Asia’s contribution to global rebalancing

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Developing Asia remains at the core of global payment imbalances. While the geographical concentration of current account imbalances is significant—with the People’s Republic of China accounting for the lion’s share of the region’s current account surplus—how Asia contributes to global rebalancing also depends critically on the newly industrialising economies and larger Association of Southeast Asian Nations economies. Given the region’s huge diversity, the necessary national macroeconomic and structural policies will vary significantly across Asia’s emerging economies. Whereas near-term rebalancing efforts will be driven primarily by macroeconomic and exchange rate policies, structural reforms are essential for boosting domestic and regional demand as sources of economic growth over medium to long-term. We argue that regional rebalancing will depend critically on the adoption of deeper and more comprehensive structural reforms and further trade liberalisation to unlock the potential of strong domestic and regional spending—thus reducing Asia’s high dependence on extra-regional demand. Priority policies should include infrastructure spending, competition, trade, financial development, investment, immigration, and other social policies to reduce national savings.

Introduction

Developing Asia remains at the core of global payment imbalances. Globally, developing Asia’s net current account surplus amounted to 36 per cent of the world’s current account surpluses in 2010, while averaging about 30 per cent during the past decade (see Figure 1).

The region has also accumulated sizable—and in some cases excessive—foreign exchange reserves since the late 1990s. The bulk of the remaining current account surpluses were in the Middle East and the Commonwealth of Independent States. On the other side of the ledger, the USA continues to be home for the lion’s share of global current account deficits.

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1 Gross reserves can be increased either through current account surpluses (‘own’ reserves) or through financial and capital account surpluses (‘borrowed’ reserves).

2 Given international current account asymmetry, surpluses and deficits across economies do not add to zero.
The geographical concentration of current account imbalances is rather significant in developing Asia, with the People’s Republic of China accounting for the lion’s share of the region’s current account surplus. The most significant surpluses have been in the People’s Republic of China (PRC), with its current account surpluses accounting for 48.7 per cent of Asia’s total for the period 2005–2010. Excluding Japan, where surpluses have been large but stable, the PRC’s share of the region’s current account surplus is nearly 68.2 per cent over this period. The PRC’s contribution to the region’s reserves accumulation has been also substantial—its reserves now account for over 60 per cent of emerging Asia’s total. Then follow the four newly industrialising economies (NIEs) of Hong Kong, China; Republic of Korea (Korea); Taipei, China; and Singapore; and other large Association of Southeast Asian Nations (ASEAN) economies. In contrast, several emerging Asian economies—including India and Viet Nam—have been running current account deficits.

While how emerging Asia contributes to global rebalancing depends critically on the PRC, the NIEs and larger ASEAN economies will also have to contribute depending on the size of their surpluses. The region’s economic diversity requires a wide-ranging set of policy measures to tackle the domestic, regional, and global imbalances. The PRC needs to play a critical role in the region’s contribution to global rebalancing—given the large and increasing size of its economy and external imbalances [see Asian Development Bank (ADB) 2009]. But the NIEs and larger ASEAN economies will also have to contribute, depending on the size of their surpluses. Many of the region’s smaller economies also face country-specific external imbalances, even if their contribution to the overall global imbal-

3 ASEAN-4 comprises Indonesia, Malaysia, Philippines, and Thailand.
ance remains negligible. Understanding these different policy requirements is essential to achieving more harmonious global, regional, and domestic rebalancing.

Ultimately, a concerted and coordinated regional approach will be key to an orderly global rebalancing process. Concerted policy adjustments can potentially reinforce this process through two key channels. First, there are important positive spillovers when countries work together to boost demand while avoiding unnecessary adverse movements in intra-regional exchange rates. Second, enhancing intra-regional trade offers each of the region’s economies a high degree of trade openness—with all associated benefits—even as the region as a whole becomes less dependent on extra-regional demand.

