are made in Japan. So it is not only a Chinese surplus. It is a surplus of East Asian countries vis-a-vis the United States.

So that really tells a story about the East Asian countries. As a matter of fact, if you look at the trade, in East Asia, trade in parts and components has expanded enormously within this region. And when you talk about the trade of parts and components in the world as a whole, one of this region's characteristics is the eminence of parts and components. That is, a huge factory has been built in this region. And some way, Korean companies and Japanese companies have become multi-regional companies, spanning all over those countries. This network of production is now expanding.

Dr. Il SaKong has introduced me as heading the Indian Institute for Economic Studies in Japan. And what is noticeable with regard to India is that Indian-Chinese trade has been expanding very rapidly. Now India is the biggest importer from China. And the Indian exports to China are second only to the Indian exports to the United States. So not only East Asia, but also South Asia is now becoming part of this Asian division of labor, or this production network; a country

like India is coming into manufacturing. This is a very conspicuous phenomenon. ASEAN Plus Three integration is proceeding, and this is expanding, toward India and Southeast Asia. Relatedly, institutional building has started, this is a topic I would like to touch on today, particularly in monetary and financial areas.

But before touching on that, let me mention the other very conspicuous phenomenon in this integration of East Asian economies. That is the emergence of a new middle class in this region. Of course, in areas like Japan and Korea, the middle class emerged much earlier than in other countries. But the emergence of the middle class in countries like China, in some of the ASEAN countries is actually transforming this region quite significantly. That is to say that the life pattern or value of that middle class is quite similar; a new sensitivity of being Asian is now emerging among the middle class. You know, the middle class in Korea, the middle class in Japan, the middle class in Thailand, the middle class in China, have pretty much a similar type of life patterns. They drive cars; they eat fast food, they go and shop the brands items, they buy fairly luxurious apartments. And that similarity of life patterns in the middle class is now creating what could be called the awareness of being a new Asian. This awareness of being a new Asian or the creation of what could be called the common value among East Asian countries is quite explicit, despite the rise of nationalism here in Korea and in Japan, and elsewhere. So these are two sides of the same coin. As the new middle class emerges, politicians tend to use nationalism to increase their popularity. But at the same time, among those emerging middle classes, common values have been developing.

Look at the Japanese movie and television scene. It is full of Korean dramas and Korean movies. If you turn on the Japanese television, almost every hour you will hit a Korean drama. It's very fashionable these days. As you know, it's called the "Korean boom" in Japan. And this is not ending; this is just the start of that. And the same thing could be said about Japanese animation, Japanese pop music in the East Asian region. So that those middle classes are starting to share the same value judgment, the same tastes. And this is a very sound development, I think, in this region. Eventually, political nationalism could be overcome by this common value among those new emerging middle classes.

What is very important from the point of view of business is that a huge new market is now emerging in the East Asian region, or the Asian region in general. It is said that new middle class in China is between 200 and 250 million, which is twice the size of the Japanese population. If you combine the new middle class in the ASEAN countries, which is probably a combined 200 million, and combine that with Korea, Japan, and Taiwan, we have a huge cluster

of middle classes in the East Asian region already. In addition to that, it is said that in India, a 150-200 million member middle class is emerging. If you combine those middle classes in Asia together, this is more than the middle classes in the United States and Europe combined. That is to say, not only in manufacturing and production, but also in terms of final goods, in terms of consumer markets, Asia has already become the biggest in the world. As you know, the growth rate in this region is much faster than the growth rates of the countries in the rest of the world so that this biggest consumer market in the world is growing at a very rapid rate. So, within ten to twenty years, Asian region both in production and consumption will become the major engine of the world economy. It is already the major engine of the world economy, but it will become a much bigger engine within five to ten years.

When I was in the Ministry of Finance, negotiating with the United States, their persistent demand on Japan was to consume and consume and consume. And Larry Summers, my counterpart, used to say that the United States could not continue to be the spender of the last resort forever. But that situation now has changed. Domestic regional demand in Asia has been expanding. And the United States is no more the only spender of the world economy. True, it is spending too much; it is accumulating too many trade deficits. But now, China and East Asia are a much bigger consumer market; a much bigger final demand destination as compared with the United States. I think this is very important to recognize for our fellow Asians.

