

## **Working Group of NEAT**

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Main theme: Promoting Economic Integration in Asia through Resolving  
New Global Imbalances

Motivation: The on-going economic integration in Asia, including institutional establishments of FTA/EPA, has strongly been supported by deepening trade-FDI linkages. Such linkages are featured by the well-developed production-distribution networks among ASEAN plus Three, resulting in the emergence of the triangular global trade pattern. At the same time, this triangular trade pattern has recently generated huge imbalances of the “bilateral” trade between China and US, causing merchantistic reactions in the latter, when China’s “multilateral” trade surplus remains relatively small.

The advancing Asian integration is now challenged by new global imbalances, that is, the huge external deficit of the US and large trade surpluses and rapid foreign reserve accumulation in Asia. The sustainability of such new global imbalances has been seriously questioned. The rule of econometric thumb indicates that at least a 30 percent effective depreciation of the US dollar would be required to reduce US external deficit from the current 5 percent down to 2 percent of GDP, implying the need for more or less equivalent magnitude of appreciations of Asia currencies.

Substantial changes in the exchange rates should be accompanied by domestic macroeconomic (both fiscal and monetary) policy adjustments and structural reforms in both the US and Asian economies. A key policy question is what kinds of policy coordination should be designed and undertaken particularly among Asian economies so as not only to minimize the adjustment costs but also to further facilitate the on-going economic integration in Asia. How should we coordinate currency adjustments and macroeconomic and structural policies in Asia, based on what

grounds and criteria?

Such criteria would have to take into account the specific features of the triangular trade pattern and the well-developed production-distribution networks in Asia. Furthermore, it will be utmost important to search what kind of coordination of currency adjustments will be best suited for institutional efforts to establish FTA/EPA covering not only goods but also services, labor and FDI. The coordinated currency adjustments may also raise another key policy question: what sort of exchange rate regime will be most appropriate for individual countries in Asia, and again on what economic criteria?

#### Suggested Structure of Research:

- A. Identifying driving forces for Asian integration and the triangular trade pattern
- B. Questioning the sustainability of the new global imbalance
  - International financing mechanisms of the huge US deficit: private capital inflows into US and foreign reserve accumulation in Asia
- C. Resolving new global imbalances consistently with promoting economic integration in Asia
  - (1) Asian currency adjustments: What are the impacts of exchange rate changes on the triangular trade pattern? What coordination is needed? Why? On what economic criteria?
  - (2) Macro-economic adjustments: Searching for better policy mix of monetary and fiscal measures.
  - (3) How will large exchange rate changes affect institutional efforts to promote integration in Asia in terms of the geographic scope of FTAs, and economic area coverage of EPAs?
  - (4) What structural reforms are to be accelerated in individual economies under large currency adjustments?

D. Integrated approach to economic integration in Asia

– Searching for exchange rate regimes consistent both with reducing currency and maturity mismatches and with promoting economic integration through the production-distribution networks and FTA/EPA

Time schedule: (1) 1<sup>st</sup> WG meeting in December 2004: designing work program on scientific analysis and policy issues.  
(2) 2<sup>nd</sup> WG meeting in early spring 2005: examining progress report of each member of WG  
(3) Last WG meeting in early summer 2005: discussing near final reports of each member and policy recommendations.

Sponsor: Research Institute of Economy, Trade and Industry (RIETI)  
(RIETI, a research institute affiliated with the Ministry of Economy, Trade and Industry)

Members

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