Reducing Global Imbalances and Accelerating Growth: Role of Regional Cooperation in Asia

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Ramgopal Agarwala and Prabir De

1. Introduction

In this paper we would like to present following six propositions.

- First, the current and prospective global imbalances pose a serious threat to the world economy, both developed and developing economies.
- Second, the conventional medicine along the line of structural reforms are quite inadequate to tackle the problem and can even lead to global recession if the emphasis is mainly on demand reduction in the US
- Third, these measures need to be combined with a Keynesian approach focusing on global demand augmentation in addition to demand switching for correcting the global imbalances without a global deflation.
- Fourth, there is a high level of latent demand for national and regional investments in Southern Asia (about 10 percent of GDP).[1] Asia has now grown up and such additional investment could amount to US$ 1 trillion over the medium-term and that could make a significant contribution to reducing global imbalances while accelerating GDP growth in the region by about 2 percentage points.
- Fifth, only a fraction of the ongoing surpluses of Asia is needed to finance these investments and such redirection in the use of Asian surpluses would increase the rate of return on these surpluses while contributing to additional growth and poverty reduction in the region.
- Lastly, such a program of regional cooperation presents a win-win-win opportunity for Southern Asia, Northern Asia and the rest of the world and the international community (in particular the US, Northern Asia and Southern Asia) should work in a concerted way to promote such cooperation.

2. Risks of Global Imbalances

A recent World Bank report (2005) points out sharply the risks faced by the world economy due to high current account deficits of the US economy. It notes that:

- Over the last two decades, the US has been transformed from a significant net international investor in the 1970s to the world's largest debtor.
- Foreign exchange reserves of developing countries which stood at US$ 378 billion during 2004 are "excessive' for many countries and these reserves carry serious risk of capital losses and growing quasi-fiscal carrying costs.
- Looking ahead, the possibility of "disorderly" adjustments of external payments imbalances in the global economy could pose acute risks to emerging markets.

Similar sentiments have been expressed by a large number of official bodies as well as individual experts. For example, European Central Bank in its latest Financial Stability Review (2005) argues that large and growing financial imbalances continue to pose medium-term risks for the stability of foreign exchange and other financial markets. It goes on to say that a disorderly correction of the large US current account deficit and surpluses in Asia remained possible, particularly as the imbalances could increase further.

[1] By Southern Asia, we mean a geographic region combining South, Southeast and Central Asia.

International Monetary Fund in its World Economic Outlook (2005) also presents a disturbing picture on the consequences of high global imbalances for the world economy.

The WEO projections based on the assumption of constant real exchange rates, suggests little improvements in global imbalances. The US current account deficit is projected to remain at about 6 percent of GDP into the medium term and the United States' net external position would continue to deteriorate, reaching a record 50 percent of GDP by 2010, matched by rising net creditor positions in the rest of the world. However, WEO regards these global imbalances as unsustainable in the long run and argues that the issue is not *whether* but *how* they adjust. In the "benign baseline scenario", where non-US residents are willing to continue increasing their holdings of US assets for a considerable period without demanding a large risk premium, there is some slowdown in GDP growth in the US but the current account deficit remains 3.5 percent of GDP by 2010 and 3 percent over the long term with US net foreign liabilities eventually stabilizing at about 70 percent of GDP, which is hardly a healthy figure of foreign indebtedness.[2]

In the second scenario, WEO assumes a combination of a temporary rise in protectionist pressures, accompanied by a sudden decline in demand for US assets including an abandonment of pegs in emerging Asia. The consequence of these shocks is a sharp contraction in US economic activity, a large depreciation of the dollar and a sharp contraction in the US trade balance. Together with the increase in protectionism, this leads to rising inflationary pressures, requiring a significant monetary tightening, which amplify the contractionary effects on GDP growth. This is also accompanied by a slow down in economic activity in emerging Asia and a sharp slow down in growth in Euro area and Japan. In addition, there are, in this scenario, significant risks of financial market disruption with further negative implications for global stability and growth. Noriel Roubini Global Economics Blog provides an excellent overview of the opinions of eminent economists in the US on the subject.[3]

There are some who believe that the US is helping to absorb the surplus savings of the world and the situation can continue indefinitely along these lines. For example, Richard Cooper states in his recent (October 31, 2004) Financial Times column: "America's current account deficit is not only sustainable, it is perfectly logical given the world's hunger for investment returns and dollar reserves"