Global imbalances and Asia

While running current account surpluses or deficits, per se, is not necessarily a cause of concern for an economy, the current condition of global payment imbalances is alarming in their size, persistence, and geographic concentration, raising significant concerns about their sustainability. There is no reason why an economy has to balance its current account position at all times. In theory, as the result of voluntary choices of economic entities driven by the desire for inter-temporal consumption smoothing, current account imbalances do not necessarily pose an economic danger. These imbalances are simply a reflection of different patterns of savings and investment behaviour across economic entities, which are strongly influenced by income growth, trade volatility, ability to access international funding, and demographics. Nevertheless, there is a fundamental concern that deficit countries cannot go into debt forever. Many have argued the US current account deficits at current rates are not sustainable and potentially destabilising.

Some distinctive characteristics of the current imbalances provide the ground for concerns, not least because the deficit countries (the US in this case) cannot continue building debts indefinitely. From the perspective of the developing economies in Asia, the persistent, large current account surpluses present a puzzle and involve both explicit and implicit costs. Economic theory says capital flows from advanced economies with abundant capital to developing economies with capital shortages. Both capital-rich and capital-poor countries benefit from these flows as they increase labour productivity in capital-poor countries and provide higher returns on savings for capital-rich countries. However, the current pattern of international capital flows from developing Asia to the USA casts doubt on the optimality of the region’s excess savings. A number of hypotheses have been put forward to explain the puzzle, such as large fiscal deficits, declining private savings, and high productivity growth in the USA; financial globalisation and a global savings glut; and relatively underdeveloped financial markets, crisis-induced risk aversion, and exchange rate pegs in developing Asian economies. None of these hypotheses seems to provide a clear answer to why such a pattern has emerged; but the cost of the global imbalances—whether it is implicit in terms of the welfare cost of excess saving and foregone investment benefits of excess reserves or explicit in terms of the cost of crisis—is abundantly clear (see Adams and Park 2009).

Although there is no single explanation for international payment imbalances, the underlying cause appears to be the stark differences in saving and investment behavior across economies. The striking differences in national

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4 In some cases, for example, in Brunei Darussalam and Timor-Leste, current account surpluses have been over 50 per cent of gross domestic product (GDP). But given their small size and resource-based economies, their contribution to the region’s overall current account surplus has been negligible.

5 There is an extensive literature on the US debt problem and global imbalances. See Cline (2005) and the literature listed there for a summary.
saving and investment behaviour⁶ must reflect the different macroeconomic and exchange rate policies, as well as structural factors—with the usual suspects being the stage of economic development, the degree of financial development, and demographics (see Figures 2 and 3). In Asia, current account imbalances have visibly increased since the 1997–98 Asian financial crisis, suggesting that there must have been some policy factors in play beyond the long-term structural factors. For example, large current account surpluses also derived from the success of outward-orientated growth strategies that supported high levels of extra-regional exports at the expense of bolstering domestic demand. Strong exports in the aftermath of the 1997–98 crisis contributed significantly to the region’s rapid recovery and growth in the post-crisis period leading up to the recent global crisis.

The region’s substantially large external imbalances also reflect its post 1997/98 crisis efforts to build strong international reserves. In many of the region’s economies, imbalances

Figure 2
Savings rates of selected Asian economies, 1990–2009 (%)

A. Low-income current account surplus economy

B. Asian crisis-affected economies

C. Other NIEs

D. Other low-income emerging economies

Note: Data refer to gross national saving as percentage of gross GDP, except for Hong Kong, China; Singapore; and Taipei, China where data is for gross domestic saving as percentage of GDP.

Source: Key Indicators 2010, Asian Development Bank. NIEs = newly industrialised economies.
have also come from a determined effort to build large stockpiles of (gross) international reserves.\(^7\) In response to the 1997/98 Asian financial crisis, authorities sought self-insurance against the kinds of capital flow reversals that occurred then and during other episodes of systemic stress. This was also done with an eye to managing stress in international financial markets.

