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Asia's global impact

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Suman Bery India, China and Asian economic integration

Shinji Takagi Financial integration: an unfinished agenda

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Yiping Huang What does China want in global economic reforms?

and more . . .

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From the Editors' desk

Suddenly Asia has emerged as a major player in the global economy. Asia already accounts for 27 per cent of world GDP and the Asian Development Bank 2050 Report issued last May suggests that it will account for as much as 51 per cent a generation hence. The economies of the developed world are slipping back into recession. Asia, especially China, India and Indonesia, continue their exceptional and rapid growth with the rest of the region, including Australia in tow. There are high levels of interdependence in the region itself, especially within East Asia and between it and the rest of the world. It has a deep stake in the strength of the global economic system that supports open trade and international capital flows.

What sort of changes will these developments wreak in the regional and global order? Yiping Huang argues that what China wants is reform, not radical change, of the international economic system, because China has been among the biggest beneficiaries of the existing order.

There are great expectations of Asia, not only as an engine of global growth but also of its leadership at a time of global economic fragility. The new global order, centred on the G20, includes six Asian powers and provides a platform for Asian leadership. But is Asia up to the task? And do the institutional structures and arrangements within Asia provide the foundations that are needed to build coherent policy strategies to deal with the economic problems the world now faces?

The essays in this volume address these questions. It is not yet clear how trans-Pacific regional institutions should relate to East Asian regional institutions or how regional institutions should relate to the G20 process. An increasingly prominent interest is how regional institutions can accommodate dialogues on political and security concerns as well as economic matters as changes in the structure of regional economic power lead inexorably to shifts in regional political power. The expansion of the East Asia Summit to include the US and Russia begins to address this interest, but it is only a first step.

This is Asia's global moment. Will it meet the test? The verdict is out and far from certain. But this issue of EAFQ provides the outline of the agenda with which Asia will have to deal if it is measure up, both economically and politically.

Peter Drysdale and Shiro Armstrong
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COVER: Reach for the sky: Nothing better exemplifies China's economic confidence than the 632-metre Shanghai Tower, seen here in the architectural rendering created by San Francisco-based Gensler Architecture, Design and Planning Worldwide. The skyscraper, now under construction, will tower over the city's Lujiazui financial centre. Picture: Gensler Architecture, Design and Planning Worldwide / Color China Photo / AP Photo / AAP.

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Evolving institutions: roles and prospects

WENDY DOBSON

WITH no clear regional leadership and few strong incentives for deep integration, Asian cooperation for the foreseeable future is likely to be intergovernmental, with little pooling of sovereignty to create supranational institutions or agree on common rules and disciplines.

As Asia's weight in the world economy grows, however, its interests will also be served by a strong commitment to global institutions.

Asia is unlikely to see the institutionalisation or pooling of sovereignty that occurred earlier in Europe, because the region lacks the same incentives for doing so. Tariffs on goods are now relatively low, as governments have reduced barriers through spontaneous unilateral liberalisation, while sensitivities remain to pooling sovereignty to the extent necessary for deeper integration — even within ASEAN, the default leader. The China–ASEAN free trade agreement, however, created incentives for other large economies to counter potential discrimination with similar deals of their own.

The future of economic cooperation is complicated. The recent global crisis revealed the vulnerabilities of continued reliance on export-led growth strategies and created, at least for a time, incentives to rebalance growth in economies throughout the region so that they rely more on domestic and regional demand. Reforms of previously protected service sectors will be needed, implying more emphasis in future trade agreements on competition policies, investment performance measures, technical barriers to trade, and the like. The Trans-Pacific Partnership (TPP) might create further incentives in this direction but those negotiations are becoming quite complicated. The negotiating frameworks agreed at the November 2011 summit might provide a clearer basis for evaluating what liberalisation the TPP will be able to achieve.

If services and investment liberalisation proceed unilaterally, as was the case in goods, there is the danger pointed out by Richard Baldwin that writing rules to eliminate behind-the-border barriers will reflect power asymmetries (such as those between the United States, the European Union and Japan and the smaller economies with which they have agreements) which could undermine universally accepted World Trade Organization (WTO) trade. At the same time, China, India and Brazil are large enough to ignore such agreements — for now. When they reach the levels of development where their multinationals produce more abroad, the rules will have been written and they will be rule-takers, which could further undermine the WTO's future legitimacy.

> Asia's rising weight in the world economy brings with it external expectations about its role in shaping the future world order

With no clear leadership in prospect ASEAN will continue to fill this role. The 2007 commitment to achieve an economic community by 2015 is visionary and ambitious; but the deep integration needed for a single market with goods, services, capital, investment and skilled labour flowing freely seems unlikely by that date. Even so, ASEAN is developing a framework for macroeconomic cooperation within which the ASEAN+3 are beginning to gain traction.

The record suggests sequenced integration in Asia. Thus the current level of institutionalisation will see more consultation, greater transparency, more formalised arrangements and efforts to prevent policy reversals and crises without pooling sovereignty.

More likely are efforts to better use scarce leadership resources in the continuing variable geometry in which the broadest membership meets (as is the case in the Asian Economic Summit) to discuss strategic issues. With time and experience it might also engage in setting and monitoring goals and targets if such were adopted,

similar to the G20's emerging role at the global level. To prevent crises, ASEAN+3 institutions would focus on surveillance and analysis among the systemically significant economies — with the view that as members gain more confidence in the process and in each other, the forum would be used for bargaining and closer policy coordination. Crises will require managers, however, and are likely to evoke a steering committee of the largest economies. Will ASEAN remain at the core?

Asia's rising weight in the world economy brings with it external expectations about its role in shaping the future world order. Will the region continue to cede the leadership of the world trading system to the United States and Europe, as it has through much of the post-war period? Or will it use its increasing economic weight to shape the world order by, say, helping to conclude the Doha Round or building a Pacific-wide free trade area? In macroeconomic surveillance and cooperation the precedent has been set for close Chiang Mai Initiative Multilateralisation–International Monetary Fund (CMIM-IMF) cooperation. Europe's recent experience with the European Financial Stability Facility (EFSF) has underlined the need for such cooperation, but that precedent has not yet been formalised.

Yet Asia's growing economic weight and its strong interdependence with the rest of the world economy suggest that purely regional institutions are unlikely to accommodate its long-term interests. A very positive outcome of this dilemma would be Asian leaders and institutions emerging as champions of a stable and open global economic system in both word and deed. EAFQ

PICTURE: AFP PHOTO / AAP

Foreign exchange dealers watching currency movements in Tokyo: Asia's rising weight in the world economy brings with it expectations about its role in shaping thr world order.

Positioning Asian regional architecture internationally

PETER DRYSDALE

WHATEVER is done to reposition Asian regional architecture, it needs to take account of Asia's new role in global economic governance. It needs to attend to the implications of Asia's rise for political and security affairs. And it needs to build on the foundations of established regional structures — APEC and East Asian arrangements. It will sensibly coordinate with, and draw on the base of, all of the established trans-Pacific and East Asian arrangements.

ASEAN is still the fulcrum of Asian cooperation arrangements, including APEC, the ASEAN Regional Forum (ARF), ASEAN+3 and the newly expanded East Asian Summit (EAS). But with the rise of the bigger powers in Asia and the emergence of the G20 after the global financial crisis and the role of the Asian 6, including Australia, within it, this seems destined to change. And there is a new and immense fluidity in the shape of regional architecture despite the recent initiative to include the US and Russia in the EAS dialogues.

None of the existing Asian or Asia Pacific institutions addresses all the key dimensions of regional cooperation that they now need to face — providing a collective forum for regional leaders to address the full range of regional and global economic issues; dealing effectively with the consequences of economic integration, particularly its trade and investment but also its financial and macroeconomic dimensions; addressing issues of political change and security; and educating the public and opinion leaders about the region. Nor should any one organisation need to perform all these roles. Each of the established forums has evolved to serve some or other of these roles and all can make an input across the range of issues that are now important.

There are two big gaps in the structure and operation of regional architecture. The first is its failure to connect to evolving global arrangements, including the G20 process. The second is that it does not yet encompass the political and security dialogues that are a necessary anchor in managing the impact on political and security affairs of the huge changes in the structure of economic power that are taking place in the region.

In principle, the first of these issues can be remedied relatively easily. Already there are informal dialogues among Asian G20 members and participants in the EAS and other regional processes. These dialogues could be formalised so that regional input and regional initiatives are a recognised part of the G20 process and its reach.

> In East Asia, the economics is the politics – and the positive part of the politics

Getting this right in practice will be more complicated than it appears in principle. It will require decisions about which regional arrangements provide the most effective link between regional and global cooperation. Many of the initiatives will sensibly require strengthening East Asian arrangements (at least within ASEAN+6), perhaps via enhanced financial cooperation through finance ministry and finance regulatory agency involvement (the idea that an Asian Financial Stability Dialogue might be established, for example, and develop an association with the G20's Financial Stability Board). Others will benefit from participation of a broader Asia Pacific group, including the United States. Getting the connection between regional and global arrangements right will require careful attention to scheduling regional meetings and initiatives so that they can both make useful input into, and be reinforced by, the efforts in global cooperation. Success will turn heavily upon the logistical detail. There needs to be much careful thought given to this question. The legitimacy of the G20 will ultimately depend on how the interests and views of non-G20 members are brought to the G20 process. Structuring the timing of Asia's regional meetings around the G20 to give the regional non-G20

PICTURE: WONG MAYE-E / AP PHOTO / AAP

There is a new fluidity in the shape of regional architecture.

members input and ownership of initiatives is an important start. The implication is that, while ASEAN provides a critical modus operandi for regional initiatives, the agenda and schedule for regional arrangements, if regional institutions are to remain relevant, need to be more flexible also and essentially to be driven from elsewhere.

The second issue is one that leaders throughout the region have been struggling with in different ways. Former Australian Prime Minister Kevin Rudd advanced the idea of an Asia Pacific Community to address this gap. Former Japanese Prime Minister Yukio Hatoyama's idea of an East Asian Community sought to serve a similar purpose. At the core of both ideas was the development of a framework which might help to reduce the risk of a fracture in political confidence through political and security dialogue around the rise of China's (and India's) political influence alongside the established military and political power of the United States, a goal consistent with growing East Asian economic cooperation.

WHEN the United States announced that it wanted to join the East Asia Summit, it was a move that ASEAN was strategically in no position to resist, even if it had wanted. From this year, the US and Russia are participating in the EAS meetings. For some, this development creates the framework which includes all the key players — the United States, China, India, Japan, Korea, Indonesia and the core ASEAN group, Australia, Russia — that are needed for effective political and security discussion. Of course, it also includes others who are not central to that. India is not a member of APEC, and the EAS and APEC include others that are not central to this objective.