However, there is a long list of eminent economists who hold an opposite view and have warned of the high risks posed by the global imbalances in particular the high current account deficits of the US. The list includes Rubin, Sinai and Orszag, Summers, Peterson, Roach, Gross, Bergsten, Rogoff and Obstfeld, Eichengreen, and Volcker. As an illustration one can perhaps concentrate on statements of Larry Summers[4], former Secretary of Treasury of the US. He has argued eloquently how the large current account deficits of the US carry significant risks to the US as well as the rest of the world. For the US, he emphasizes the risk of the incipient protectionist pressures that are generated by a large trade deficit, and that are connected with the current furor over outsourcing. Secondly, he notes that dependence on foreign governments for short-term financing creates vulnerabilities in both the economic and political realms. He uses the term "balance of financial terror" to refer to a situation where the

[2] It is worth noting that in the context of World Bank initiative on Highly Indebted Poor Countries, an External debt /GDP ratio of – is regarded as too high.

[3] www.roubinglobal.com/archives/2005/05/global-imbalanc.htm

[4] Lawrence H. Summers, Third Annual Stavros S. Niarchos Lecture, Institute for International Economics, Washington, DC March 23, 2004

US relies on the costs to others of not financing the US current account deficit as assurance that financing will continue. For the rest of the world, Larry Summers notes that a great deal of money is being invested at what is almost certainly a very low rate of return. Secondly, for countries trying to avoid appreciation of their exchange rates there is the loss of domestic monetary control and the difficulty of maintaining. He notes that much of the speculative bubble in Japan during the late 1980s that had such a catastrophic long-run impact on the Japanese economy was driven by liquidity produced by a desire to avoid excessive yen appreciation.

3. Inadequacies of the Conventional Medicine

Despite the seriousness of the problem, there is a dearth of credible proposals for curing the malady. The standard recipes are three: revaluation of currencies in Asia in particular the Chinese Yuan, reflationary policies in EU and reduction of fiscal deficits in the US. For all three of these recipes, there are doubts as to the extent to which concrete actions may be taken and the extent to which probable actions can help cure the global imbalances.

On revaluation of the Chinese Yaun, an ADB Economist Dr. Cyn-Young Park in her paper on "Coping with Global Imbalances and Asian Currencies" has shown that a projected 10 percent revaluation of the renminbi would only improve the US trade balance by US$ 3.6 billion, a mere 0.02 percent change in the current account as a percent of GDP. Even with a 20 percent revaluation, the situation changes little, contributing only to a 0.05 percent reduction in the current account deficit. Dr. Park argues that despite the China’s significant trade surplus with the US, this is the case because imports from the China account for a relatively small share of total US imports, and exports to the China constitute an even smaller share of total US exports. On a broader front the Chinese authorities may well be concerned about the deflationary effects of revaluation along the lines suggested by Ron Mckinnon who has argued that exchange rate flexibility in China could lead to repetitive appreciations resulting in severe deflation throughout China’s economy and a zero-interest liquidity trap—as in Japan, when forced into repeated appreciations of the yen in the 1980s into the mid 1990s. In any case, any likely change in exchange rate regime in China cannot be expected to have a significant impact on the current account deficits of the US.

Nor is EU ready to adopt reflationary measures in the near-term. In its recent announcement, the European Central Bank held its key interest rate steady at 2.0 percent at its regular monthly policy-setting meeting here, refusing to bow to pressure to cut rates to inject life into the eurozone's stagnating economy. ECB fears that interest rate cuts would cause inflation.

Nor are the prospects of reducing fiscal deficits particularly bright. Again to quote Larry Summers: “There is much that one can argue about in the forecasts and the models, but I’m aware of no credible argument that without some form of discontinuity, the US current account deficit will not increase from its current high level.”

Perhaps in recognition of the weaknesses of the conventional remedies, World Bank’s Global Development Finance (GDF) report (2005) is projecting only a marginal fall in the US current account deficit over the medium-term: from 5.6 percent in 2004 to 5.3 percent in 2007. WEO exercise also does not suggest a much better prospect of reducing global imbalances through conventional measures. As noted in the WEO report, the model used there assumes higher price elasticities of demand for both exports and imports than is normally found is standard export and import equations. Even then, greater exchange rate flexibility in emerging

Asia reduces current account deficit of the US by 2015 by less than 0.5 percent of GDP compared with the baseline scenario. Similarly, the incremental effects of "competition-friendly policies" in Europe and Japan on US current account deficit are less than 0.3 percent of GDP by 2010. In WEO analysis, the benefits of reforms in terms of reducing the US current account deficit come mainly from fiscal consolidation in the US (about 2 percentage point of GDP by 2010) but that may not be a realistic prospect until and unless the US faces a harder external budget constraint. Moreover if the emphasis is on reducing demand in the US without compensating increase in demand elsewhere, it could lead to recessionary pressures in the world economy. Altogether, the conventional medicines do not offer a bright prospect of effectively dealing with the problem of global imbalances. They may be ineffective at best and even counterproductive (in the sense of causing global deflation) at worst.