Nonetheless, the aggregate Asia’s picture masks important differences in external positions across the region and over time. Although Asia, in aggregate, has had large current account surpluses since the 1997–98 financial crisis, this masks important differences in external positions across the region and over time (Figure 4).\(^8\) Different structural reasons underlie a rather wide spectrum of current account imbalances across the region. In the PRC, unusually high savings rates (and unusually low consumption rates) reflect its rapid GDP growth, unfavourable demographic changes, inadequate social safety nets, and largely underdeveloped financial markets unable to effi-

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\(^7\) Reserves can be either owned or borrowed; it is only in the former case that their accumulation will require a current account surplus.

\(^8\) In the decade prior to the Asian financial crisis, the region—excluding Japan—ran current account deficits.
ciently channel these savings into productive investment. In the Asian crisis-affected countries, sharp declines in investment rates following a period of over-investment and more stringent evaluation of financial risks in the post-crisis may provide an explanation. In India and Viet Nam, relatively large fiscal deficits may explain the current account deficits.

Meanwhile, most emerging Asian economies have accelerated the pace of reserves accumulation since the Asian financial crisis (Figure 5). The increase was largely due to a combination of sustained current account surpluses and persistent exchange market intervention. The exceptions were India and Viet Nam, where reserves were largely ‘borrowed’ in the sense that the reserve build-up derived from large financial and capital account surpluses that exceeded the current account deficits.

9 Kujis (2005) and Weimer (2008) explore factors behind the PRC’s high savings rates. IMF (2005) and ADB (2009) provide empirical analysis more broadly on the region, finding that rapid GDP growth and demographic factors seem to play an important role in the region’s (particularly the PRC’s) high saving rates.

10 Again, various studies explored why investment fell sharply and never fully recovered in many Asian crisis-affected countries in the region. Chinn and Ito (2005) and Eichengreen (2006) pointed to an investment overhang prior to the crisis and the lingering crisis effects. ADB (2007) suggested that the crisis prompted re-evaluation of regional risk. Some blame the region’s unfriendly investment climate, which has not improved much since the crisis.
Domestic rebalancing

Appropriate policy measures will inevitably differ across the region depending on the differences in individual economies’ current account dynamics. The region’s current account dynamics during the 12 years since the 1997/98 Asian financial crisis can be grouped into five broad types. Each of these five sets of economies exhibited similar underlying factors that drove their current account performance (Adams and Park 2009).11

The rapid build-up in the PRC current account surplus since 2002 comes from a surge in corporate savings, calling for effective mechanisms to enhance the worker’s share in the corporate profits. The PRC’s domestic saving rate continues to rise even as investment has stabilised, if at relatively high levels. Government data show the large increase in PRC savings derives mainly from enterprises rather than from households or the public sector—even though household savings has been relatively high over an extended period (Figure 6). Between 2002 and 2008, PRC enterprise savings grew from 12.5 per cent of GDP to 18.8 per cent. This could be the result of the recent shift in income distribution from wages to profits (due to the high investment profitability). Ineffective mechanisms for ‘releasing’ enterprise savings to a firm’s ultimate owners—especially in the case of state-owned enterprises—could account for the large impact of enterprise savings on the PRC’s overall savings rate.

Sustained high savings rates in some of the region’s high-income economies draw attention toward promoting investment in more advanced service and value-added sector reflecting the needs of these economies. In the case of the small, open, high income, and current account surplus economies—Hong Kong, China; Singapore; and Taipei, China—the upward trend in current account surpluses over the past decade from already high levels stems from sustained high savings rates (and increases in already high enterprise savings),

11 The marginal imbalances in many smaller economies in the region are not relevant to the following discussion.
and modest reductions in investment rates. The average savings rate (that is, gross domestic saving over GDP) for these economies has dropped marginally from 35.9 per cent in 1995 to 34.8 per cent in 2009, while the average investment rate (gross domestic investment over GDP) fell from 31.3 per cent to 22.4 per cent over the same period. Possible reasons for high current account surpluses and savings rates include rapid GDP growth, increased uncertainty in the wake of the 1997/98 financial crisis, and demographic factors. Reflecting the demand power of these high-income economies, the policies need to focus on promoting more advanced service and value-added sectors to unlock their consumption potential.