Yet it is by no means clear that this development, in the longer or even the medium-term, will serve the political-security purpose of the Asia Pacific Community idea which Rudd had in mind. Reservations include the lack of depth of its economic agenda, the ASEAN anchor, and the breadth of membership. Should the EAS become primarily a dialogue for political affairs without the ballast of economic dialogues to which the United States can effectively relate, it would likely exacerbate rather than calm trans-Pacific tensions. There have already been signs of how this could happen.

There is hope within ASEAN that the economic agenda of the EAS might take off, with ASEAN firmly at its core, linking the ASEAN-plus trade arrangements gradually into an Asian Free Trade Area. But America now has its Trans-Pacific Trade Partnership and getting into bed with China in a free trade area any time soon is unlikely.

It would appear wise, especially from the perspective of the US or the Chinese presidents, not to put all the eggs into that one basket. A more practical strategy might be for the major players to use both the East Asian and the Asia Pacific Summit arrangements for side meetings on critical issues, fashioning over time a high-level council of the principal parties that links both structures. Specifically, it is likely to prove impractical over time for the US president to join every East Asia Summit and every APEC Summit. It would be very damaging to US and broader regional interests to ditch the economic and political asset that America has built so patiently in APEC while the prospect of building anything remotely similar in the EAS that organically involves the US is distant.

Back-to-back regional summits are a real and practical option. This might appear messy to the tidy-minded. But given the character of the region, neat and tidy arrangements are less likely to be useful than arrangements that draw the whole region together in different ways.

In East Asia, and especially in the trans-Pacific relationship, the APEC experience demonstrates that it is the economic dialogue upon which substantial cooperation has been built. In East Asia, the economics is the politics — and the positive part of the politics. Political dialogues not tightly nested in a framework of economic cooperation will quickly turn to focus on points of contention and friction. This is why APEC remains a core functioning forum that puts America in harness with Asia.

In the EAS the US will be, for some time yet, an economic visitor rather than an organic participant.

This worry recommends the need for a heads of government meeting that transcends, and incorporates, APEC and the EAS and could address the full range of regional and global issues, including issues that might arise in APEC, EAS, ASEAN+3 or other regional forums. Asian leaders who are involved in the G20 group, except India, are all currently members of the EAS and APEC. It is a group whose economic deliberations could also feed into the G20 and other global processes. And it is a group that should naturally draw in the broader regional membership of APEC and the EAS to its deliberations. The EAS group now forms the nucleus of a new political partnership with the US and Russia. US and Russian participation in EAS is another useful step in the evolution of Asian regional architecture but not the end-point. EAFQ

EMERGING GROUPINGS

India, China and Asian economic integration

SUMAN BERY

THE narrative on the economic growth of 'maritime East Asia' in the period after the Korean War is well established, and runs roughly as follows: Japan's reconstruction was facilitated by its integration with the US and Europe within the liberal trading and monetary order set up under US leadership at the end of the Second World War. This phase was followed in the1970s by the rise of the so-called Newly-Industrialised Economies (NIEs): South Korea, Taiwan, Hong Kong and Singapore. These countries followed essentially the same path as Japan, but with a more prominent role accorded to the import of foreign capital. The third wave, in the 1980s, was associated with the rise of the core economies of ASEAN, powered through deeper integration with the still-vibrant Japanese economy.

> Less remarked . . . is the scope for much deeper integration between India and China than currently exists

This third phase lost momentum in the face of the prolonged financial and growth crisis of Japan as well as the Asian financial crisis of 1998, and gave way to the current phase, prominently associated with the sustained, rapid growth of China in the first decade of the new century.

China is following its Asian predecessors in significant and sustained unilateral trade liberalisation. Where it differs in its integration model is in its openness to foreign direct investment. These Chinese policies, further supported by the sheer scale of the Chinese labour force and the quality of Chinese infrastructure, facilitate a continued deepening of already strong intra-regional trade integration, and the development of production networks centred on final assembly in China.

The reshaping of the Asian economy around the rise of China is facilitated by the development of political consultation mechanisms in the ASEAN+3 countries (the ASEAN 10 plus China, Japan and Korea). An important issue facing Asia is whether and how these consultation mechanisms need to be adjusted for the next wave of Asian economic growth.

Several of these developments are already widely commented on. These include the likely shift in China's

PICTURE: MANISH SWARUP / AP PHOTO / AAP

Chinese Premier Wen Jiabao and Indian Prime Minister Manmohan Singh after signing agreements in New Delhi on 16 December 2010: lack of familiarity and trust is impeding closer economic engagement between the two nations.

own growth strategy away from merchandise exports toward domestic demand, and a corresponding shift in domestic saving-investment imbalances to levels that prevailed a decade ago, even as the country remains a significant capital exporter. Also fairly likely is continued sluggish growth in the advanced countries as their public finances and financial systems rebalance.

All this is the new, post-crisis, conventional wisdom. Less remarked, though, is another potentially important trend, which is the scope for much deeper integration between India and China than currently exists. Measured in terms of purchasing power parity, China and India are already the largest and third-largest economies in Asia, with some prospect that India will soon become the second-largest Asian economy. Two-way trade between the two countries is growing rapidly to an estimated US$60 billion in 2010, roughly a quarter of the volume of trade between China and all of ASEAN. Investment ties are also developing, though at a slower pace.

Notwithstanding these positive developments, economic engagement between these two fast-growing and large economies is well below potential. While this is partially a matter of weak infrastructure links, a deeper cause is lack of familiarity and trust between official and corporate elites in the two countries. The source of this distrust is primarily military and strategic, dating back to the border conflict between the two countries in 1962, and China's close military links with Pakistan. But it is also in good measure economic, with the Indian corporate sector delicately poised between greed and fear — wishing to benefit from the scale and productivity of Chinese manufacturing while uneasy about permitting full-throated competition in India's domestic market. India does not accord China 'market economy' status, and believes that China applies significant non-market barriers to access by Indian firms in areas such as pharmaceutical products and IT services where Indian firms are widely accepted as being internationally competitive.

Both countries have preferred to address these issues through intensive bilateral contacts, as well as contact in various multilateral forums such as the G20 and East Asia Summit (EAS). In a speech delivered earlier this year, former Indian

foreign secretary Mrs Nirupama Rao (previously an ambassador to China and current Ambassador to the US) noted that between 2005 and 2010, Prime Minister Manmohan Singh and Premier Wen Jiabao had met no less than 11 times. Following Premier Wen's official visit to New Delhi in December 2010, the two sides agreed to institute a strategic bilateral economic dialogue, the first meeting of which will take place in late September this year.

The issue is whether any of these tensions could be better eased through participation in plurilateral groupings rather than purely bilaterally, and, if so, what such a grouping might look like. At the global level, India and China are leading emerging-market members of the G20 and have coordinated their positions in areas such as the multilateral trading system, reform of the international financial institutions and climate change finance. The competitive issues are likely to be sharper within Asia, where India has valid concerns of being marginalised by Chinese trade and finance in a dynamic region of historic, cultural and strategic interest to it.

These issues of regional economic architecture are yet to receive sustained attention within the Indian establishment. Much will depend on how an expanded East Asia Summit, now to include Russia and the US, begins to function on security issues, and on whether that expanded EAS generates any economic coordination mechanism similar to that provided by ASEAN+3. In my view, India should embrace the EAS process vigorously as a way of complementing bilateral contacts with China that span economic and security issues. Whether this would also be the Chinese preference remains to be seen. EAFQ

TRADING TENSIONS AWAY

Regional economic integration and geopolitics

SHIRO ARMSTRONG

EAST Asia's pursuit of policy strategies of openness to trade and investment have resulted in its being economically one of the world's most internationally-integrated regions — both intraregionally and towards the rest of the world. South Asia, on the other hand, is one of the world's least integrated regions and, measured in terms of intraregional trade as a share of total trade, is the region with the lowest integration globally. Intraregional trade in South Asia was 3.5 per cent of total South Asian trade in 2009, up from a low of 2 per cent in 1967 but significantly lower than the 19 per cent in 1948. Intraregional trade in East Asia was 40 per cent in 2009.

The differences in regional economic integration mean that the effect of political tensions between countries on trade is more pronounced for South Asia than it is in East Asia.

Trading partnerships between open economies are determined by comparative advantage and market forces, and the advantages of proximity are also important. A region with low economic integration is likely to be losing out on the benefits that flow from trade due to economic proximity. But additionally, because political interactions tend to occur much more frequently between neighbours, higher economic interdependence can ameliorate the adverse effects of political tensions that may arise between neighbouring countries.

Political tensions can, of course, act as a barrier to economic integration; and lack of economic integration and interdependence can constrain improving political relations. The relationship between India and Pakistan is an obvious example of the latter. The East Asian case is very different, where the region's economies enjoy high levels of trade and economic integration, despite unresolved historical issues and long-standing political mistrust in some of the region's bilateral relationships.

Political tensions between Japan and China from 2001 to 2006, for example, rose to a level where leadership visits between the two countries were suspended and there were large protests in China against Japan and boycotts aimed at Japanese goods. Yet these political tensions did not derail economic relations, nor significantly affect the continued growth of Sino-Japanese trade. The start of this period of political tension coincided with China's accession to the World Trade Organisation (WTO) in December 2001.

It was not simply the increased trade and positive news from China joining the WTO that offset the conflict and tension between Japan and China. But it was China's commitment to the global trading system after

PICTURE: /TEH ENG KOON / AP PHOTO / AAP

East Asian economies enjoy high levels of trade and economic integration, despite unresolved historical issues and long-standing political mistrust in some of the region's bilateral relationships.

1986, with rapid trade liberalisation and economic reform, that gave Japanese firms confidence in dealing with Chinese counterparts. China steadily adopted, and constrained itself to, global trading rules and norms through its 15-year accession march towards membership of the GATT and later the WTO. The experience of the Japan-China relationship shows the importance of countries' integrating into the global economy and being part of the global trading system for bilateral relationships to prosper.

The experience of the cross-Straits (China-Taiwan) relationship highlights the importance of intraregional economic integration in improving bilateral economic relations. Political relations between Beijing and Taipei have been even more difficult than Japan-China relations. Taiwan had banned imports from China up until the early 1990s for political reasons. In the 1990s, these bans were lifted gradually, and then more rapidly after both China's and Taiwan's accession to the WTO in 2001. Taiwan and China have become increasingly integrated into the complex production networks in East Asia. As their economies' integration into the regional economy deepened, indirect interdependence increased and the indirect as well as the direct costs of Taiwan's discrimination against mainland Chinese imports became more apparent. The trading relationship is now more 'normal' despite the residual trade bans that are still in place. Deep integration into the regional economy has carried the bilateral Taiwan-China economic relationship beyond being simply bilateral in nature.

In contrast, the non-integrating East Asian economies of North Korea and Myanmar are important examples of closed economies whose bilateral relations with their neighbours and beyond are dominated by political conflict.

Unlike Taiwan-China relations, where impediments to trade were reduced over time as the regional economy became more integrated around them, the under-development of South Asian economic integration and interdependence means there is less incentive to reduce barriers to trade or improve poor infrastructure, lift bans on investment and ease people movement across borders.