I often refer to history. This is not an emergence of new Asian markets like China and India. This is the reemergence of the Asian countries into world history. I often quote the numbers compiled by Angus Madison who is a very well known economic historian. According to his statistics, in the early 19<sup>th</sup> century the United Kingdom had already colonized a substantial part of Asia already. But even as late as 1820, with regard to the share of the GDP in the world, the Chinese share was 29%. India's was 16%. China and India together in 1820 had 45% of the world GDP. At that time, the United Kingdom, an emerging imperialist country, only had 5% of the world GDP. By 1820, a substantial part of India was already colonized. But even at that time, India was the second-largest economy in the world. China, of course, was the biggest economy in the world. What we are experiencing in this moment is the reemergence of those sleeping giants. Asia had been the center of the world economy, from the 7<sup>th</sup> century or the 8<sup>th</sup> century, up until the 19<sup>th</sup> century. It was only in the last 150 years that western countries have dominated and colonized the Asian economies. And it is now changing. I've been saying throughout the last 5-10 years, that the 21<sup>st</sup> century is the century of Asian countries.

Asian countries are now integrating. One thing that could be said about the Asian integration is

that this is open integration. This is not closed regionalism. In this production network in East Asia, both American and European countries are actively participating. And this region is open to all the countries in the world. This is probably somewhat different from the European integration. Again, there's a historical legacy in this. Up until the 19<sup>th</sup> century, Asia (China and India in particular) was at the center of the world trading mechanism. Even when you look back at the 15<sup>th</sup> and 16<sup>th</sup> centuries, to Columbus: Where did he sail? He targeted India. He wanted to come to India. Vasco de Gama of Portugal wanted to come to India. All those Europeans wanted to come to India, because India at that time was the center of the world trade. So Arab merchants, Italian merchants, Indian merchants and Chinese merchants monopolized those benefits of the world trade. So the Spaniards and the Portuguese wanted to get a share of those benefits of trade. That's why they wanted to come to India in the late 15<sup>th</sup> century and in the early 16<sup>th</sup> century. So historically, Asia has been an open trading area. And it is again becoming an open trading area.

Let me make one small comment on this: This is the age of globalization. Why regional integration? Why localization? On the surface, this seems to be a paradox, because in terms of IT, in terms of finance, and in terms of information, the world has become global. It has become almost costless to transfer information, to transfer technology, to transfer money. In terms of the finance and information, it is truly global. What are costly in this world are the movement of physical goods and the movement of human beings. It's so easy to come to Seoul from Tokyo. It's only two hours; it's like a domestic flight. It's so time consuming and very tiring to go to New York. It takes 14 hours, with the time difference. So, in this global age, actually, distance counts, because the transfer of technology, information, and money has become costless, and has become global. So in this kind of global world, distance actually counts. It is much better to trade with the neighbors rather than to trade with the other continents. This may sound paradoxical, but this is an economic reality. So this kind of regional integration is only a natural outgrowth of the past developments of the world economy during the course of the last five or ten years, because of the globalization of banking and information and technology, regionalization is taking place in manufacturing and face-to-face service industries,. So it is highly sensible to trade with your neighbors, and with countries that are close in terms of distance.

With that, let me move on to my main theme today, which is that as those trade and direct investments are being integrated in the region, some kinds of institution building have belatedly taken place. At the time of the East Asian crisis, Donald Tsang, the current Chief Executive of Hong Kong, was the Financial Secretary of Hong Kong, and has talked about the dual

mismatch: The dual mismatch being the currency mismatch, and the maturity mismatch. These were one of the major causes of the East Asian crisis. That is, a huge amount of Asian savings was first channeled into US dollars in dollar denominated deposits. That is still taking place in this region. Most of the Japanese and Korean assets both private and public are still being channeled into US dollars. Then those US dollars were channeled back into this region in US dollars, in the short term. And that short term US lending was converted into local currencies for the long term. So there was a currency mismatch and a maturity mismatch. And when that money was suddenly withdrawn with some kind of trigger, the Asian crisis took place. So from that time on, concern of the authorities in this region, Korea, Japan, Hong Kong, China, and elsewhere, has been to a significant degree addressed to this currency mismatch.