4. Need for a Keynesian Approach

In this context there is clearly a need for some out-of-the-box thinking and one such line could be to bring in the Keynesian economics. Perhaps the focus should be shifted from demand-switching alone to demand augmentation. The point has been made forcefully by Larry Summers: "Notice that exchange rate manipulation and adjustments, even if they could be controlled or willed by policymakers, do not address the global demand-supply imbalance created by an increase in US saving. They serve simply to redistribute it from one country to another. For example, the scenario advocated by many, in which increased US global saving is associated with a depreciation in the dollar, may offset the adverse demand impact in the United States of increased saving by switching the demand for expenditure from foreign goods to American goods, but only at the cost of increasing the demand-supply imbalance abroad. A healthy global adjustment process requires a healthy US economy, which requires increased national saving, which in turn requires measures that replace the demand that is lost from increased national saving. Indeed, even with the assumption of constant US national savings, the global economy today appears to be suffering more from the deflationary pressures associated with too little demand than the inflationary pressures associated with too much demand."

It is worth remembering that it is this kind of Keynesian strategy that helped China to maintain growth in post-1997 period. Depreciations in exchange rates in Thailand, Korea, Indonesia and Japan during 1997-1998 imposed strong deflationary pressure on China. Starting in March 1998, China took strong "Keynesian" measures to slow its internal deflation. Its 'New Deal' encompassed a huge expansion of government expenditure on infrastructure and on mass residential housing. Not only was fiscal deficit allowed to increase from 0.7 percent of GDP in 1997 to 2.8 percent in 2000 and 2.5 percent in 2001 but there were heavy borrowing from China's state-owned banks in the form of what was called 'policy loans". This was accompanied by expansionary monetary policy which included decline in China's inter-bank rates from 9 percent in 1996 to 2.7 percent by the end of 2002. The People's Bank of China also eased the austerity policy, which had been adopted in 1993, by pressuring the state banks to extend credit for the construction industry, exporters, home purchases, and infrastructure projects as well as to the struggling state-owned enterprises. Altogether the Keynesian package perhaps pumped in close to a trillion dollar stimulus in the Chinese economy during the period 1998-2002. That helped to boost the Chinese economy while the rest of East Asia went through an economic slowdown.

It is the contention of this paper that Southern Asia can learn from the experience of China and can pump in about a trillion dollars of additional investment over the medium-term which can increase its GDP growth rate by about 2 percentage points and make a significant contribution to reducing the global imbalances.

5. Latent Demand for Higher Investment in Southern Asia

In this context, the saving-investment perspective provided by WEO is particularly useful for understanding the sources of the current malady and seeking its cure. The increased current account balances could be due to a combination of increased investment or diminished savings in the US and increased savings or diminished investments in the rest of the world, in particular Asia. WEO and the IMF Regional Report on Asia and Pacific (2005) point out that during the last few years when the US current account deficit has increased, the country's investment rate has remained largely stable; it is the decline in savings rate both public and private that has led to the imbalances. On the Asian side, saving rates have remained roughly stable and it is the investment rate that has declined: the problem is not "saving glut" but "investment drought". This suggests that the solution may be sought in increasing US savings on the one hand and increasing Asian investments on the other. IMF report also points out the risks of continued dependence of Asia on exports, particularly to the US and calls for greater attention to domestic demand generation .It is this context that the present paper examines the opportunity of increasing investments in Southern Asia (defined as South Asia, Southeast Asia and Central Asia) and their implications for increasing growth in this region and reducing global imbalances.