Pakistan is yet to reciprocate most favoured nation (MFN) status in trade with India and maintains a narrow positive list (786 items) of goods that India may export to Pakistan. At the same time, India's tariff rates remain high, especially for goods of particular interest to Pakistan, such as textiles, leather and onyx, and non-tariff barriers are substantial. The relationship between India and Pakistan is not nested in robust regional cooperation, so bilateral economic dealings are swamped by bilateral political dealings and negative-sum or zero-sum security issues.

East Asia's experience suggests that bilateral economic relations nested in a highly integrated region that is outward-looking and globally oriented helps to dampen, and even reverse, the effects of political conflict on trade. Thus political problems that limit economic integration in South Asia are likely to become more tractable if the whole region is tied more closely into positive trade and economic relations, trans-regionally and globally, and committed to full observance of the global rules of trade. EAFQ

PICTURE: RUNGROJ YONGRIT / EPA / AAP

Leadership at a difficult time

ANDREW ELEK

THE 2008 global financial crisis catalysed a long-overdue transformation in the oversight of global affairs, bringing large emerging Asian economies to the G20 table.

A transition in the role of Asian countries at the G20 — from cautious and sometimes defensive to visionary and examplary — was expected to unfold slowly, possibly taking a decade or more. Yet the renewed threat to recovery arising from the self-created problems of the United States and European Union has created an urgent demand for Asian leadership in 2011.

As in 2008, the world is looking to the G20 to deal with the renewed threat of recession.

The US and EU are certainly not going to boost global demand. Asian and other emerging economies have some scope to stimulate domestic demand, but not nearly as much as in 2008. By the time G20 leaders meet in France in November 2011, the short-term prospect will be, at best, to avoid recession in the US and EU.

Such an outcome may be adequate for one year but risks the future of the G20. Continued stagnation of mature economies will accelerate the ongoing shift of economic power and influence towards emerging economies. Economies with growing shares of wealth and dynamism will be blamed for not doing more. But aggressive attempts to attribute blame to dynamic economies, China in particular, just makes it politically harder for these economies to implement reforms.

US Secretary of State Hillary Clinton checks the leaders' line-up during a group photo at the 17th ASEAN summit and related summits in Hanoi on 30 October 2010. The challenge of leadership is being thrust on Asia sooner than the region had hoped.

To avoid falling into a swamp of unproductive recrimination, the G20 needs to find a strategy to stimulate effective demand which all its members can support.

At a time of deficient global demand, substantial savings generated by emerging economies are locked up in excessive foreign exchange reserves alongside vast potential for investment in economic infrastructure. Much of the vast unmet demand for infrastructure is in the emerging economies of Asia, which are also the

source of much of these savings.

Asian governments have recognised the costs and risks of continuing to accumulate reserves. Those risks include significant capital losses, ongoing blame for inadequate global growth, and the costs of prolonged weak global demand on their own economies.

Now is a good time to address a global financial market failure in order to reduce these growing risks. Bringing forward some badly needed investments in infrastructure could be a decisive circuit-breaker to spark sustained global recovery.

Asian governments can put the challenge of fixing the current massive market failure squarely on the G20 agenda. A concerted effort by all members of the G20 gradually to make better use of Asia's huge accumulated savings will allow them to work constructively to solve a shared policy problem, rather than blaming each other for there being too little growth and too many exports.

Channelling more of Asia's savings into productive investment in infrastructure will not happen quickly or easily. G20 leaders can challenge their officials, financial sector managers, and international financial institutions to use their expertise to find creative ways to intermediate savings to finance more investment in infrastructure.

The Asian Development Bank (ADB) and other multilateral development banks can step up their roles. They can be sound borrowers of Asian savings; they can invest them in productive projects, including projects to improve connectivity among economies. Commercial banks can also do more in credit-worthy emerging economies.

There will be some risks. One or two governments may act irresponsibly and make a mess of some investments. But, with care, most investments in infrastructure will prove to be viable. There is a lot of international experience on designing public-private partnerships and shaping policies to set prices and to contain project risks within acceptable limits. And the risk of some projects being less successful than expected is far less than the risks of prolonged recession.

An effort to create more effective demand for investment will need to be accompanied by ongoing efforts to cope with long-term problems of debt in mature economies and structural adjustment in emerging economies. These complementary efforts can restore confidence in the world economy.

In the meantime, G20 leaders might delay thinking about other significant global problems. Unfortunately, the window of opportunity to avoid disastrous climate change is closing fast, and the future of an open non-discriminatory WTO-based regime for international commerce is being undermined by misplaced faith in preferential trade deals.

> A concerted effort by all members of the G20 gradually to make better use of Asia's huge accumulated savings will allow them to work constructively to solve a shared policy problem, rather than blaming each other for there being too little growth and too many exports

It will take a long time to find consensus on how to contain, let alone resolve, such problems. In a voluntary process of cooperation like the G20, there will be no big breakthroughs in any one year. It will not be possible to deal with these big problems in sequence. A more prudent option is to start a discussion of these issues in a patient, non-confrontational manner.

Right now, the US and EU are both caught in a vicious circle of acrimony and repeated attempts to defer hard decisions. They cannot be expected to lead the consensus-building needed to deal more adequately with global warming or rescue the WTO. Nor can Asian governments rely on them to deal wisely with global issues, respecting differences and searching for consensus rather than confrontation.

At a time of weak global governance the challenge of leadership is being thrust on Asia sooner than it had hoped.

The agenda of Asian institutions for regional cooperation can move beyond preoccupation with local issues and trade negotiations to an outward-looking effort to address important matters which require global solutions. Forums like ASEAN+3 and the East Asia Summit can be used to consult on how Asia can use the G20 opportunity — an opportunity which may not be repeated — to defend, then reform, the international economic order in ways needed to complete their emergence from poverty. EAFQ

Clear benefits in stronger Asian regional institutions

PICTURE: TORU YAMANAKA / AFP PHOTO / AAP

ASEAN plays a unique role in building a strong economic and financial architecture in Asia.

MASAHIRO KAWAI

ACCORDING to the Asian Development Bank (ADB) study Institutions for Asian Integration: Toward an Asian Economic Community (2010), Asia is supported by a dense web of 40 overlapping regional and sub-regional institutions that promote regional cooperation and integration at the intergovernmental level. Yet with few formal or explicit commitments from members of these institutions, Asia remains 'institution-light'.

The Association of Southeast Asian Nations (ASEAN) clearly plays a unique and leading role in building a strong economic and financial architecture in Asia, as all major regional and interregional forums gravitate around it. Moving towards its goal of creating an ASEAN Economic Community by 2015, ASEAN has forged a series of free trade agreements (FTAs) — called ASEAN+1 FTAs — with its dialogue partners, while non-ASEAN members have also implemented various FTAs. As a result, the number of FTAs in Asia has surged over the last 10 years, creating an Asian 'noodle bowl' situation.

To tackle the Asian noodle bowl, numerous proposals have been made to consolidate overlapping FTAs into a single regional FTA, like an East Asia Free Trade Area (EAFTA) among the ASEAN+3 countries — the 10 ASEAN members plus the People's Republic of China (PRC), Japan and the Republic of Korea — or a Comprehensive Economic Partnership in East Asia (CEPEA) among the ASEAN+6 countries — also including Australia, India and New Zealand. These initiatives may

be seen as a first step towards the creation of a region-wide economic community. A large region-wide FTA would also stimulate the growth of regional demand and the rest of the world's exports, thereby contributing to the reduction of global economic imbalances.

The realisation of a single regional FTA in Asia would require both a trilateral FTA among the PRC, Japan and Korea and its integration with the existing ASEAN+1 FTAs. The biggest challenge lies in summoning the political will of these countries not only to liberalise trade in goods and services and investment, but also to reduce behind-the-border barriers, harmonise rules, regulations and standards, and pursue further domestic reforms. Deeper trade and investment integration at the regional level would serve the interests of firms and consumers, regionally as well as globally, and be highly complementary with World Trade Organization (WTO) liberalisation which does not require deep integration.

Does the Trans-Pacific Partnership (TPP) agreement, which is considered an early step toward a larger APEC-wide FTA, impede Asia-wide trade integration? The answer is no. While some Asian countries might decide to join the TPP for security and geopolitical reasons as it strengthens ties with the United States, the TPP would make any Asian member a more open economy. Institutional competition created by the TPP process would force some countries, notably the PRC, to accelerate the process of forging an Asia-wide FTA. In fact, the PRC and Japan are together now more aggressive in promoting an EAFTA/CEPEA. In this sense, the two processes are not mutually exclusive and can be complementary and create synergy.

On the financial front, the ASEAN+3 countries have strengthened regional financial and monetary cooperation following the Asian financial crisis. Important recent progress includes the multilateralisation of the Chiang Mai Initiative (CMIM), the establishment of the ASEAN+3 Macroeconomic Research Office (AMRO) in Singapore, and the creation of the Credit Guarantee and Investment Facility (CGIF) as an ADB-based trust fund in Manila under the Asian Bond Markets Initiative.

THE CMIM needs improvements if it is to become a full-fledged regional facility and promote regional financial stability. First, at US$120 billion it is too small and needs to be substantially expanded. Second, a new precautionary credit facility should be introduced to prevent a crisis from developing, because the current arrangement is designed to address crises only after they occur. Third, the CMIM should be delinked from International Monetary Fund (IMF) programs. Fourth, the AMRO needs to acquire sufficient resources and staffing to support its surveillance capabilities and to facilitate policy dialogues among the finance ministers and central bank governors. Once these shortcomings are addressed, the CMIM and AMRO can be transformed into a de facto Asian monetary fund, and the principles governing their cooperation with the IMF in providing liquidity assistance can be determined.

Regional financial stability requires further institutional support. For example, Asian financial authorities — including finance ministries, central banks, and financial supervisory and regulatory agencies — could choose to establish an 'Asian financial stability dialogue' to complement efforts by the Financial Stability Board at the global level. Such a dialogue would bring together all the financial authorities in the region to discuss regional financial market vulnerabilities, regional financial and capital flows, common issues affecting financial sector supervision and regulation, and efforts to strengthen regional financial integration.

Asia's regional institutions can complement and work with global institutions in a number of functional areas. In the area of development finance, regional development banks already exist alongside the World Bank, and the challenge is to improve the division of labour between regional and global development banks. In other areas where global institutions exist but regional institutions do not, there is substantial scope for creating new regional institutions — to promote trade and investment expansion, and economic and financial stability as international public goods — and for redesigning the prospective division of labour between global and new regional institutions, based on the principle of subsidiary.