How can we solve this currency mismatch? Two policies have been followed. One is what has been called the Chiang Mai Initiative, which is the use of foreign reserves to prepare for the time of the crisis. This Chiang Mai agreement is a bilateral swap agreement for the foreign currency reserves of the countries concerned. Right now, the Korean government, the Japanese government, and the Chinese government, along with the ASEAN countries are negotiating to multilateralize this bilateral swap agreement. I think these negotiations will probably succeed within the matter of a short period of time. Beyond this multilateralization of the Chiang Mai Initiative is the earmarking of foreign reserves. I've been proposing the setting aside of 5% of foreign reserves of East Asian countries. Foreign reserves of the East Asian countries have now exceeded \$3 trillion. This is an enormous amount. China has accumulated a huge amount of foreign reserves, now exceeding that of Japan. Chinese foreign reserves, Korean foreign reserves, and Japanese foreign reserves added together exceed \$2 trillion. So we should be able to make good use of those foreign reserves. If we can set aside 5% of those foreign reserves, it would be a huge amount. We could utilize those foreign reserves to mature securities market within this region, or to prepare for a time of crisis; for joint actions among those countries. Or perhaps five to ten years from now, we could conduct joint foreign currency intervention by the use of those full foreign reserves. This is a very significant institution building.

There may be some political difficulties, because we need to coordinate our monetary policies to some extent, even if it is a setting aside of 5% of our foreign reserves. But I think this is a feasible proposition for the countries. If we are to set aside 100% of the foreign reserves, this is a politically very difficult, because we've got to coordinate monetary policies completely. This could be done 30-40 years from now, but it cannot be done within the matter of 5-10 years. But something like setting aside 5% of the foreign reserves I think could be done even now, with the resolve of those experts of the countries concerned, or with the resolve of the politicians of this

region.

Along with this cooperation in foreign policy, some major developments have been taking place in the creation of Asian bond markets. This is called the Asian Bond Market Initiative. China, Korea and Japan, along with the ASEAN countries, in the Finance Ministers' meeting of ASEAN Plus Three, have been making strenuous efforts to create a regional bond market, that is, a bond market which is denominated in local currencies. There were some bond markets denominated in Yen. Those are called "Samurai Bonds" or "Shogun Bonds" alike, but other than the Yen, there has not been a major international flotation of the bonds in local currency. The ASEAN Plus Three Finance Ministers' meeting that was held in May 2005 has formally created four working groups to expedite the creation of the local bond markets. These are major developments. Asia Development Bank has been helping, and some of the export/import banks of various countries have been supporting from the sidelines. There has been an international flotation of bonds, denominated in local currencies: Thai Baht, RMB, Philippine Pesos, and so on. At this moment, they need some kind of semi-official assistance. The share of the regional bond market in 1999 was only 16.5% of the GDP. But in the year 2005, the regional bond market (that is, the international bond market denominated in local currencies, excluding the Yen, but including Vietnam, the Philippines, Indonesia, Thailand, Singapore, Malaysia, Korea and the People's Republic of China) has expanded to 48% of the GDP. Compared to the larger markets, like the US markets, which are about 150% of the GDP, this 48% is still very small. But this expansion of the regional bonds market by three times in eight years is quite a phenomenal development. If we could expand this local bond market to 100% of the GDP within 5 years, this would be a major development.

As a matter of fact, the East Asian region is a major source of savings of the world. Why should we channel those savings entirely to New York or London, and then let the financiers in New York and London, or American or European investment banks mediate that money? Why can't we do that locally in this region by developing local bond markets? This is the basic idea of the countries concerned. Some major efforts are now being taken, and are succeeding to a significant degree. Finance ministry officials are consulting on this issue quite frequently, and holding negotiations about how to expand these efforts into the future. I'm hopeful that these efforts would bear fruit in developing local bond markets and local securities markets to channel Asian savings within this region, at least to a significant degree.