During the period 1980-2003, East Asian GDP grew by 7.7 percent per year and that in South Asia by 5.5 percent (Table 1). The difference was largely because of the difference in investment rate (34.4 percent of GDP in East Asia and 21.9 percent in South Asia) and not because of the efficiency of investment (with income rate of return on investment[5] in East Asia being slightly lower (at 22.4 percent) than in South Asia (25 percent). This point is also evident for the two dominant economies of the two regions: China and India. During the period 1980-2003, GDP in China grew by 9.5 percent per year and that in India by 5.7 percent per year. The striking difference between the two economies was in terms of investment rate (37.4 percent of GDP in China vs. 22.6 percent in India). So far efficiency of investment was concerned, performance of India was in fact somewhat better than China. Similar picture about the importance of investment emerges from the experience of Southeast Asia after the financial crisis of 1996-97. During the period 1996-2003, average GDP growth rate in Indonesia, Malaysia, Philippines and Thailand was 2-4 percent per year and the investment rates declined dramatically in 2003: the investment rate as percent of GDP was 17.6 percent in Indonesia, 21.4 percent in Malaysia, 16.6 percent in Pakistan, 16.6 percent in the Philippines, 14.8 percent in Singapore, 16.1 percent in Kyrgyz Republic, 18 percent in Tajikistan and 19.5 percent in Uzbekistan. Thus, there is clearly an "investment drought" in Southern Asia.

High rate of investment is of course not a sufficient condition for rapid growth but it has been a necessary condition for higher growth in East Asia and elsewhere. Looking ahead it seems plausible to argue that if Southern Asian countries are to grow at 7-8 percent per year, the investment rate may have to increase 30 percent plus. It has been estimated by the World Bank[6] that for achieving the target growth rate of 8 percent per annum. India needs to increase its investment rate to 30 percent of GDP while its rate of investment in 2003 was only 23 percent of GDP. Similar increases in investment rates will be necessary in other countries in Southern Asia, if the growth rates are to increase to 7 percent per year and above.

[5] Defined as GDP growth rate divided by investment-income ratio, which is equivalent to increase in income per unit of investment adjusted by relative price of capital goods and gross domestic output.

[6] See World Bank, India: Investment Climate Assessment 2004, November 2004.

Table 1. Investment Deficit in Asia

Period	Region / Country	GDP growth rate	Investment rate	IRRI*
		%	% of GDP	%
1980-2003	East Asia & Pacific	7.70	34.36	22.41
	China	9.49	37.38	25.38
	Korea, Rep.	6.74	31.69	21.26
	Indonesia	5.35	26.11	20.47
	Malaysia	6.24	30.71	20.33
	Philippines	2.74	22.02	12.45
	Thailand	6.03	31.39	19.22
	Vietnam	6.57	23.60	27.84
1980-1996	Korea, Rep.	7.77	32.45	23.94
	Indonesia	7.04	29.51	23.87
	Malaysia	7.36	32.27	22.81
	Philippines	2.35	22.65	10.37
	Thailand	7.83	34.28	22.85
1996-2003	Korea, Rep.	4.58	30.97	14.79
	Indonesia	2.02	19.47	10.38
	Malaysia	4.34	28.74	15.11
	Philippines	3.96	20.92	18.95
	Thailand	2.20	26.56	8.28
1980-2003	South Asia	5.47	21.87	25.00
	Bangladesh	4.21	18.70	22.52
	India	5.74	22.60	25.39
	Pakistan	5.12	18.16	28.20
	Sri Lanka	4.52	25.14	17.96
2000-2003	Central Asia	7.72	21.62	35.69
	Turkmenistan	15.69	30.65	51.19
	Kyrgyz Republic	3.51	17.95	19.58
	Uzbekistan	3.64	18.46	19.74
	Tajikistan	7.06	16.33	43.22
	Kazakhstan	8.44	24.73	34.15

* Income rate of return on investment
Source: Calculated based on WDI CD ROM 2005

Where can such increase in investment rate come from? Obviously, the principal source of that increase has to be private sector investment. WEO emphasize the need for continued structural reforms for increasing private investment. However, it is interesting to note that WEO also finds the evidence of relatively low internal rate of private sector, at least for companies that are represented on the equity markets. This naturally leads to the discussion of investment climate (IC) for private sector. World Bank reports on the subject for India and other Southern Asian countries have emphasized the importance of reforms in the following areas: regulatory reforms including reducing entry and exit barriers, addressing impediments to the smooth functioning of labor, land, and product markets, and streamlining the regulation of business startups, bankruptcy procedures, industrial and trade routines, addressing physical infrastructure bottlenecks and weaknesses in financial and other business services. Clearly reforms need to be continued at vigorous pace to improve IC significantly.