The development of effective regional institutions in Asia in support of global governance can be hugely beneficial, not only for Asia, but also for the global community as a whole. It would result in Asia acting more responsibly, with greater accountability in its management of regional and global issues, and the provision of international public goods. It can also give Asia a bigger voice and result in a more effective Asian input in the global governance system. Regional institution-building should not be considered an end in itself and should further the shared goals of all countries, both within and outside the region. EAFQ

ALLEVIATING POVERTY

Economic integration: a driver for development

PICTURE: RAJESH KUMAR SINGH/ AP PHOTO / AAP

RAM UPENDRA DAS

REGIONAL integration initiatives are rich in plans for trade liberalisation and investment cooperation agreements, but they have rarely been contextualised in terms of development goals like creating employment and reducing poverty. This is possibly due to a lack of proper understanding of the ways in which regional trade and investment integration could promote development outcomes. It is particularly important to understand these issues in poverty-stricken areas like those of South Asia. If development outcomes are to be achieved, the link between regional integration and employment must be emphasised.

Strengthening trade and investment links will promote higher levels of regional trade. Increased regional trade will, in turn, improve the export industries of countries, promote trade-creating joint ventures, and, subsequently, generate employment. Improvements in market access, promotion of trade joint ventures, decreasing transaction costs through trade facilitation, and improvements in the development and flow of knowledge and technology produce increases in trade and regional integration. In turn, these promote developments in export industry, and increases in investment — domestic investment caused by expanding export industries and foreign direct investment (FDI) from regional and extra-regional sources — also generate employment. All of these steps improve the ability of export industries to grow, and, importantly, to specialise across a region — increasing the possibilities to take advantage of potential economies of scale.

Increased market access results from reductions in trade barriers (in a static scenario), from the incumbent scale expansion effect (in a dynamic scenario), and from the trade augmentation effect that comes from increased investment based on the perception of reduced trade barriers. Removal of trade barriers will also produce employment generation effects. A reduction in tariffs means greater market access to member countries, which produces two results. First, export growth. Second, enhanced market access will produce economies of scale as the production process becomes specialised across countries. These economies of scale will involve cost reduction and increase the competitiveness of the product overall. The effects of short-term trade diversion, if any, will be outweighed in the long run by this increased competitiveness, and the export growth and employment generation this will produce over time.

Technology and knowledge increases improve supply-side efficiency and product competitiveness. Rules of origin, less obviously, can also increase the developmental effects of trade. Appropriate rules of origin usually

involve subjecting a product to serious transformation, a process that involves value-adding and, subsequently, employment generation, at a local level. Improved supply-side efficiency and product competitiveness increase the capacity of an export industry, while rules of origin can have the effect of promoting regional specialisation.

Cross-country investment flows will also strengthen trade-investment linkages. If investment policy in this context focuses on specialisation across the region, and vertical integration in specific member nations, further gains in terms of higher trade and investment flows may promote increased employment generation. This may essentially mean distributing different stages of production in a particular industry regionally.

THE linkage between trade openness and employment can be examined through the effects on labour productivity. For labour productivity increases to translate into increased demands for labour depends on the possibilities for expansion of economies of scale. In the absence of scale expansion, labour productivity gains could result in a lower demand for labour per unit of output production, precisely since labour has become more productive. Thus, scale expansion becomes a crucial variable in generating positive employment effects. This means greater regional integration initiatives that ensure greater market access and subsequent opportunities for scale increases are essential. Foreign direct investment distributed according to specialised regional production networks are therefore essential for improving employment, increasing incomes and achieving development outcomes.

EAFQ

PICTURE: EPA / AFP / AAP

Financial integration: an unfinished agenda

SHINJI TAKAGI

FINANCIAL integration can be defined in several ways. But the only relevant definition, in the context of ongoing policy debate in Asia, is in terms of bilateral financial links analogous to the way trade integration is typically defined. No other definition would highlight the asymmetry between trade and finance in Asia. Indeed, some economies are very open financially, and interest rates and equity prices may be highly correlated across some national borders. Despite this, bilateral financial links in the region are much more limited than bilateral trade links.

In 2009, Asia's intraregional trade amounted to more than 50 per cent of global trade, compared to less than 35 per cent for foreign direct investment (FDI) and around 6 per cent for portfolio investment. Asia's so-called market-driven economic integration, therefore, yielded a lopsided outcome. In one sense, this outcome is not surprising. Finance is little affected by distance, whereas for trade distance matters critically. Money should flow to a financial centre that offers the smallest intermediation costs and to a country that offers the highest risk-adjusted returns, regardless of the location.

Even so, regional financial integration remains an important unfinished agenda for Asia. Despite there being no theoretical case for preferring regional to global financial integration, promoting regional financial transactions will

have its benefits. As the region integrates in trade and production, information is created through face-to-face contacts and the specifics of economic activities. Given the nature of asymmetric information that characterises financial transactions, such local information is more conducive to making regional financing deals than global ones. If markets and institutions are sufficiently developed, then there should be some 'home bias' within Asia favouring regional financial transactions. This should be the case even in situations where global transactions offer absolute advantage. The clear lack of home bias in Asia suggests that there are imperfections to be addressed as well as unmet financing needs.

In this respect there are insights to be gained from taking a close look at the cross-border financial links of Japan, the region's largest creditor country. In 2009 Japan's intraregional trade with Asia was more than 40 per cent of its total global trade. In contrast, Asia's share in Japan's financial transactions was only 24 per cent for FDI assets, and was even smaller, at less than 9 per cent, for FDI liabilities. The importance of Asia was almost negligible for portfolio investments: 8 per cent for equity assets, 1 per cent for debt assets and 1.7 per cent for equity liabilities. The exception is Japan's debt liabilities, where Asia accounted for 18 per cent at the end of 2009. This indicates that Asian investors are active participants in Japan's large bond market. In terms of cross-border banking flows, Asia's share was only 7 per cent, broadly similar to the share in total global cross-border bank claims. This suggests that Japanese banks differ little from other international banks in their lending behaviour towards

. . . to promote regional financial integration, the authorities of many of the region's economies must develop their domestic capital markets further, and make them deep, liquid and efficient

Asia. In short, Japan's financial links with Asia are much weaker than the links with North America and Europe, though Asia is by far the most important trading partner.

The pattern of investment activity points to a few possible factors to explain Asia's lopsidedly small share in Japan's financial transactions, and hence the lack of regional financial integration within Asia. First are the underdeveloped and small domestic capital markets. Second are the capital account restrictions that limit the scope for two-way capital flows. Third are the licensing and other regulatory practices that discriminate ex post against the cross-border activity of Asia-based banks.

Accordingly, in order to promote regional financial integration, the authorities of many of the region's economies must develop their domestic capital markets further, and make them deep, liquid and efficient. They should also ease or remove controls on the ability of residents to invest abroad. And finally, they should relax the regulatory barriers on the entry of foreign banks, especially those from within the region. Because Asian financial systems remain largely bank-based, promoting this cross-border activity would be especially important.

Undoubtedly part of the limited financial integration we now observe in Asia is related to the stages of development of many of the economies. Regional financial integration is bound to deepen to a level more commensurate with trade integration as Asian economies grow, per capita incomes rise, and financial wealth is accumulated.

Even so, some of the identified gaps require remedial action by governments. This is likely to be a long process because it involves institution and capacity building. Regional cooperative efforts may be needed to safeguard the process of capital account liberalisation and to relax the licensing standards for Asia-based foreign banks. Similarly, regional cooperation may be useful in setting common standards for domestic capital markets and cross-border issues of financial products. In the long run, a region-wide consolidation of domestic capital markets may help create a market with the size, depth and liquidity that is sufficiently attractive to large international and regional investors. EAFQ

Asia's challenge: rebuilding the global economic order in a generation

SHEKHAR SHAH

WE LIVE in troubled times. The Dow has taken several multi-hundred point hits as fears rise and fall on Europe's debt crisis. The rising debt crisis has left many seriously doubting the United States' ability to provide global economic leadership. And the news about the global economy's slowing down is not good.

Over the long term, no other forum but the G20 can continue to represent the shifting locus of economic power away from the developed economies of the West and to the emerging economies of Asia — and no other is likely to emerge. Even in the short term, following the G20's successful collective response to the 2008 global financial crisis, the world will look to the G20 again to deal with the renewed threat of a global recession. And with all the domestic constraints that Europe and the US currently face on the third round of quantitive easing and further stimulus, the G20 is bound to focus on the role of Asia.

We should strive for two things in thinking about Asia's role in the G20. First, handling the short-term problems of global demand and the anxieties about a double-dip recession. Second, and of equal importance, addressing the question of how to rebuild the global economic order in one generation.

A generation might seem a very leisurely pace of change, but it will take time for both the West and the East to adjust to new economic realities. And pretending otherwise will rule out real opportunities for shaping the G20 into the longstanding forum it deserves to become. It must learn from the Asian experience of steady, even if often slow, economic cooperation.

Let's consider two approaches to addressing these two priorities. First, on the immediate question of sustaining global demand, it now seems clear that the G20 has not been able to repeat the success it had in dealing with the 2008 crisis in the much harder task of rebalancing the global economy. That success put the G20 in a somewhat more complacent mood than it can afford. It may also have placed its Asian members in what the Asian Development Bank (ADB) has called the role of 'a passive onlooker in the debate on global rule-making and a reluctant follower of the rules'. This has to change. The world cannot afford the G20 to lose credibility.

> Adopting an explicit longer-term framework allows us to think about future developments that need to be shaped now, such as the G3 relationship between the US, China and India, and the shape it will be in 10 years from now

Substantially increasing and advancing investments in productive infrastructure is one way of boosting global demand. The report of the G20 High-Level Panel on Infrastructure on ways to boost and improve infrastructure investments in low-income economies will be timely. This report should catalyse an effort by the Asian G20 members at the 2011 Cannes Summit to address financial and other policy constraints in order to generate accelerated investment in economic infrastructure. We need new ways of raising capital and new ways of sharing the risks that will go with the returns from such infrastructure investments. Developing economies such as India will need serious policy reforms, including better governance, better land acquisition policies, and overall improvements to the investment climate. This is a win-win strategy, and falling prey to narrow domestic political interests and bureaucratic gridlock will mean passing up on an historical opportunity for many Asian countries.

Second, when it comes to the

future of the G20 and its role in bringing about a new economic order, much will depend on whether the organisation remains effective over the long haul. Can the G20 be as effective over a generation as it has been in generating the short-term, collective response to the threat of global recession and of competitive devaluations or protectionism? Much will depend on how the Asian emerging newcomers, including India, take up their responsibilities to shepherd the G20 agenda. There is a lot to lose if the G20 descends into nothing more than the old G7 plus others. ASEAN has had considerable experience in coordinating policy responses and domestic policy choices, both those that have been successful and those that have failed. Asian members should bring this experience to the G20. ASEAN's durability and openness to change presents an opportunity for the Asian G20 members to bring this ASEAN spirit to the G20. This will equip the G20 to be effective over the generation that will be required to rebuild the global economic order.