Economies where high savings are the cause of the imbalances need to carefully study the origins of such high savings—either public or private as well as either household or corporates—in order to design appropriate solutions. Where the savings rate is suboptimal because of low public savings, the solution is relatively straightforward—budgetary expansion. However, when the problem lies with excessive private savings through either household or enterprise saving, the solution may be more complex. Robust social safety nets can help reduce the household need for precautionary savings. Financial development that improves household access to financial services can also contribute. Alternatively, where high enterprise savings is an important factor—in the PRC, Malaysia, and Singapore, for example—one can also consider various policy measures that unlock business opportunities.

For the five 1997/98 crisis-affected economies, the shift from current account deficit to surplus was due to a sharp and sustained reduction in investment from high pre-Asian crisis rates, requiring measures to bolster investment. Investment in the five crisis-hit economies—Indonesia, Korea, Malaysia, Philippines, and Thailand—has never regained its pre-crisis levels—with average investment rates falling to 21.6 per cent of GDP in 2009 from 35.4 per cent in 1995. National savings rates for these countries have remained mostly stable because of offsetting changes in household, enterprise, and government savings. The average savings rate dropped only one per cent between 1995 and 2009. That is, current account surpluses largely derive from disappointingly weak domestic investment. Thus,
resolving imbalances in these countries should be closely linked to bolstering investment.\textsuperscript{12}

Beyond broad proposals to improve the business climate and address the risk factors that have been keeping investment weak, there are more specific measures that promote private investment—through infrastructure, non-tradable services, and small and medium enterprises (SMEs). There are many developing economies in the region that continue to suffer problems of chronic under-investment. These economies could introduce tax and subsidy schemes to promote investment and adopt policies that develop the supporting infrastructure and ensure adequate financing—particularly for small and medium-sized enterprises. Efforts are also underway to encourage more foreign direct investment (FDI)—not just to raise foreign investment but also to stimulate complementary domestic investment. The key is to enhance the investment climate by implementing more comprehensive structural reforms in areas such as (1) minimising unnecessary regulatory barriers in business activities; (2) encouraging private incentives and market discipline; (3) creating a level playing field across all sectors; and (4) fostering competition to upgrade institutional capacity (Schou-Zibell and Madhur 2010).

Some current account deficit economies in the region, notably India and Viet Nam, face huge infrastructure needs and may have little to contribute to global rebalancing. Among most low-income countries in the region, poor savings coupled with high investment has combined to produce persistent current account deficits. Thus, these economies cannot be expected to play a major role in the rebalancing process. In the future, they will likely prefer smaller deficits, cognizant of the risks associated with large external imbalances evident during the recent crisis. Both India and Viet Nam face huge infrastructure investment needs to maintain rapid, sustained economic growth. But with relatively low domestic savings rates, a key policy priority will be increasing rather than reducing savings.

\textbf{Regional rebalancing}

Reducing emerging Asia’s current account surpluses and high dependence on extra-regional demand are the key elements of the rebalancing challenge. Asia’s rebalancing will require efforts at both national and regional levels. First, at the national level, surplus countries in emerging Asia need to increase domestic demand relative to trend output, with more spending directed toward imports—both externally and intra-regionally, either through increasing private consumption demand or investment spending. Second, at the regional level, promoting greater intra-regional trade in final goods and services is the key. This will require further trade liberalisation and facilitation with particular emphasis on reducing behind-the-border barriers to trade and investments that promote intra-regional connectivity.

In aggregate, emerging Asia’s high export dependence may be another reason for current account imbalances. The region’s outward-orientated growth model has involved both export promotion and the containment of domestic demand. Thus, one would expect a strong link between export dependence and current account surpluses (see Figure 7). Empirical findings also show a close-knit relationship between the region’s export dependence and increases in current account surpluses since the 1997/98 financial crisis (ADB 2009). The increases in current account surpluses have generally been accompanied by increases in the ratio of exports to GDP—with the exceptions of India and Viet Nam.