The other development that you may have noticed is the start of the studies of the Asian Currency Unit. The Asian Development Bank initially promoted it. Mr. Kuroda, the president of

the Asian Development bank is a very strong promoter of the Asian Currency Unit. He was my successor as the Vice-Minister of Finance for International Affairs in the Ministry of Finance, and we are very close friends. But this Asian Currency Unit initiative has moved from the Asian Development Bank to the ASEAN Plus Three Finance Ministers' meeting. The Asian Development Bank is a very difficult international organization. It has various countries including the United States. In order to promote relatively regional initiatives, ADB may not be the final forum to do it. This Asian Currency Unit study has been shifted to the ASEAN Plus Three Finance Ministers' meeting.

This is a long-term proposition. When you talk about the Asian Currency Union, it will probably take another thirty or forty years. Sure, the Asian economy is being integrated in terms of trade and direct investment. But institution building is currently lacking. In order to build a common currency *ala* Europe, you need to unify monetary policy. Here, institution differences among the countries matter. China, for example, does not have a mature financial system yet. It will probably take another ten years before they liberalize capital account and before they come up with a solid and sound financial system domestically. The creation of the common currency would take a fairly long period of time. I also think that probably it will take thirty years or so. I won't see it, or maybe I'll see it at my deathbed. But the first step has been taken by starting the study on the Asian currency unit. And I have just talked about the successful attempts to create an Asian bond market within the region. The next step in terms of the currency unification is to issue local bonds denominated in the Asian currency unit. That is the first thing that happened in Europe with regard the European currency units. You have some sort of unit, which is a currency basket for calculations. You float the bonds: Chinese sovereign bonds, or Korean sovereign bonds or Thai sovereign bonds or ADB bonds, denominated in ACU. And then transferred into local currency. I think that is possible within the matter of the next 2-3 years, if we can agree on some kind of Unit, even a tentative unit. Weights, in the ACU could be variable. With some kind of weights we could issue a bond denominated in that currency unit. And that is the first step.

I think the Finance Ministries or authorities concerned (Central Banks) are now targeting that first step in the use of ACU. This is a long-term proposition; we should not be hasty. Economic integration, both in trade and direct investment is proceeding. As I said, a new middle class is emerging. A new awareness of being a new Asia is emerging. The currency unification comes at the final stage.

But as intra-regional trade increases, it is very important that intra-regional currency values



stabilize. Of course, the Korean economy is doing very well at this moment. But Korean Won might have appreciated a little too much against the Yen. So stabilization of the Korean Won with the Japanese Yen is very important. Stabilization of the Korean Won *vis-à-vis* the Chinese RMB is very important. Stabilization of the Japanese Yen *vis-à-vis* the RMB is important. We talk about the foreign exchange rate in terms of Dollars at this moment, because that's the only market we have. We don't have Won-Yen markets yet. We only have Won-Dollar and Yen-Dollar markets. But eventually, it is only natural that regional-foreign currency markets develop. Euro market has developed. Euro-Yen market has become a fairly big market in Tokyo, along with the Yen-Dollar market. As the Chinese economy eventually liberalizes its capital markets; and as Hong Kong moves, following the RMB, it is only natural for the regional currency markets to develop. Why should we use US Dollars to settle a Korean-Japanese account? Why can't we use an Asian currency unit? Why can't we use local currencies? Of course, this takes time. US Dollar is the key currency, and it will continue to be the key currency for decades; there's no question about that. The Euro is emerging as the second key currency, and there have been some shift from US Dollars to Euro, but this is a slow process. And particularly when we talk about Asian currencies, this is a very slow and gradual process. But this is going to happen because intra-regional trade is expanding very rapidly. As I said at the outset, intra-regional trade will reach 65%, which is the level of the European Union at this moment. It is only natural for those countries to develop local currency markets, and to eventually settle the accounts in this region with local currencies.

A major shift in the currency markets would cause major confusions. Even now, if Japanese and Korean authorities all of a sudden decide to hold 50% of the foreign reserves in the Euro, that would be a disaster for the foreign currency market. Those moves have to be done very gradually, and very carefully. However, this is the trend.

As I said the 21<sup>st</sup> century is the century of Asian economies. For the Asian currency markets to develop, and for Asian Currency Unit to be used in transactions and settlement, is a long-term trend. We have to nurture it. As I said, the Asian bond market is now being created and rapidly developing. All those movements have to be coordinated effectively with the movements in trade, investments, and other areas. This region has to be an open region. Open-regionalism is the key word. We should maintain a good relationship with the United States, we should maintain a very close relationship with Europe, and participation by American and European companies in this region is extremely important.