Adopting an explicit longer-term framework allows us to think about future developments that need to be shaped now, such as the G3 relationship between the US, China and India, and the shape it will be in 10 years from now. The relationship between these countries will be important in determining future G20 behaviour. India is today by far the poorest member of the G20. But it is nonetheless the fourth biggest economy in the G20, measured at purchasing power parity, and the 11th biggest measured at market exchange rates. Laying the foundations of a more cooperative relationship now will go a long way towards shaping it in productive ways for the future. EAFQ

INCLUSION OR FAILURE

Asia and global governance

ISHRAT HUSAIN

THE expansion of the G7 to the G20, thereby incorporating Asia, is a welcome step. Economic power relations have changed considerably in the past decade or so and it was thus only natural that the global governance architecture should begin to reflect this new reality. The efforts of the G20 in tackling the 2008–2009 global crisis reinforced the efficacy of this initiative.

The question now is whether the G20 can become an effective coordinating mechanism for maintaining stable conditions in the global economy. If successful, it could promote sustainable and equitable growth for improving living standards while holding inflation under control and generating gainful employment opportunities. The other objectives for the G20 would be reducing global imbalances, keeping markets open for trade and reforming the international financial system. There seems to be a broad consensus on this agenda but anxieties persist over whether the G20 possesses the tools, leadership, culture and authority required to resolve conflict and enforce its decisions. In order to proceed, the G20 will have to confront several challenges.

The first challenge is to demonstrate that the G20 is not an attempt by G7 countries to perpetuate their ascendency by co-opting other countries that have developed economic muscle and thus become critical for the wellbeing of the advanced countries. The G20 must make it clear that it grants equal status to all members and is not simply the G7 plus 13.

Secondly, the G20 will have to address the disjunction that exists between the key international institutions through which it implements its decisions, and those institutions' structure and mandate. For example, the International Monetary and Financial Committee (IMFC) is the policy-setting body for the International Monetary Fund (IMF) and has a system of representation drawing on all its 180 members. But what happens if a decision taken by the G20 is perceived to be against the interests of some of the 160 members represented at the IMFC but not the G20?

Thirdly, there are serious doubts about the quality of the present leadership of the G20 which will need to be ameliorated. The political divisiveness in the US and the tension between the Northern European countries led by Germany and peripheral countries within the EU have made it difficult for either President Obama or Chancellor Merkel to assert any moral authority in the leadership role. Unfortunately, Japan has gone through too many prime ministers in the last few years and the developing countries are too new to the game to take on leadership. This leaves few alternatives.

Fourthly, the culture of the G7 is derived primarily from the Western

PICTURE: AMY SANCETTA / AP PHOTO / AAP

. . . the G20 will have to find a way to legitimise its authority for conflict resolution and decision enforcement

values of direct, decisive and result-oriented action while the Asian countries believe in slow, painstaking, patient dialogue and consensus building. This legacy, inherited from the G7, makes it difficult for newcomers like Indonesia and Saudi Arabia to feel comfortable. It remains to be seen whether the G20 will be able to reach agreements on time and with broad-based support.

Finally, the G20 will have to find a way to legitimise its authority for conflict resolution and decision enforcement. The UN, World Trade Organization and Bretton Woods institutions have negotiated and established agreements, protocols, practices and rules for cooperative mutual governance, resulting in a collective acceptance of each other's decisions. But unlike these institutions, the G20 is merely an informal talk shop where participants can articulate their viewpoints. Suppose China does not think it should appreciate its currency the way the US wants it to, or the US does not think it should discontinue quantitative easing because developing countries are facing undesirable capital inflows. It is hard to see how these differences will be reconciled in the G20 when the IMF is unable to do so, despite the authority it enjoys.

These challenges will hopefully be taken on in future deliberations of the group to try to find solutions. Asia, as an emerging power of the global economy, will have to play a more active role within the G20.

CHINA has already overtaken Japan as the second largest economy in the world and is likely to take over the top spot by 2020. India is moving rapidly up the ladder and will soon become the third largest economy globally. The IMF estimates that emerging Asia will be the main propellant of world economic growth in the coming decades. Europe, the US and Japan face a serious risk of double-dip recession. By contrast, the public finances of Asian countries are in good shape, debt ratios are low, banking systems are healthier, corporate balance sheets are less stressed, and huge foreign exchange reserves act as an insurance against unexpected shocks. Wages and incomes are rising and unemployment rates are nowhere alarming. Regional trade is at an all-time high and the dependence on the US and EU for exports has declined. China ships only 35 per cent of its exports to the US and EU.

These strengths of the Asian economies clearly show why they should be in the driver's seat, or at least the co-pilot's seat, of the G20. The existing arrangements of ASEAN+6 and the South Asian Association for Regional Cooperation (SAARC) should be used to consult other member countries in the region and add their voices to the G20, using the existing six Asian member countries as a conduit. EAFQ

A SEAT AT THE TOP

Asia's role in the G20

WOOK CHAE

FOR MANY reasons, the G20 may be justifiably considered the world's premier economic forum. These reasons are often associated with problems inherent in the earlier G7 grouping. The most prominent among those problems was that the G7 consisted only of advanced industrial countries and thus could not legitimately claim the privilege of making important decisions on global economic issues. For the G20 to maintain its authority in future it must continue to incorporate the developing world, and Asia in particular.

Developing economies now account for around 40 per cent of global GDP and their share is expected to continue rising in the coming years. The Asian economy is projected to take up one half of global production by 2050, given its current pace of growth. This has led many economists and futurists to predict that the centre of gravity for the global economy will shift toward Asia. In fact, that shift is already taking place.

Asia has shown a strong presence at all stages of the G20 process during the global economic crisis, from its first meeting in Washington DC in 2008 to the Seoul Summit last year. While the international community as a whole has been active in cooperating on policies to overcome the crisis and in drawing the basic blueprint for global economic governance, the actions of the Asian countries in this effort were vital. The weight and influence that Asian countries brought to bear was felt throughout every major issue on the agenda, including the resolution of global imbalances, the reform of international financial institutions, the creation of a global financial safety net and deliberations on development issues.

Needless to say, maintaining the vitality of the G20 as the world's premier economic forum hinges on the continuing and dynamic role of Asian economies. This is underscored by the fact that Asia is home not only to the world's second and third largest economies, but also to 60 per cent of the world's population. The region also holds more than half of the world's foreign exchange reserves.

Asia's status in the world economy is unique in that, although it is a major contributor to the global imbalance, it is also in the best position to provide a solution to the problem. The G20 devoted the greatest amount of energy to the issue of global imbalances because it was the most important and difficult one facing the forum. American consumerism can be readily pointed out as a major contributing factor, but the division of production now firmly established within the structure of the Asian economy must take an equal share of the blame.

The structure of the Asian economy involves tariff-free or low-tariff export of raw materials or intermediate goods from Korea, Japan and Southeast Asia to China. They are then processed or assembled in China for export to the US or Europe, thereby adding to the global imbalance. An earnest reform of such trade or production structures is no doubt essential for relieving the pervasive global imbalance. This reform could be realised through trade liberalisation among the countries in the Asian region, with complete removal of tariffs and non-tariff barriers — not just for raw materials and intermediate goods but for

PICTURE: ADRIAN BRADSHAW / EPA / AAP

Asia has shown a strong presence at all stages of the G20 process.

finished products as well.

Another remedy for the imbalance would be strengthening monetary cooperation among Asian economies to promote greater stability of financial markets in the region. This would alleviate strong tendencies by individual countries to accumulate foreign exchange reserves. In this regard, the multilateralised Chiang Mai Initiative (CMIM) regime established among East Asian economies needs to be strengthened and expanded further.

ASIAN countries are expected to play a more active role on the issue of development, a matter of great importance for the G20 and the world. It is worth noting that Asia is a region where major aid donors and recipients coexist. In the region there are OECD Development Assistance Committee (DAC) members such as Korea and Japan, emerging economies like China and India that are leaders in south–south cooperation, and recipients of large international aid like some Southeast Asian countries. The creation of an effective regime for cooperation on regional development in Asia will most likely lead to improvements in global regimes for aid and development.

It was through sheer determination and effort as well as economic growth that Asian economies have attained their place in the sun. But as Asian economies are now being asked to assume a more active role in the decision-making processes of the G20 on important global issues, they are coming under increasing pressure to improve their political and economic capacity. In order to achieve this requirement they will need to strengthen their respective market systems and democratic institutions. EAFQ

AMBIVALENT STAKEHOLDERS

An uncertain path to global economic leadership

HELEN E. S. NESADURAI

EAST ASIA is once again regarded as the world's engine of growth. But whether East Asia will remain a key locomotive for the world economy and become the world's economic powerhouse is not certain. Since the 1997 Asian crisis and the 2008 global financial crisis, such predications have become more difficult as the risks and associated uncertainties increase. Clearly, wealth has shifted to East Asia, which is increasingly integrated with the global economy. But if wealth accords East Asia some political weight in the world economy, the more pertinent question is what this means for the global economic order. Will East Asia support a liberal international order or is East Asia heading towards an economic order characterised by the 'Beijing Consensus' in which there is greater acceptance of illiberal economic and political arrangements with a concomitant substantial role for the state in the market. A related question is whether East Asia's economic weight can translate into leadership in the world economy.

Although East Asian states have adopted pro-integration reforms aimed at liberalising their economies and enhancing market-based economic arrangements, there is still a degree of ambivalence between liberalisation, protectionism and state intervention, despite official recognition of the benefits of competitive markets and global integration. Policy ambivalence is also a feature of regional and bilateral cooperation strategies, such as the rather flexible regional liberalisation schedules and carve-outs in bilateral preferential trading arrangements (PTAs). This mix of strategies is aimed at aiding global market integration but in ways that do not disadvantage domestic firms, sectors or groups deemed to be strategically or politically important. In short, East Asia does support a liberal global economic order, albeit on East Asian terms. While seeking the gains from global market integration, there remains concern with maintaining a degree of domestic policy autonomy in order to meet domestic social and political goals that cannot be attained through the market.

But it is because of these domestic preoccupations that it becomes hard to see East Asia assuming any form of leadership in the global economy. This is not just a question of whether East Asia will be permitted to assume that role, as Kishore Mahbubani recently asked in a 2011 article in the *Review of International Political Economy.* It is also whether East Asia is willing to shoulder the global responsibilities that come with leadership. East Asian states remain constrained by domestic politics that make it difficult for the

PICTURE: BAY ISMOYO / AFP PHOTO / AAP

As wealth shifts to East Asia, a key question is whether the region's economic weight can be translated into leadership in the world economy.

region, either in a coalition of regional states or individually, to assume global responsibilities, because that means acting beyond national interests to safeguard system stability or advance global economic justice. The case of undervalued exchange rates and global imbalances is a case in point. Global financial stability is a global public good that requires changes in domestic economic governance in both the US and East Asia. Although a degree of East Asian leadership is evident in the multilateralised Chiang Mai Initiative (CMIM), domestic political constraints mean that a more effective CMIM will not be easy to come by if that requires a more intrusive surveillance system beyond information-sharing.