With the growing importance of the regional economy and its rising urban middle-income households, however, emerging Asia’s own domestic spending could become a major source of increased demand within the

\textsuperscript{12} The ADB (2009) cited three major reasons for continued investment weakness in the five 1997/98 crisis-affected economies: lingering effects from the crisis itself; unsuccessful competition for FDI between the PRC and the rest of the region; and a poor investment climate. While none of these explanations is sufficient to explain the weakness, each was found to have influenced the fall in investment among the five countries.
region. Despite the impressive rise in intra-regional trade in emerging Asia, the final sources of demand for intra-regional trade continue to lie outside the region. Much intra-regional trade in emerging Asia has been in intermediate goods and components—ultimately as components for goods consumed outside the region (ADB 2007 and Kim, Lee and Park 2011). Thus, the region continues to depend on extra-regional rather than on intra-regional demand. Growing intra-regional trade does not automatically lead to significantly less dependence on extra-regional demand, unless the intra-regional trade is driven by more robust domestic demand for final goods within regional countries. With growing incomes, however, the region’s urban middle-income households present potentially large demand sources for final goods. Domestic rebalancing efforts can unlock the large domestic demand potential to allow for more substantial intra-regional trade in emerging Asia along the lines of the European Union.

The crisis highlighted the risk of excess reliance on external demand—rebalancing domestic and regional economies would be largely in Asia’s self-interest. After a short pause during the current crisis, there have been signs that global imbalances are on the rise again, largely driven by the US current account deficits, which suggests a reduction in US consumption in the years to come. Given the uncertainty of external demand, emerging Asia must strengthen both domestic and regional demand to fill the gap. In the near term, re-balancing is one way to help mitigate the sharp slowdown of exports and growth because of the slump of the advanced economies. However, over the medium to long term, rebalancing the sources of economic growth toward more domestic and regional demand is an integral part of sustaining emerging Asia’s rapid growth and of improving its welfare. Left unresolved, the global imbalances will continue to pose a threat to global financial stability and could even lead to a crisis. With generally much improved macroeconomic fundamentals and fiscal positions, Asia is in better position to rebalance the structure of its demand, hence contributing to the orderly resolution of the large global payments imbalances.

Rebalancing efforts will be driven initially by macroeconomic and exchange rate policies,
but ultimately trade and structural policies will need to take the lead afterward. Given the region’s vast diversity, the macroeconomic and structural policies needed to meet these challenges will vary significantly across economies. The near-term focus of rebalancing will inevitably be centred on increasing macroeconomic expenditure and on switching to policies favouring imports, given the urgency of rebalancing but yet the rigidity of structural issues. This will primarily require monetary and fiscal policies, supported by greater exchange rate flexibility where appropriate.

When employing macroeconomic policy tools, it is important to support private demand. For example, ongoing fiscal support in surplus economies will need to be carefully calibrated to have maximum impact on private spending, with public spending programs geared toward promoting private spending. Also, allowing currencies of surplus economies to appreciate will support global rebalancing, as it helps induce expenditure switching. It can also help ease the risk of overheating, thus avoiding the need to tighten monetary policy too fast. Thus, it would help narrow the global payment imbalances while containing inflationary pressures.

Beyond the near term, however, the successful rebalancing will depend on the adoption of deep-seated structural and trade reforms to reduce the impediments that have held back domestic spending and contributed to Asia’s high dependence on extra-regional demand. Ultimately, the medium-term structural reform agenda will require several components aimed at increasing spending relative to output, encouraging consumption not only in home goods but also in imports, bolstering intra-regional trade, and improving economic efficiency.

**Increasing spending on home goods and imports**

For the region as a whole, three broad areas require policy attention. First, efforts to broaden the access to financial services and credit can help increase investment and consumption rates, thereby contributing to the rebalancing process. The region’s predominantly bank-based financial systems have made considerable progress in expanding financial services and their breadth of clientele since the 1997/98 Asian financial crisis (Ghosh 2006). In many economies, however, the access of consumers and SMEs to formal credit remains limited. While efforts that continue to strengthen banking systems and to broaden public access to more diverse financial services can play an important role in middle-income economies, low-income economies may need support to increase micro-credit facilities. Local currency bond market development can also provide alternative funding for firms—unlocking vast investment potential.

