

The Eurozone Crisis and Challenges to East Asia's Growth and Integration

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The lingering problems of fiscal and financial weaknesses are devastating the Eurozone economies. Countries in the Euro region must take more decisive and comprehensive actions to address financial instability, weak growth and persistently high unemployment.

The Eurozone countries have sufficient resources and capacities to solve their own problems and to restore confidence and growth. The priority must be placed on adoption and implementation of growth-enhancing policies, structural reform and financial stability measures, while promoting fiscal responsibility.

Weak economies in southern Europe must implement structural reforms including financial restructuring and labor market reform. The timing and speed of fiscal consolidation is important. A country-specific, gradual fiscal adjustment in the short-term with a credible mid-term debt reduction plan is preferred. To facilitate intra-Euro area adjustment, reforms to strengthen competitiveness in deficit countries can go together with promotion of demand and growth in surplus countries.

An immediate resolution of the Eurozone crisis is unlikely due to continuing economic deterioration and institutional and structural limitations in the Euro area. Europe will likely continue to strive to muddle through existing risks. Political leaders know that the costs of breaking the Eurozone apart are very high and also maintaining the currency is important to Europe not only for economic but political reasons. The Eurozone will continue its efforts to move towards a more integrated financial and fiscal architecture for a well-functioning monetary union. In the long-term, this crisis can be an

opportunity to strengthen European integration.

With deteriorating growth prospects in the Euro area, the world economy encounters significant uncertainties and downside risks. East Asian countries should be proud of the resilience of their economies. But, they cannot be complacent. The global financial crisis exposed weaknesses in emerging economies through financial and trade linkages. East Asian emerging economies still depend heavily on markets in North America and Europe, remaining vulnerable to external shocks.

The financial deleveraging and stagnation in the real sector of the Euro area are taking a toll on the emerging and developing economies in East Asia through negative spillovers from trade and financial transmission channels. China's GDP growth rate in the second quarter of 2012 averaged 7.6%, reflecting a significant slowdown. The growth slowdown in China incurs significant repercussions on East Asian economies, given a close link through production and trade networks.

In the face of risks and uncertainties, East Asian economies must pursue the right policies to improve resilience and sustain growth. They should use a judicious mix of policies that improve financial system resilience, promote effective macroeconomic management, and continue reforms to rebalance sources of growth. With preemptive policies and improved capacity, East Asian countries can minimize the likelihood and adverse effects of crises.

Regional and global cooperation must be enhanced. At a time of great interdependence, the global community can benefit tremendously from close cooperation. Greater global integration requires closer policy cooperation at the global level, including those at the G20 and the IMF, to respond more effectively to shocks and crises in global markets.

Economic integration and cooperation within East Asia have deepened for the last 30 years. East Asia's strong growth has been associated with increased trade and production linkages with regional markets. Intra-regional trade within East Asia now accounts for more than half of its total trade.

On the financial side, the degree of integration of financial markets of East Asian economies also increased substantially. Yet, the extent of regional financial integration remains limited, falling behind that of integration with global financial markets as well as that of real-side integration with regional trading partners.

Monetary cooperation in Asia remains weak as well. Formal regional institutions are underdeveloped in the region, especially when compared to those of Europe. A key regional initiative is the ASEAN plus three's multilateralized reserve pool of USD 240 billion, which can provide short-term liquidity to members when needed.

Moving towards a pegged exchange rate system in East Asia is likely to require a lengthy period

of preparation and negotiation for necessary institutional arrangements in the region. A currency in East Asia is quite unlikely in the immediate future. East Asia does not appear to have very favorable economic and political conditions for a currency union, especially when compared with the Eurozone.

But, the prospect for an East Asian currency will hinge on future developments of economic and political conditions, rather than current environments. However it develops, China and the renminbi will play a major role in any new East Asian currency arrangement.

Fortunately East Asia can learn from Europe. Europe's integration process over half a century and the current crisis suggest that preconditions and institutional frameworks are important for a successful integration.

Korea will continue our contributions to promoting regional and international cooperation by actively participating in various regional, trans-regional and global institutions including the Korea-China-Japan summit, ASEAN+3, ASEM and the G20. The success of the G20 Seoul Summit implies that an emerging economy like Korea can play a global role as a rule-maker and bridge-builder in a new global governance system.



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