China has the wherewithal to act as a leader and no doubt boosted global growth by acting as the world's factory. However, China has much to do on the domestic front, which can make it less willing to take on system stabilising roles, including maintaining liberal markets if these do not coincide with its domestic interests. Whether Japan and China will act in concert globally or even regionally is also uncertain. While the compromise that allowed multilateralisation of the CMIM suggests that such rivalries can be managed, that may not always be possible.

THE prevailing multiple, overlapping and less than reliably effective regional institutional architecture is also unhelpful. Even if the region's different institutions provide functional benefits to members, this alone is not sufficient for international leadership. East Asia's 'concentric circle' approach to regional governance, rather than being mutually reinforcing, can undermine regional coherence and the capacity of the region to act in concert in providing leadership on a range of pressing global and regional issues such as global trade governance, open markets in the region, rebalancing, financial architecture and climate change.

Although East Asian governments rightly challenge elements of contemporary global governance that are ineffective or unjust, and may even offer statist or developmental variants of economic governance, ultimately leadership must encompass more than this. It is not evident at this point that regional states are themselves clear on the kinds of global change or global/regional governance arrangement they want to see. East Asia's preoccupation with domestic agendas and the diversity of domestic interests, the strategic rivalry between Japan and China, and the fragmented and still rather ineffective East Asian regional institutional architecture means that East Asia's economic weight in the world economy may not easily translate into political leadership in the near to medium-term. EAFQ

ASIA AND THE IMF

Stepping up from regional influence to a global role

MOHSIN KHAN

ASIA IS in a strong position to assert itself in global financial governance. The remarkable growth of the economies in the region and their integration in global trade and finance bestow upon Asian states considerable potential clout in international forums and institutions. However, Asia's current influence is not yet commensurate with its economic weight in the International Monetary Fund (IMF), arguably the premier institution in global finance.

Asia's relationship with the IMF before the Asian financial crisis of 1997–1998 can be best characterised as cool, but not hostile. The main interaction between them was in the context of annual Article IV Consultations and the IMF's advice on economic policies was broadly considered useful by Asian countries, although there was no imperative to follow it.

The picture changed dramatically after the crisis hit Asia and the mode of interaction changed from annual consultations to adjustment programs with the IMF. This new relationship between the IMF and Asia had a rocky start and the Asians became increasingly antagonistic towards the IMF. This hostility persisted for a number of years and well after the IMF programs themselves had ended.

The main reason for the breakdown in the relationship was Asian countries' unhappiness with the macroeconomic and structural conditionality associated with the IMF's programs that were negotiated with Thailand (August 1997), Indonesia (November 1997, August 1998) and Korea (December 1997). The conditionality contained in these programs was seen as overly harsh and intrusive and this soured the relationship. Asian countries were convinced that the IMF had misdiagnosed the problems they were facing and had imposed excessive and inappropriate conditionality on the financing it was providing. It is noteworthy that the IMF later acknowledged the mistakes it made, which presumably gave the Asian countries some degree of satisfaction.

There are now signs that the relationship is improving, as seen in the context of the global financial crisis in 2008–2009. While Asian countries made it perfectly clear that they would not again engage in adjustment programs of any type with the IMF, there was Asian support for the IMF in its borrowing arrangements and in quota increases, from which Asian countries stood most to benefit.

Historically, Asia has had a less prominent position in the governance of the IMF than either Europe or the United States. Despite periodic review, the adjustment of quotas and voting shares for member countries has lagged far behind changes in relative economic position, which has operated to the disadvantage of the fast-growing countries of East Asia, in particular. There was a concerted effort over the last decade to redress this discrepancy and this effort has produced significant results. The combined quotas of ASEAN+3 represent 15.7 per cent of total quotas and their votes comprise 15.2 per cent of total votes. If ASEAN+3 voted as a bloc, it could now exercise a veto over decisions requiring the supermajority of 85 per cent, much as the US can do acting by itself. Furthermore, it is worth noting that the ASEAN+6 countries — including Australia, New Zealand and India — collectively command almost 20 per cent of quotas and 19.2 per cent of votes. Although Asian representatives are now becoming more assertive, when the chips are down, some Asian countries have still been reticent in pushing a unified Asian agenda in the IMF.

The process of selecting the managing director of the IMF is a case in point. Asian governments are sometimes frustrated that the United States and European countries have a 'lock' on the positions of the president of the World Bank and the managing director of the IMF — an informal arrangement referred to as the 'convention'. This convention should be broken and these appointments should go to the best-qualified candidates. Because regional diversity is an important consideration, a non-European will sometimes be the best candidate in the case of the IMF and a non-American will sometimes be the best candidate in the case of the World Bank. This does not necessarily mean that the managing director must be Asian, but Asia has a strong claim

to this position as the world's fastest-growing region with large lending commitments to the IMF.

Yet Asian officials have not competed with much determination for this position and, unless they do, Asian governments cannot legitimately complain about the convention. Not since 1999 has there been a formally declared Asian candidate for the managing director post. During the round in June 2011, several Asian names were mentioned for the position but none was nominated.

Asian countries' reservations about the IMF have led ASEAN+3 to develop regional arrangements, principally the Chiang Mai Initiative Multilateralisation (CMIM) and the ASEAN+3 Macroeconomic Research Office (AMRO) for crisis financing and economic surveillance. These arrangements change the international financial architecture for the region in important ways. Yet despite the hopes of some, they cannot be relied upon alone to provide financial stability; instead, they will have to work with the IMF for the time being.

Asia's role in the IMF to date has been limited. Given the size and strength of Asia in the global economy, it is evident that the region 'punches below its weight'. This is partly the result of a conscious choice by Asian countries to keep the IMF at arm's length, reflecting bitter memories of the IMF's role in the Asian financial crisis. But it is also due to the fact that, at least until recently, Asia has not pushed to have a larger say in global financial circles, but has chosen instead to develop its own regional arrangements and institutions. But playing its rightful role in the IMF need not detract from regional arrangements. The global and regional institutions can easily work together in a complementary way. EAFQ

PROGRESS OR PARALYSIS?

An uncertain future for policy reforms in South Asia

DUSHNI WEERAKOON

SOUTH Asia presents an interesting study of a region that managed to implement broadly based structural-adjustment type reforms in the early 1990s, but has since failed to pursue more politically challenging 'second generation' market reforms. It raises important questions about what political, economic and social forces drive or block policy change in the region, and how these have changed over time. Not surprisingly perhaps, the current policy paralysis appears to be the outcome of incentives created by strengthened client-patron relationships permeating the policymaking process across the region.

Institutions, historical and cultural settings, and the stage of development matter in understanding the political economy of policymaking. Across South Asia, there are differences in the way institutions and governance structures have evolved. India and Sri Lanka have relatively mature and established democratic institutions and systems. Pakistan and Bangladesh, on the other hand, have been subject to frequent authoritarian military rule. Yet the commonalities across the region are far greater, emanating from a shared colonial history that saw each country inheriting very similar political and administrative structures.

A need to repudiate links with the past saw South Asian governments strive for national self-sufficiency by enthusiastically adopting inward-looking economic policies. Despite rising evidence that such policies were failing to deliver the desired development goals, the democratic forms of government practised in the region were slow to react, owing largely to the need to build consensus. A hesitant reform process that began in the late 1970s and progressed through the 1980s only became a more comprehensive effort from the early 1990s when India began a major reform initiative.

Many of the key elements that drive reform in developing countries — such as the presence of domestic economic difficulties, pressure from international financial institutions, a break from groups with vested interests and strong political leadership — were present in each of the major reform episodes. Notwithstanding the presence of international financial institutions, national policymakers played a leading role, as evident from the sequencing, pacing and design of reforms.

Bangladesh tackled its agricultural inputs market first, before moving on to more contentious import tariff reforms. Where difficult reforms were implemented — such as withdrawal of food subsidies — compensatory policies such as public works programs were built in, even when they had an

obvious fiscal cost. Yet despite the inroads made, South Asia's reform efforts have drawn considerable criticism for their narrowness of scope.

Nonetheless, there is no reversal of reforms. More importantly, since the mid-1990s, there has been a convergence on economic policy across mainstream political parties in the region. It is thus even more paradoxical that South Asia has been gripped by policy paralysis over the last decade.

A failure to strengthen institutions and governance structures lies at the heart of this paralysis. Indeed, the region's record in most global governance indicators is very poor, with India doing marginally better than its neighbours. The typical rent-seeking activities under a licence regime have been replaced by stronger patron-client relationships between politicians and other key actors in the policymaking process. The concentration of state power has intensified, with political parties dominated by a handful of families, stifling democratic practice within parties, and centralising decision-making.

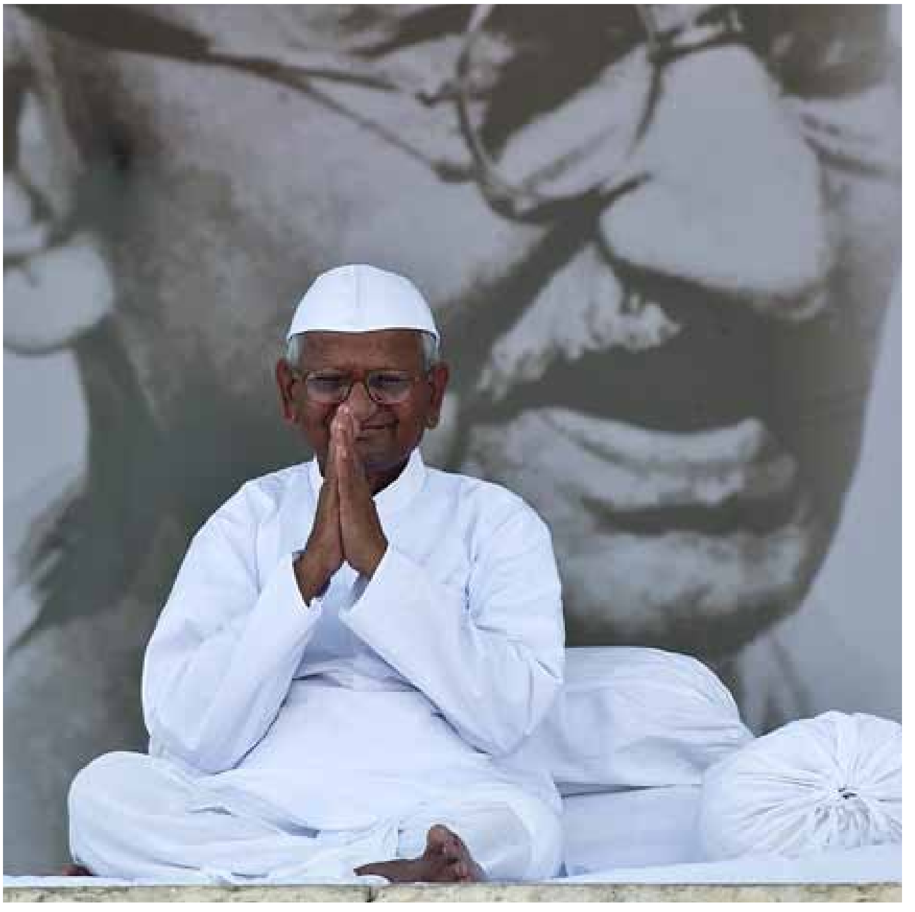
In turn, South Asia's bureaucracy is more politicised and powerful, performing both administrative and political functions as politicians rely on a few 'hand-picked' technocrats to formulate and implement policy. The dual role and discretionary powers they enjoy mean a greater blurring of transparency and accountability in policy decisions, and a distancing of policymakers and elected politicians from their constituencies.