Second, extending infrastructure is not just urgently needed across emerging Asia, but it can be a critically important contribution to raising domestic demand. ADB estimates that the region will need to spend about $750 billion a year for infrastructure over the next decade—close to US$8 trillion. Although infrastructure needs vary significantly across the region, there is large potential demand for investment in cross-border infrastructure to promote intra-regional trade. Innovative approaches to finance infrastructure investment must be explored further as well. In addition to bolstering public–private partnerships, ADB has been reviewing a range of options for special infrastructure financing investment vehicles—to tap the region’s vast pool of savings and to support required levels of the region’s infrastructure spending needs.

Finally, economic policies that promote market efficiency and flexibility can help promote spending in domestic markets. These include policies that allow prices to better reflect market signals and to improve the flexibility of resource allocation when market demand shifts. Greater exchange rate flexibility will also contribute to cross-border reallocation of demand and needed production adjustments. These often involve painful adjustments and social costs. Thus, social safety nets should be designed accordingly to balance the competing objectives of ‘security’ and ‘flexibility’ during the rebalancing process.
Trade and investment facilitation/liberalisation

Regional cooperation is an important issue, as it can address regional trade issues while remaining aligned with global requirements under the World Trade Organization. Emerging Asia needs to establish a comprehensive trade liberalisation and facilitation program emphasising agriculture and services. It should address price distortions and other impediments to trade—including behind-the-border restrictions—associated with labour mobility and capital flows. The program should be directed toward promoting growth of intra-regional trade and investment through close regional cooperation. Cooperation in eventually forging a region-wide free trade agreement (FTA) should be further pursued—consolidating the current ‘noodle bowl’ of FTAs.

While the greatest progress to date for many of the region’s economies has been on ‘at-the-border’ liberalisation, reducing restrictions on trade in manufactures, the focus should shift to the removal of behind-the-border impediments to trade in goods and, importantly, services—by allowing freer flow of labour and capital. There will be huge benefits from improving regional connectivity through upgrading and extending the region’s infrastructure networks. Potential benefits include increased market access, reduced trade costs, and more efficient energy use. This will not only boost intra-regional trade but can also contribute to more efficient supply chains and production networks, and allow more consumers from within the region greater cost-efficient access to final products produced in Asia. More proactively, easing trade should aim at reducing the costs of doing business across the region by reducing red tape, simplifying and harmonising customs procedures, and agreeing on product standards, among others.

Accelerating liberalisation of agricultural and services trade and easing impediments freer cross border flow of labor and capital should be prioritized. Under its 2015 ASEAN Economic Community roadmap, ASEAN has built a comprehensive framework for substantial trade liberalisation covering goods, services, labour, and investment. Using the ASEAN+1 approach or through other processes, these frameworks can be extended to cover the removal of impediments to cross-border flows of labour, capital, and services—thus promoting growth in intra-regional trade. However, it is important to ensure that the region’s trade rules are consistent with international rules, guidelines, and best practices.

Even though trade liberalisation should cover a broad range of services, key focus should be on providing support to investments in manufacturing, construction, and infrastructure. Of particular importance are basic infrastructure services including business, financial, and freight services, along with information technology and communications. Liberalisation will indirectly benefit other sectors of an economy by making transactions more efficient. There are also large potential benefits in liberalising service trade more broadly—to tourism, education, and medical services, for example. Several economies in South East Asia, including Malaysia, Singapore, and Thailand, have already taken steps in this direction. Given the region’s heterogeneity, different economies will benefit more from different kinds of liberalisation. Thus, regional support for trade liberalisation must ensure that national approaches to trade liberalisation are broad and comprehensive, with enough