One factor that is particularly relevant for the present discussion is inadequacies of infrastructure facilities. Most of the IC surveys find inadequate infrastructure facilities as a key constraint on private sector investment. A recent IMF paper (2005) argues that infrastructure investment investments in India need to increase from about 5 percent of GDP to about 7 percent. The report on infrastructure by the Development Committee of the World Bank and IMF also highlights the gap in infrastructure investments in South Asia, though it does not put a number on the additional investment needs. The high growth economies of Asia such as China and Korea consistently invested more than 10 percent of GDP in infrastructure during their periods of high growth. In the light of that experience, infrastructure investment deficits in Southern Asian countries could well be about 5 percent of GDP.

In addition to these national infrastructure investments, there are unmet needs of regional infrastructure investments. Improving regional connectivity in roads, railways, air transport, ports and shipping, telecommunication, gas and oil pipelines, etc. could well require investments in hundreds of billions of dollars.[7]

Table 2. Infrastructure Investments Needs in Developing Asia, 2006-2010

Countries	**Investment (2006-2010)**	
	Volume (US$ billion)	**Rate (% of GDP)**
China	1198	21
India	367	15
Indonesia	128	18
Malaysia	56	13
Philippines	44	12
Thailand	65	11
Vietnam	26	16
Total	1885	18

Source: Taken from De (2005)

These broad estimates of infrastructure investment needs are supported by aggregative analysis of investment needs in the region based on regression equations linking GDP growth to infrastructure investment needs presented in De (2005). According to this study, developing countries in Asia will need to spend an estimated total of US$ 377 billion per year between 2006 and 2010 (or approximately US$ 2 trillion in a five year period) in infrastructure sectors such as roads, railways, airways, ports and electricity (Table 2). For India alone, the study estimates a need for investment in infrastructure of US$ 367 billion during 2006-2010 as against the estimated US$ 215 billion during 2001-2006.[8]

The economies in Southern Asia have grown up by over 6 percent per annum during 2001-2003 and together their GDP in 2003 was over US$ 1.6 trillion. A 10 percentage point boost in investment rate (private and public) in Southern Asia can pump in about US$ 1 trillion over the next five to seven years. Combined with the conventional measures on exchange rate adjustments, structural reforms in the Japan and EU and austerity in the US they could substantially reduce the global imbalances while meeting the problem of "too little demand" mentioned by Larry Summers.

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7 For example, according to UNESCAP, upgrading of 26,000 km roads falling under the Asian Highway requires US$ 18 billion investment during 2005-08, out of which Southern Asia alone needs approximately US$ 9 billion (UNESCAP, 2005).

8 Estimated in India Infrastructure Report, Government of India, 1996

Many of these investments (such as gas pipelines) seem to be viable on commercial terms and should be suitable for partnership with private investors. For many other infrastructure investments also Public-Private –Partnership (PPP) is emerging as the preferred instrument, where the private sector gets its normal financial rates of return while the public sector partner provides concessional funding based on the long-term direct and indirect benefits to the economy. New instruments such as special purpose vehicle (SPV) set up recently by the Government of India to fund mega infrastructure projects may be relevant for other Asian countries as well (see, Box 1). Concerns have been expressed by IMF that these investments may lead to excessive debt burden of Government in many of these countries. These concerns may be exaggerated. The benefits from infrastructure investment should not be seen in narrow terms of direct collection from provision of infrastructure services but should include the indirect benefits in terms of increased income of the country and enhanced value of land and other assets. If provision of better infrastructure helps increase in private investment and accelerated GDP growth, the increased revenues therefrom may over time help these economies to mange their debt burden better. In the Chinese case of boosting investment after the Asian financial crisis mentioned above, government revenue-GDP ratio increased from 5.80 percent in 1997 to 10.30 percent in 2003[9] and there has been no unmanageable increase in Government debt or of inflationary pressures.

Box 1. Financing Infrastructure through Public-Private Partnership

The Government of India has decided setting up of a special purpose vehicle (SPV) to fund mega infrastructure projects. Borrowing up to Rs. 100 billion by the SPV — India Infrastructure Finance Company Ltd (IIFCL) — during the current fiscal (2005-06) would be guaranteed by the Government.

The SPV would fund projects in the public and private sectors as well as public-private partnership (PPP) scheme. Fresh annual limits for Government guarantee would be decided at the beginning of every fiscal. Besides raising long-term funds from domestic and overseas markets, the SPV would also borrow from multilateral lending agencies.