While democracy has spread in South Asia, political party rivalry and confrontational politics is more pronounced, particularly in countries such as Bangladesh and Pakistan. The growth of small parties representing narrow interests is giving rise to minority coalition governments in India and Sri Lanka. They not only hamper reform efforts, but strengthen patron-client relationships. Coalition arrangements require that posts and privileges are dispensed freely, and polarisation in party politics encourages the practice of 'competitive populism' to the detriment of sound policymaking.

In the absence of credible channels through which the public or interest groups can influence policymaking, the region is increasingly seeing judicial intervention being sought as a compensatory mechanism. In Sri Lanka and Pakistan, interest groups have successfully petitioned the Supreme Court to halt or reverse privatisation deals. India has witnessed judicial intervention in corruption scams, as well as petitioners seeking court intervention in pushing forward civil service reforms.

But judicial intervention is not an appropriate compensatory channel to fix weaknesses in institutionalising a reform process. More often than not, governments view judicial intervention as an overreaching of court powers whereby any ensuing tussle holds the risk of compromising judicial independence. Instead of seeking judicial intervention, South Asia should focus on reinvigorating its politico-institutional structures to institute norms and rules that will restrain the drift towards arbitrary action and corruption. EAFQ

PICTURE: MANAN VATSYAYANA / AFP PHOTO / AAP



Indian anti-corruption activist Anna Hazare during his hunger strike in August 2011: norms and rules will also restrain the drift towards arbitrary action and corruption.

Creating community without a grand design

MAHANI ZAINAL ABIDIN

ASIAN institutions for regional integration have proliferated since the 1998 financial crisis. They range from highly formal to very informal. Most were not based on a grand design or mission but were responses to key issues. Some institutions evolved according to the needs of the market, and their final form owes much to pragmatism and flexibility. Others were established following formal agreements: the top-down approach. These institutions have served well to date, but more needs to done to effect region-wide integration.

Thanks to the many initiatives undertaken by ASEAN, the pace of sub-regional integration is fastest in Southeast Asia. By contrast, Northeast Asia is hardly active, and South Asia has a number of slow-moving initiatives.

ASEAN is moving towards more integration through its community initiatives — in economic, political and security, and social and cultural fields. The grouping is also the central force in East Asian integration, which is driven by its initiatives — ASEAN+1 free trade agreements (FTAs), ASEAN+3, the East Asia Summit (ASEAN+6) and the expanded East Asia Summit (ASEAN+6 plus the US and Russia).

Asian countries have also signed many bilateral FTAs. Trans-regional cooperation promoted by APEC is important but its proposal for an Asia-Pacific FTA is a long-term target. On the other hand, trans-regional integration, albeit selectively, is moving faster through the Trans-Pacific Partnership (TPP), partly because the US indicated this initiative is its preferred route for integration.

Besides these established institutions Asia is also seeing the emergence of a cooperation mechanism, and institutions that could be a major influence on the direction and structure of regional integration. A trilateral FTA between China, Japan and South Korea may be possible because these three countries have a very close economic and business relationship. The Greater Mekong Sub-region Economic Cooperation Program is focused on building connectivity, competitiveness and a sense of community among its member states. East Asia has tested a number of mechanisms such as the Asian Bond Markets Initiative and ASEAN Infrastructure Fund to recycle its massive savings for the benefit of the region, but success is still elusive. Another effort is the establishment of mechanisms to help the region avoid and respond better to the next crisis, namely the ASEAN+3 Macroeconomic Research Office (AMRO) and the Chiang Mai Initiative Multilateralism (CMIM).

The various integration efforts continue to serve the region well. Growth is robust and there is a reasonable degree of integration among regional economies, with increased intra-regional trade and investment. The East Asian manufacturing sector is also tightly linked by the regional production network, and East Asian countries kept their economies open during the recent crisis. Growth was able to take place because there is peace and stability.

Yet region-wide integration remains elusive because growth is still dependent on demand from outside the region and the outcome of bilateral FTAs is unclear.

More than ever, comprehensive regional integration is crucial. Without it, Asia will not be able to become the third global node of growth because it will not be able to ensure existing liberalisation commitments are implemented uniformly across the region. Comprehensive integration would also ensure the region is compatible with the global economic system.

EXISTING and new regional mechanisms must help Asia manage future economic and financial crises, especially if they are caused by massive capital flows that can destabilise markets and exports. Regional integration will also have to narrow the development gaps between Asian member countries.

Achieving economic integration alone is not sufficient — in the future the region needs to build an Asian community. Even the economic challenge of responding to the shifting of the centre of economic gravity to Asia has become more daunting because growth now has to come from domestic demand. A strong response from Asia requires physical

connectivity. The biggest challenge is to persuade member countries to give up some of their sovereignty so that decisions can be made at the regional level for faster implementation.

Can Asian institutions produce the desired regional integration, and can they deal with the new issues facing the region? In the past, issues have determined the type and structure of integration institutions. But the recent proliferation of institutions and regional architecture for integration, and the increased complexity of emerging transnational challenges, may require different kinds of institutions and players.

BUT WHAT is the best way to proceed? With so many institutions already active or planned, should Asia create new ones, strengthen existing ones or even consider consolidating some? How can Asia strike a balance between structure, flexibility and dynamism? Now is an opportune time for Asia to answer these questions and establish the best way to approach regional integration.

The 'looseness' of the Asian integration process has been touted as the most suitable ideology for institutions, as it can take into account the wide variety of developmental, social and political systems. But there is a growing call for structured and institutionalised integration that will accelerate progress.

Nonetheless, Asian integration is likely to continue as an agglomeration of many frameworks and agreements and not follow a 'grand design'. In all these configurations, the most pressing question is whether Asian countries are prepared to give up some of their sovereign powers that will be vested instead in a region-wide institution.

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FIXING THE OLD

China's role in global and regional architecture

SUN XUEGONG

INTEGRATION in the regional and global economies is an important aspect of China's rapid rise. China's interests now lie well beyond its border and extend around the globe. This reality has prompted China to actively engage in regional and global architecture to assure that its rise continues peacefully.

China's participation comes at a critical stage. Due to the changing landscape of the world economy and the reverberations of the financial crisis, the global and regional architecture is bound to vary. In East Asia, a region emerging as the powerhouse of the world economy, there are competing visions for regional integration. The financial crisis has reshaped the global architecture as new challenges no longer rest on developed countries to solve. China has tentatively set its strategy to participate in global and regional architecture, weighing its responsibility, capability and the benefits it can gain. Five focal points have been developed thus far.

> Faced with common challenges in climate change, food security, energy security and many other fields, China has strengthened its cooperation with emerging economies.

The first is to promote the G20 as the main platform for global economic governance. Compared to the G2 and the G8+5 the G20 provides a more even representation from both developed and emerging economies, which China finds appealing. On the one hand, China does not want to be seen as detached from other developing countries due to the potential political fallout. On the other hand, the presence of other large developing countries like India helps take the heat away from China.

The G20 is still only used to deal with emergencies rather than an institution for managing and charting the global economy on a regular basis. China is pushing for that transformation within the G20. Work within the G20 is one of China's top priorities in global architecture participation.

Revamping the existing international institutions is the second

PICTURE: WU HONG / EPA / AAP

Container trucks load up at the port of Qingdao, in Shandong province: China relies on the multilateral trade system to advance its development.

focal point. The prolonged sovereign debt crisis on both sides of the Atlantic highlights the inability of the International Monetary Fund (IMF) and the World Bank, both of which had their credibility damaged in East Asia because of the widely perceived mismanagement of the Asian financial crisis. China prefers to amend rather than dismantle these institutions. With increased voting weight and the appointment of Chinese nationals to management positions within these institutions, China is assured a role in managing the reform process which it will ensure is in the interest of developing countries.

The third focal point is to support and improve the multilateral trade system. With fledgling bilateral and regional free trade agreements (FTAs), China relies on the multilateral trade system to advance its development. As the biggest exporter in the world, China has a great stake in an open and non-discriminatory multilateral trade system. The early conclusion of the Doha round negotiations has been in China's interest. There is concern, however, at the attempts by developed countries to limit market access due to social and/or environmental standards. As the stakes are so high for China, we can expect to see it take a more active role in the negotiation.

TO PUSH for greater regional integration is the fourth focal point. Regional integration is economically and politically important to China. Riding the wave of Asia's rise will help to sustain China's growth in the long term. More importantly, regional integration will provide a mechanism to minimise the likelihood of potential conflicts between countries in the region through increased interdependency. Clashing with its neighbours is the last

thing that China wants. China takes an active but also realistic position in pushing for regional integration. China is open to the possibilities that regional integration will bring but it also believes the short-term focus should be on 10+1, 10+3 and China-Japan-Korea cooperation. The Shanghai Cooperation Organisation (SCO) is another platform that China uses to strengthen its cooperation with Central Asia and Russia. The SCO has played an important role in stabilising the security situation in the region. It is expected that the SCO will go beyond security issues and expand into the economic field in the future.

The final focal point is to deepen the cooperation with emerging market economies and developing countries. Relations with developing countries have always been the foundation of China's foreign policy. In this manner, China will continue to reach out to developing countries through such mechanisms as the China-Africa Cooperation Forum and the China-Arab Cooperation Forum. Faced with common challenges in climate change, food security, energy security and many other fields, China has strengthened its cooperation with emerging economies. The BRICS grouping — Brazil, Russia, India, China and South Africa — has emerged as the main mechanism for emerging market economies to cooperate and coordinate. China will support BRICS to play a large role in international affairs.

China's upward trend will only continue if it becomes more involved in regional and international architecture. Nonetheless, this process is likely to take a long time as China is not fully prepared for this role and is preoccupied with a heavy domestic agenda. EAFQ

TAKING ON RESPONSIBILITIES

What does China want in global economic reforms?

YIPING HUANG

THE current international economic system is defined by three key features. First, the United States is a dominant leader in designing and enforcing the international economic rules. Second, the US dollar is the cornerstone of the international monetary system. Third, three international organisations — the International Monetary Fund (IMF), World Bank and World Trade Organization (WTO) — are responsible for maintaining order in the international economy.

For more than half a century this system facilitated steady growth of the global economy. But recently there are growing calls for reform. Two important events have strengthened these demands. The first is the ascendancy of emerging market economies, with calls for some emerging economies to move to the centre stage of international economic decision-making. The second is the subprime crisis in the US, which raised serious questions about the future international roles of the US and its dollar.