But at the same time, localization is taking place. Even those American and European

companies that are active in this region are localizing their operations. They are multi-national companies. As far as their East Asian operations are concerned, they are East Asian companies. This globalization and localization are not mutually exclusive. And Korea and Japan are very close neighbors, and have been very close neighbors for the last 2000 years, and the Korea-Japan relationship is extremely important. As I said, at least at the level of the middle class, at the level of the mass, the relationship has been improving quite dramatically. I've been saying in Japan and elsewhere that it is a matter of time before the politicians of those two countries will catch up with the people of those two countries; they have to, otherwise they will eventually fail. To some extent, promoting nationalism benefits the political objectives of some political issues. But nationalism is not the key word. The common values of this emerging middle class in this region are the key. And this is developing a very close relationship, which culturally and economically has been developing within this region. Politics will have to catch up. I'm quite hopeful that Mr. Abe will catch up at least to some degree compared to the current administration in Japan. Thank you very much.

### **Questions and Answers**

**Q** In your view, what is the likelihood of success of integration in Northeast Asia alone, or possibly the East Asian members of APEC? In this way, the US Dollar could be used as the anchor currency.

**A** I'll be candid. If you use the US Dollar as the anchor currency, nothing changes. It *is* the anchor currency at this moment in Asia. Use of the US Dollar as an anchor currency in terms of the current situation means maintaining the status quo. As I said, we have to be very careful about moving to a different régime, because moving to a different régime usually involves major confusion in the world market, as was the case in the world depression; that was the transfer of power from the United Kingdom to the United States. So we have to be careful. But having said that, I think that eventually the creation of an Asian currency is necessary. Yes, at this moment there is a rivalry between China and Japan. But there was also a rivalry between France and Germany at the outset of the creation of the European Union. France and Germany have been warring for hundreds of years. What I'm saying is that if France and Germany can form a coalition, why not China and Japan?

This is a long-term proposition. I'm not talking about two or three years from now, I'm talking

about twenty years from now. I could say that Japanese civilization is a derivative of Chinese civilization, or that those Chinese, Korean, and Japanese civilizations are similar. I don't think it is that difficult if you think in terms of a long span, to have some sort of compromise among the countries of East Asia. Is it ASEAN Plus Three, or does it include other countries, like Australia, New Zealand, the United States, and so on? These have been the major issues of contention in the regional integration. In this age of globalization, distance matters because of the relative increase of the costs in the movements of goods and movements of human beings. Forming an economic integration with other continents, be it the American continent or Australia, really doesn't make much economic sense. I think that this sort of economic efficiency directs us toward the integration of neighboring countries. When I say neighboring countries, ASEAN Plus Three could be expanded to ASEAN Plus Four, or ASEAN Plus- some South Asian countries, because China is bordering with India. ASEAN countries are bordering with India. Border trade between China and India is now developing quite rapidly. Expansion into India is a natural development. And this regional integration should be an open integration, or should never antagonize the United States, or Australia, or New Zealand. This is the difficult part.

**Q** Why is Japan not doing more to initiate a Northeast Asian FTA between Korea, China, and Japan?

**A** I would agree with this proposition that the Northeast Asian FTA needs to be promoted, whether it is initiated by Korea, Japan, or China. The obstacle to the FTA so far, both in Japan and Korea, has been agriculture. But I've been arguing in Japan that the Japanese agriculture products are quite competitive when it comes to quality products, like in manufacturing. Countries like Japan and Korea should concentrate on producing high-quality agricultural products. Japan is known to produce very high-quality tomatoes, apples and other kinds fruits, and they're exporting fairly well. Even with regards to rice, I've been saying that it's possible to export Japanese rice to the United States and elsewhere.