The SPV, that would be 100 percent Government-owned, would fund projects in sectors such as road, bridges, railways, seaports, airports, inland waterways, power, urban transport, water supply, gas pipeline, special economic zones, international convention centres and tourism projects and more.

Source: The Hindu Business Line, 4 November 2005

6. Sources of Funds for Financing Additional Investments

Where can funds come for such large investments? Fortunately, the Asia is sitting on a mountain of foreign exchange reserves where the current and prospective rate of return is extremely small. And most of the Asian countries with large reserves are looking for investment opportunities better than those provided by US Treasuries. A proper mechanism needs to be devised so that Asians can invest their surplus savings in the assets represented by regional investments. If such investment opportunities reduce the flow of funds into US treasuries, they would create a harder external budget constraint and will help the US reduce its excessive spending at a gradual and measured pace.

[9] Source – World Development Indicator 2005, World Bank.

There are several specific proposals afloat for financing these infrastructure investments. For example, Kim Hak-Su, Executive Secretary of UNESCAP has agued that "At this stage of transformation, Asia and the Pacific region requires an institution like the European Investment Bank (EIB) - an independent, government-owned Asian Investment Bank to promote regional capital markets," Such an Asian Investment bank (AIB) could provide infrastructure loans and collaborate with the banking community in both raising and investing resources. It could work with private sector by co-financing and guaranteeing private investment financing. Malaysia has proposed the setting up of an Asian Infrastructure Development Fund to finance projects in the region. In a similar vein, Datuk Seri Abdullah Ahmad Badawi, Prime Minister of Malaysia said Asian countries could use "a fraction" of their massive foreign exchange reserves as capital for the fund, which would invest in basic economic infrastructure including super highways and super railways linking and binding the Asian community. The programs for Asian bonds can also help fund these investments.

7. Win-Win Outcome for the Major Players in the World Economy

From the forgoing discussion, it is clear that in many countries, particularly in Southern Asia, higher investment would be highly desirable. Desirable adjustment would then see higher investment in many parts of the developing world, higher savings in the developed region (particularly in US) and a smooth shift in the global pattern of deficits, all without a significant recession.

Therefore, to be confident of a benign adjustment one needs changes in policies in several places at once. Among the most important elements of such policies are significant movements in higher savings in the US and higher spending, relative to GDP, in the rest of the world, but particularly in emerging Asia. Coupled with that, a Keynesian approach focusing on global demand augmentation is necessary for correcting the global imbalances without a global deflation. The result would not only be more balanced global growth, but each region would be better off.

The Southern Asian economies will of course be the most obvious beneficiaries of such regional cooperation program. Their GDP growth rate may increase by about 2 percentage points with substantial contribution to reduction on poverty. The regional investments will improve connectivity to land-locked countries in the region as well as to the remote regions in several countries of the region such as Northeastern region of India and Northwestern region of Pakistan. Since the incidence of poverty tends to be high in landlocked countries and these remote regions, the benefits of growth in terms of poverty reduction may be more than proportionate. However, substantial benefits will also accrue to other major players in the world economy.

The current global imbalances pose a serious threat to the US economy. As argued by many eminent economists in the US a disorderly correction of these imbalances could lead to a sudden deprecation of dollar, sharp increase in interest rates, a crisis in housing and stock markets and a hard landing of the economy. A large boost in investments in Southern Asia will create additional demand for exports of goods and services from the US and help reduce its current account deficits. A gently hardening external budget constraint will also help improve its saving rate gradually, without causing a disruption. Altogether, there will be improved prospect of soft landing of the US economy.

Northern Asian countries in particular Japan, China and Korea will benefit from increased demand for investment goods and services from Southern Asia and that will help in better utilization of capacity in capital goods sector, in particular, construction sector. With declining current account deficits of the US they will face reduced risk of protectionism in the US and pressures for accelerated exchange rate appreciation from the US. These economies have excessively large foreign exchange reserves which are earning very low rates of return. The investments in the Southern Asia can offer much better rates of return than what they are earning now. Similarly, EU will face the reduced risk of excessive appreciation of Euro and pressures for accelerating growth in the region.

In view of these win-win-win opportunities, the international development community (in particular Southern Asian countries, Northern Asian countries and the US) should work in concert in promoting regional cooperation in Asia. Such cooperation should not be seen as reducing the importance of the US in the region but as helping the US in reducing its external deficits while boosting growth in Asia.

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