13 The ASEAN+1 approach refers to agreements between ASEAN and a single partner economy.
14 The role of services and investment liberalisation in the promotion of intra-regional trade is recognised by the ASEAN Framework Agreement on Services (AFAS). AFAS provides broad guidelines for ASEAN members to progressively improve market access and to ensure equal national treatment for service suppliers within ASEAN. Under AFAS, Mutual Recognition Arrangements have also been created to allow professional service providers who are registered or certified in one signatory member country to be recognised in another signatory member. In principle, these agreements can be extended beyond ASEAN. The rules of AFAS are consistent with international rules for trade in services as provided by the General Agreement on Trade in Services of the World Trade Organization. This implies that AFAS can serve as an important multilateral template for other economies in the region.
room to eventually bring about a region-wide FTA.

Conclusion

Regional rebalancing will depend importantly on the adoption of deeper and more comprehensive structural reforms. The longer term reforms should aim not only at facilitating needed private expenditure increases and shifting expenditure across sectors but also at making economies less dependent on external demand. Moreover, such reforms could also contribute to improving the region’s resilience to external shocks. A checklist of reforms would include but not be limited to the following areas and issues:

- **Infrastructure Spending.** Adequate infrastructure is necessary—not only for trade but also to accelerate growth in the non-tradable sectors and internal distribution networks. Policies that focus mainly on infrastructure for special export zones, for example, should be paired with greater attention to industries and sectors that can potentially serve domestic as well as foreign markets. Given the huge infrastructure needs across the region, infrastructure investment can potentially be useful for applying Asian savings toward Asian investment.

- **Competition Policy.** While the international market is highly competitive, domestic sectors of many economies in the region are not characterised by high levels of competition and, in several cases, have monopolistic or oligopolistic structures. National authorities could usefully explore competition policies for the non-tradable sector—retailing, construction, financial services, and telecommunications, among others—including breaking down monopolistic structures and/or expanding international trade in services. In principle, a level playing field across the domestic economy and for exports needs to be built. Using tax and subsidy schemes can be one way. These measures should be broadly neutral and not provide incentives for exports over production for the domestic market.

- **Financial Development Policy.** The region’s bank-dominated financial systems have made considerable progress in strengthening risk management and in broadening credit allocation beyond traditional business (Adams 2008). During the past decade, there has also been significant progress in developing regional capital markets and, in particular, local currency bond markets. Less progress has been made, however, in ensuring access of SMEs outside the export sector to bank or non-bank financing—or in consumer credit. National authorities could usefully identify and address impediments to this type of finance as part of the effort to achieve better balanced economic structures.

- **Trade Policy.** Behind-the-border restrictions on trade in goods and services also contribute to unbalanced economic structures. Prudent liberalisation of formal and informal restrictions on trade could play a potentially important role in encouraging competition in local markets and improve economic efficiency. As part of a broad-based regional strategy, such liberalisation would also open up other markets for the more efficient provision of goods and service across the region.

- **Investment Policy.** Foreign or local investment geared toward local markets would have important payoffs and play an increasingly important role as economies mature. With growing income and expanding middle classes across the region, the demand curve for final consumer goods will naturally shift over time, bringing growth to domestic markets, especially for higher end consumer goods and services. Efforts should also be made to identify and address factors that weaken investment in the five 1997/98 crisis-affected countries.

- **Immigration Policy.** Further relaxation of the relatively tight immigration policies in several countries in the region could play a role in rebalancing. Initially, this might involve allowing only short-term employment, but in an increasing number of cases,
it could involve longer term contracts. In addition to allowing countries to access the labour required for new sectors, liberalising immigration accelerates growth of services such as tourism and expands the range of potentially tradable goods and services.

• **Other Social Policies to Reduce National Savings.** Authorities should identify the factors contributing to the very high national savings rates beyond what is considered optimal in several countries—including savings rates of households and businesses. Where high personal savings rates reflect high precautionary saving, policies to ensure adequate social insurance or, alternatively, private insurance could be strengthened. Thus, when surges in corporate savings lie behind very high national savings rates, consideration could be given to corporate governance and related reforms to help ensure that corporate profits can spill over into the households to support private consumption.

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