Sushi is a worldwide boom. I go to a sushi restaurant in New York quite often. But the worst part of New York sushi is the rice. I keep telling the New York restaurant owners to use Japanese rice, or maybe I should suggest Korean rice as well. But California rice does not suit the Japanese sushi. If we promote that image of Japanese rice or Korean rice, which is very well fit to make sushi, we may be able to export even Japanese or Korean rice. Some of the Japanese rice is very high quality. The price of rice is not that high anyway, so if you are going to pay \$100 per person in a sushi restaurant, why not use very high quality rice. I think this kind of

change in strategy in terms of the agriculture policy is necessary for Japan, and probably for Korea as well. If we shift our agricultural policy toward high-quality production, or selective production of the agricultural products, I think we could open our agriculture markets quite significantly to the rest of the world. Of course, some of the concerns about the security need to be imposed. But with the imposition of those regulations in terms of the food, I think we could open our agriculture markets. If that's the case, I think it's possible to conclude our FTA among the countries in Northeast Asia. Already, trade is expanding quite rapidly within this region. And with an FTA, that expansion would accelerate.

**Q** Japan used to support monetary cooperation, based on G3 basket currencies. But recently, many Japanese policymakers argue for the introduction of ACU. What is the reason for this change? Why is there no declaration of long-term vision?

**A** This currency basket for the Dollar, Euro, and Yen, is quite different from the currency baskets such as the ACU. For the management of foreign reserves, for example, Singapore uses currency baskets. This is an implicit basket, putting weight on US Dollars, Euros, and Japanese Yen. That is the original concept of the basket: managing foreign reserves and portfolios of private companies, for example. This ACU, however, targets the creation of an Asian Currency Unit, which is a long-term proposition. If you include Euros, for example, or the Dollar, it would not lead to the creation of the Asian Currency Unit. So I think the two are different concepts. Some of the Japanese scholars are a little confused about those two baskets. But we should be very clear. Sure, the management of the foreign reserves at this moment, in a short period of time, you might use some kind of baskets, including the Dollar and Euro and so on. And some countries are doing that. Maybe China is doing that to some extent as well. Singapore is definitely doing that. And that's fine. As a method of calculating and managing the foreign reserves, that kind of basket is fine. But the ACU is targeting the creation of an Asian currency, perhaps thirty to forty years from now. Those are two different concepts, and we should not be confused between the two.

Secondly, why shouldn't the leaders of the countries declare like Europe that we would target the creation of the Asian Currency Unit, and so on? I hope we can do that. As reconciliation among the politicians of China, Korea, and Japan would proceed gradually, so that that kind of thing could become possible eventually. But Asian leaders having a common sort of objective of economic integration is very important. We have our differences here and there; that is only natural: different races, different countries different history. However, having a common

objective is very important. The most likely common objective we could have at this moment is probably economic integration, because economic integration is already proceeding. We are cooperating with each other. Of course, we are competing with each other as well. But a kind of complementary relationship among the countries is proceeding. It is only a matter of time for the Korean president, the Chinese Prime Minister, and the Japanese Prime Minister to have some kind of common objective of economic integration in this region. Some of those Finance Ministry bureaucrats and some technocrats are talking about how to promote the integration. I think it is only a matter of time; maybe five or ten years, or less, that it will become a common political agenda among the countries concerned.

**Q** If you look at the world economy from a macroeconomic perspective, global trade imbalances are an issue. Asian savings finance the US deficit, and since you emphasized Asian consumption, what is going to happen to this relationship? What will the global economy look like once Asian consumption picks up?

**A** This is a major issue that confronts those experts in international finance. Obviously, the United States is over-consuming. Of course, China is over-investing. Over-consumption in the United States has long been a problem. However, the US could do that, because the US dollar is the key currency. In a somewhat informal way, the US is a central banker; they could issue dollar to support their over-consumption for a long period of time. But the time would come that this situation would maybe not be sustainable. The experts in international finance say that it may come next year, or it may come two years from now. It hasn't come yet, and the US economy is doing fairly well at this moment. But as the US economy weakens (signs of which we are seeing right now, here and there), this kind of major disruption in the world economy may happen, because the Euro is now emerging as the second key currency, and some people are worried about holding the US Dollar a little too much in case something like that happens.