> . . . as the world's second largest economy, China needs to abandon its small-country mentality.

China is likely to play an important part in the transformation of the international economic system. It is already the second largest economy in the world according to market-based GDP measures and may overtake the US as early as 2013 according to the purchasing power parity-based GDP measures. China's international economic influences have grown exponentially, especially in international markets for labour-intensive manufactured goods, raw materials and commodities and foreign exchange.

Given the significant role it is likely to play in the process, a key question for reforming the international economic system is: what does China want?

First, China wants reform, not revolution, of the international economic system. It recognises that the world has become a multipolar system, with a number of large economies possessing significant influence on the world economy. China shares many of the economic values of these nations, including those that relate to free trade and investment, and is keenly interested in working with the other major countries in building a 'harmonious

world'. While some existing rules are in urgent need of reform, China wants to improve the existing international economic system, not abandon it.

China sees the G20 as the best compromise between representativeness and efficiency for dealing with international economic issues and is interested in making it a permanent institution. The Sino–US partnership will remain a cornerstone for China's international economic relations, but China is not ready to formalise the institutional arrangement of a Group of Two (G2) for global economic affairs. China promotes collaboration among the BRICS countries (Brazil, Russia, India, China, South Africa) but regards the association more as a platform for formulating policy positions among key emerging market economies, not as a parallel organisation alongside the G20.

China favours any restructuring initiatives that give more influence to emerging market economies within international organisations such as the IMF and the World Bank. While these organisations have made important contributions to China's economic reforms, their governance and rules should be reformed to better reflect the new reality of the world economy. IMF reforms, for instance, should allocate more voting shares to developing countries, give up the practice of appointing Europeans to its managing directorship, abandon the US veto power and set policies more appropriate for emerging market economies.

China supports reforms of the international monetary system but sees avoiding the sudden collapse of the US dollar as critical. The transition of the global reserve system is likely to be a long-term process. China, the US and the other major economies of the world should work together to ensure a smooth transition of the role of the dollar, which is critical for providing a stable global economic environment. China also wishes to internationalise the renminbi, which could eventually become part of a multi-reserve system.

PICTURE: FRANÇOIS MORI / AP PHOTO / AAP

China's Central Bank Governor, Zhou Xiaochuan, and IMF chief Christine Lagarde: China wants to improve the international economic system, not abandon it.

If China wants to see other countries cooperate in making these desires a reality, it will have to acknowledge and follow through on its own responsibilities. For example, as the world's second largest economy, China needs to abandon its small-country mentality. Economic decisions by any large countries should take into account the possible effects on, and reactions of, other countries.

China must also promote further liberalisation of its own economy and move closer to a market economy, including reforms of its exchange rate regime, capital account controls and distortions in other factor markets. At the same time, China should also promote private sector development and contain the influence of the state sector, especially in international economic areas. This is critical for supporting an open and efficient international economic system.

Finally, it is time for China to learn to work with the US and other G20 members to provide public goods services for the world economy. In line with China and the other emerging economies asking for more rights, they should also share more of the responsibility in maintaining a stable global economic environment, enforcing the international economic rules and assisting countries temporarily struck by adverse economic shocks. EAFQ

EMERGING PRIORITIES

Indonesia and global development

SRI MULYANI INDRAWATI

THE global economic recovery remains fragile and uncertain, as risks posed by high energy and food prices, unemployment, and uncertainty over sovereign debt in Europe and the US continue to cloud the horizon.

As key members of the G20, both Indonesia and Australia understand the role of this grouping, and multilateral cooperation generally, in addressing such challenges.

Yet we sometimes forget that the global economy has new drivers, overlooking the fact that emerging markets have become a critical force on the global stage. The World Bank's 2011 Global Economic Prospects, for example, projects average global growth of 3.3 per cent this year and 3.6 per cent in 2012. By contrast, emerging and developing economies are expanding, on average, by 6 per cent or more each year. This trend is set to continue.

For the G20, the changing nature of this fast-evolving multipolar world economy presents both opportunities and challenges. Specifically, it is imperative that the G20 focuses on pro-poor growth through quality infrastructure investment, more inclusive finance and the promotion of food security, in order to remain relevant.

Investing in quality infrastructure can provide outstanding returns in terms of growth and development outcomes. But for many developing countries, financing for critical infrastructure investment is inadequate. According to the World Bank, current infrastructure investment and maintenance needs in developing countries are more than US$900 billion a year, but actual infrastructure spending is only around half that level.

Promoting financial inclusion is another high priority for the G20, as around half the world's population has no access to credit, bank accounts or payment services. Increasing access to innovative, low-cost financial service delivery models has been the subject of serious effort and the World Bank is promoting services like branchless banking and the use of mobile phones in rural areas.

> The emerging financial architecture in Asia is now significantly shaped by ASEAN and, as the largest economy in Southeast Asia, Indonesia is the voice of this grouping in the G20

The third challenge is food security: agricultural productivity is low and global food prices are at almost record levels. Combined with continued volatility, the poorest people in the developing world remain at risk. Consequently, G20 agricultural ministers endorsed a package of measures for consideration by G20 leaders at the November 2011 summit in Cannes. One such measure will support the increased transparency of food stocks and production, which will help to reduce uncertainties in the market and better match supply with demand. The G20 also agreed on exemptions for humanitarian food shipments from export bans, so as to reduce the chance that people go hungry in times of crisis because of trade barriers.

EQUALLY, the G20 is encouraging the wider use of market-based instruments to help manage food price volatility. The World Bank's private sector arm, the International Finance Corporation, has launched a new initiative to help cushion the effects of price swings for producers and consumers in developing countries.

The most critical challenge in tackling this issue over the long term is to improve agricultural productivity and resilience, requiring greater investment in agriculture. To this end, the World Bank has doubled its funding for this sector.

The Global Agriculture and Food Security Program, which was set up by the World Bank at the request of the

G20, is also sponsoring food security plans and promoting smallholder agriculture. To date, six countries — including Australia — and the Bill and Melinda Gates Foundation have pledged about US$972 million over the next three years. The program has already allocated US$481 million to 12 countries.

Indonesia is working with other G20 members to address these key development challenges, and also has the potential to provide a strategic international forum to advance the former's national interests and support its global responsibilities.

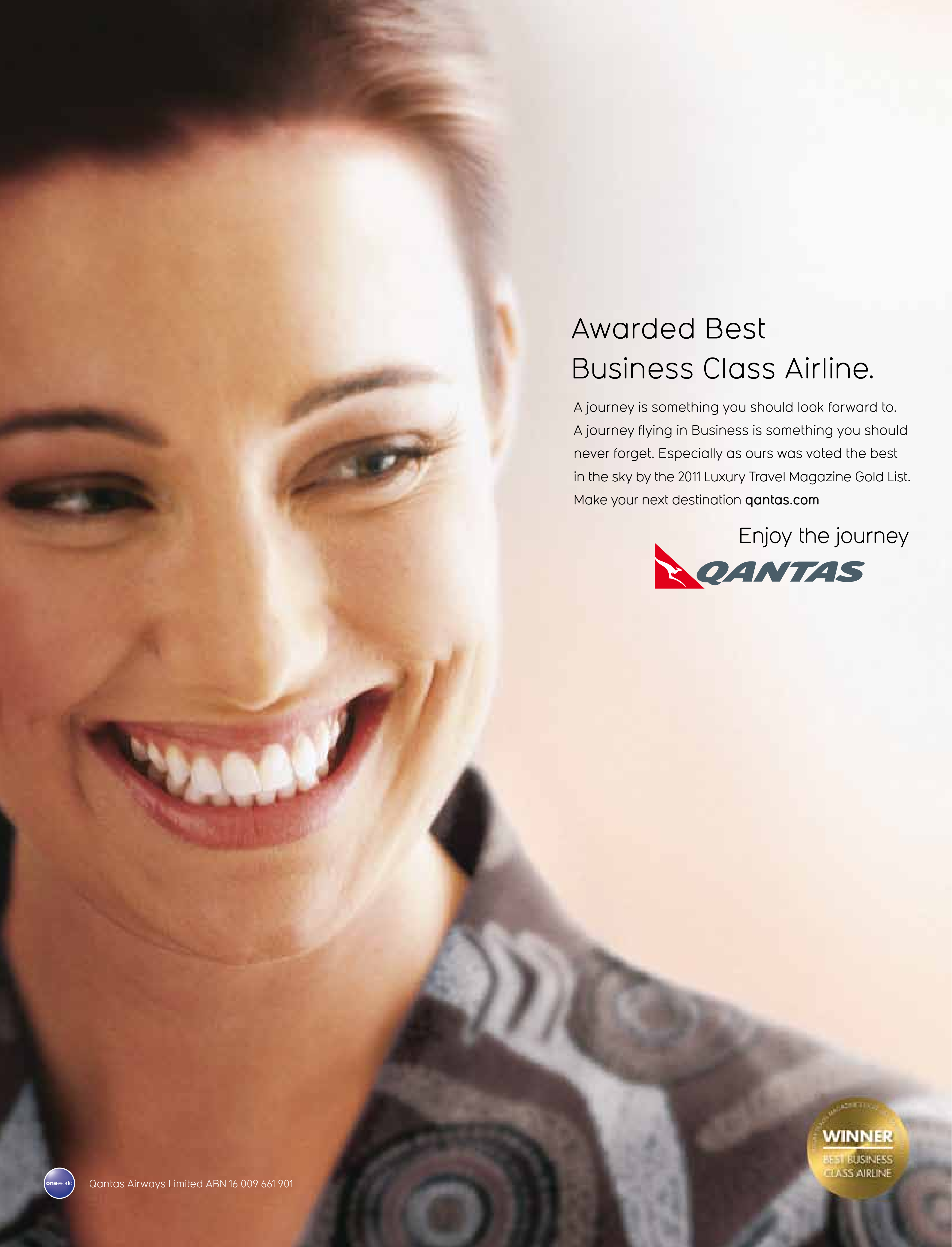
But as the economic landscape shifts, so too does that of global governance. The emerging financial architecture in Asia is now significantly shaped by ASEAN and, as the largest economy in Southeast Asia, Indonesia is the voice of this grouping in the G20.

THERE are many ways Indonesia can contribute to the development of a multilateral consensus in the G20. As a country that has survived deep economic and political crises, it has lessons to share. The country worked hard to come back bigger, better and more resilient after the Asian financial crisis and key economic and political reforms were implemented to reduce vulnerability and to strengthen the country's financial systems.

Indonesia is learning from the expertise and collaboration that comes through its participation in global forums, but it too is taking development policy and solutions forward through the G20. Indonesian perspectives are important at a time when emerging economies will be the key to global post-crisis recovery and the fight against poverty. EAFQ

PICTURE: FIRDIA LISNAWATI / AP PHOTO / AAP

Harvest in Jati Luwih, Bali: the challenge in managing food price volatility over the long term is to improve agricultural productivity and resilience, which requires greater investment in agriculture.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