I think that we need some kind of smooth transition. In order to have a smooth transition, we need to have some kind of negotiations. The G7 used to be that kind of forum, but the G7 is not functioning that well at this moment. So I'm somewhat worried that some kind of major disruption could take place within the matter of the next two to three years because of the unsustainability of world trade imbalances. But Asian regional demand is expanding. Asian domestic demand is expanding. That is a plus. We should gradually shift US demand towards Asian regional demand. And some kind of smooth transition to some different type of régime is absolutely necessary. In order to do that, we probably need some kind of an expanded version of

the G7 including China to discuss those issues. As a matter of fact, the G5 was created to include Japan, to smoothly move to the world economic situation where Japan was expanding very rapidly. In this kind of situation where the East Asian countries are expanding very rapidly, we need to include East Asian countries in the international financial negotiations.

**Q** We are worried because China is developing intermediate goods and parts. Once this is completed, we will have nothing to export.

**A** That's true, to some extent. Eventually, a Chinese company like Haier will try to catch up with Samsung and LG, and Sony and Matsushita. So we have to be ahead of them all the time in terms of technological levels, in terms of innovation and so on. The Chinese are a very competent and innovative people, so it's a difficult competition. But this kind of intra-region competition is necessary to some extent. Localization of the companies concerned is necessary as well. Yes, China is a threat, but we could also build a complementary relationship with China if we advance in terms of the technology and innovations a little bit faster than China.

**Q** You cited the Chaing Mei initiative and the Asian Bond Market initiative as a symbol of the financial integration progress on the basis of the ASEAN Plus Three framework. You also mentioned that the East Asian integration process should take the form of an open régime, rather than a closed system. I understand that Japan took the initiative to invite India, Australia and New Zealand on top of the ASEAN Plus Three framework. Which is more effective: The ASEAN Plus Tree framework, or the ASEAN Plus Six framework?

**A** Well, Japan has various ministries, and each ministry has different views against each other. My view is that ASEAN Plus Three should be the core. Since much work has started with ASEAN Plus Three, and actually, many working groups have been created to work on various projects. I think we should stick to ASEAN Plus Three for the time being. But it will eventually expand, to include India, for example. It is a natural development. Economic integration is taking place quite quickly between ASEAN and India, China and India, and Korea and India. Korean companies are very active in India right now. The inclusion of South Asian countries would probably develop quite naturally, as the relationship itself develops. That may even include Arab countries, and eventually even East African countries. These economic developments and corporate movements have already been taking place. However, as for

institution building, I think we should stick to ASEAN Plus Three for the time being, because things are proceeding already. If expansion is necessary, why not expand to include India, Australia and New Zealand? My view is that India is a stronger candidate than Australia and New Zealand.

**Q** You rhetorically asked why Asian countries should channel savings and investment through New York and London agencies as opposed to each other, since they have so much foreign capital to lend. But the market knows the answer: Wall Street firms provide more efficient financial intermediation services. There are two conditions that must take place for the Asian Bond markets to emerge: One is the stabilization of intra-Asian currency values, and the capital markets in Asian countries should be developed to the level of global standards, and be internationalized. Are the Asian bond markets focusing on these objectives? Is the Japanese capital market internationalized to the level of global standards? We should develop some scheme for the exchange rate policy coordination of financial policies among East Asian countries, while we know that the ACU won't be around until three or four decades from now. What do you propose as a short-term or medium-term approach to exchange rate policy coordination among Asian countries?

**A** First, I completely agree with you that American financial institutions have been much more efficient than Asian financial institutions. This efficiency and resilience of New York markets and New York financial institutions has been the major reasons why Asian savings are channeled through New York. I agree with you. But let me add that I was just talking with the President of Mizuho Corporate Bank yesterday. Mizuho Corporate Bank was forming an alliance with two major Korean companies recently. He said, "In terms of financial technology, Asian countries are lagging behind, but look at the Tokyo market; look at the Seoul market. Those people who are working for the investment banks are Japanese and Koreans. They may be trained in the United States; they may have their MBA from Harvard or Pennsylvania. But they are Koreans and Japanese. Why not invite them back to Mizuho Corporate Bank?" And he's actually doing that. In local markets, you need local expertise with a fairly high level of training. You have those people in Korea, and we have those people in Japan, so why not try to develop Asian financial institutions' technological level jointly. I'm not anti-American or anti-Europe in any sense. But we can catch up with some effort. And that is what needs to be done by Korean and Japanese financial institutions. After a long period of stagnation and banking problems, Japanese banks have finally started to embark on such efforts of internationalization.

So I think we can make efforts in the markets, by private corporations to improve our technological level in financial engineering.

With regards to the cooperation in foreign exchange, what I've been proposing is to set aside about 5% of foreign reserves, and to create some kind of mechanism to jointly manage them. The management mechanism could be negotiated at the outset. You don't have to use it aggressively. Setting aside 5% would not be that difficult. Why don't the central bankers or the ministry of finances' officials get together to try to manage them jointly? That would lead a long way to the cooperation in foreign exchange markets.

**Q** As follow-up to the earlier question, you suggested that the Japanese Government led this effort to create the East Asian Summit, which in addition to ASEAN Plus Three countries contains India, Australia, and New Zealand. This responsibility in leading the regional cooperation should be left in the hands of ASEAN Plus Three, at least for the time being. But for the time being, what do you see as the role of the East Asian Summit?

**A** The East Asian summit issue was a very contentious issue between Japan and China, as you know. China wanted to stick to ASEAN Plus Three, and Japan wanted to expand that ASEAN Plus Three forum to include three more countries. But although I'm Japanese, I've come to endorse the Chinese view that ASEAN Plus Three should be the core for the time being. You could invite the prime ministers, Mammohan Singh or Mr. Howard to the meeting. I have no objection to that, personally. But because things have started to move with this mechanism, we should stick to ASEAN Plus Three for the time being. Sure, we could invite various prime ministers, but I think that for the next four to five years, ASEAN Plus Three should be the core. Among ASEAN Plus Three, China, Korea, and Japan, are the keys.

**Q** In ten years, a lot has happened. As you pointed out, the strength of the economies have expanded, but despite all the discussions, real progress on this front is not really happening. Someone else mentioned "anchor" currencies, but I think that the anchor there is not the currencies themselves, but the full faith and credit of the sovereign powers behind them. In spite of its economic power, the Euro has not succeeded in supplanting the Dollar because of that. Even if we grow economically, how can we have a coherent, sovereign power that can stand behind the currency or bonds?



**A** I do not necessarily disagree with you. The US dollar is the key currency and will continue to be the key currency for some time to come. We cannot change this fact. This is a very solid fact. Even the Euro will not become the key currency within the next five to ten years. However, if you look at forty to fifty years from now, things are difficult. In the BRICs report, Goldman Sachs predicted that the Chinese GDP would exceed the American GDP by the year 2050. So I'm not talking two, or five years from now, I'm talking 43 years from now. When the Chinese GDP exceeds that of the United States, some sort of change may take place. And I don't know about the Chinese military power *vis-à-vis* the US military power but at least in terms of the economic power, China and India combined, or China, India, and East Asia combined will become a dominant power in the world. I was in the government until 1999, and I was trained to think in terms of two or three years. Now I'm in academia, so I tend to think in terms of forty or fifty years. If you think in terms of forty or fifty years, some transition in the world economy is bound to happen.

**Q** Integration will result in each sovereign power having to forgo substantial monetary and fiscal policy making instruments. What will be the real value of integration?

**A** Again, I agree with you. Currency unification means loss of independence in terms of monetary policy. And that is a major problem with currency unification. That's why I think that currency unification will not take place that quickly. If we were to do that it would be thirty or forty years from now. But even then, currency unification *ala* Europe may not take place in Asia. How things will develop is very difficult to predict. Asia, if you look at the last 1500 years, has essentially been a merchant state. Things are decided by markets. Things are decided by corporations. How the markets develop in the coming ten to twenty years is probably the key. It may sound quite paradoxical, but in Europe and the United States, states are quite important. Many things have been decided by states, by institutions, by political decisions. But in Asia, many things are decided by markets, by corporations, by the private sector. So how will the private sector develop within the next four to five years, or even twenty to thirty years? Maybe twenty years from now, many of the Japanese companies' headquarters will be in Beijing or Shanghai, or maybe Hong Kong. Lots of things could happen. I'm not that certain that European-style integration will take place in this region. We will probably have an Asian version of unification, which is probably quite different from the European version.