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ASIA AND THE G20

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Asia and the G20[1]

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The industrial transformation of Asia is a development on a scale unprecedented in human history.

Following the industrial revolution towards the end of the eighteenth century, Europe and North America each in turn came to dominate the world economy and global power. Now economic weight is shifting towards population weight due to convergence in productivity. Asia is re-emerging as the world's biggest element in the world economy. In 1980, Asia produced just under 20 per cent of global output measured at purchasing power parity. In 2010 that share was 35 per cent.[2] This has happened in the space of a few decades whereas it took more than three quarters of a century for the industrial revolution to transform the European economy and political power.

In the last twenty five years the economy of China, a nation of 1.3 billion, has grown by a factor of twenty. Twenty years from now, even ten years from now, Asia's influence will be even greater.

By 2025, one in two of the world's population and four of the 10 largest economies will be in Asia. Asia is likely then to account for almost half of the world output and more than half world trade, with China accounting for half of that. In 2010, China's per capita income was 30 per cent of the United States'; by 2050 it will be 55 per cent and India's likely 42 per cent. The Chinese economy will likely be bigger than America's within the coming half decade.

Asia has never been of greater global significance, as global economic and strategic weight shifts from west to east. Global institutional frameworks are coming to reflect this, with six Asian members of the G20, including Australia.

These developments set the context in which the G20 has emerged as a new fulcrum for global economic governance.

Genesis of the G20

The genesis of the G20 is in reality a tale of two crises. The first — the Asian financial crisis — led to the creation of the G20 as a meeting of finance ministers and central bank governors from nineteen of the world's largest economies plus the EU. The second — the global financial crisis — led then-US president George W. Bush to elevate the G20 to a leaders' level meeting. This decision effectively made the G20 the pre-eminent forum for international economic policy coordination. While there was, and there remains, resistance to the change, the G20 has replaced the G7 as the centre of global economic governance. Bush's hand was forced by the dire circumstances in which the global economy found itself in 2008. Replacing the G7 with the G20 has represented nothing short of a

[2] IMF (2012a) Here Asia is defined as ASEAN + 6 as well as Taiwan and Pakistan.

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revolution in international economic governance, one made necessary by the profound change that had occurred in the structure of the world economy over the past few decades.

In 2008, the G7 economies represented only 41 per cent of the global economy, expressed at purchasing power parity, compared with 56 per cent in 1980.[3] The declining share of the G7 economies was primarily the consequence of the extraordinary rise of Asia over the past three decades. China alone grew from 2 per cent of the global output to 12 per cent in this period and can be expected to only grow in importance, a success mirrored, or being mirrored, in the growth of Korea, India, and Indonesia among other economies.

The move from the G7 to the G20 was necessary to create a forum more representative of the global economy and the influences that shape global economic outcomes; at its formation, the G20 countries represented 83 per cent of the global economy, at purchasing power parity[4], and 80 per cent of world trade.[5] The G20 was also necessary because it was no longer possible, nor did it make sense, to attempt to coordinate global economy policy without involving the emerging Asian economies. In 2010 the Asian G20 members[6] represented 25 per cent of world trade [7] and 46 per cent of total global reserves;[8] any attempt to coordinate policy that did not include them would be international coordination in name only. The emerging economies were central to the solution of gathering economic problems. The G20 therefore includes six Asian countries, which, as a result of their size and dynamism, have an important role to play in shaping the future direction of the G20. Their inclusion has not only given a new legitimacy to the activity of coordinating international economic policy, but fundamentally changed global governance.

This transformation in global governance is a remarkable achievement. It is rare, if not unique, in the history of mankind that great powers have leadership and ceded responsibility to new or emerging powers in this way. While in the establishment of the G20 summit there has, of course, been no automatic cession of territory, sovereignty or legal authority from the established powers (though some has been set in train such as in respect of governance in international financial institutions), providing the emerging powers with a seat and authority at the global table of decision-making is a profound concession that has already changed the way in which world affairs are conducted.

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[3] IMF (2012a)
[4] *ibid*
[5] IMF (2012b)
[6] Australia, China, India, Indonesia, Japan and Korea.
[7] IMF (2012b)
[8] World Bank (2012a)

Why the G20 is needed

In 2010, global trade was US$30.3 trillion dollars, or 48.1 per cent of global GDP, [9] while in the 15 years to 2010 international capital flows have risen from US$15 trillion to US$100 trillion, or more than 150 per cent of global GDP.[10]

The dramatic increase in the importance of trade and international financial flows for the global economy has seen many areas that were traditionally considered domestic policy issues now have important effects on other countries. There are global externalities — positive and negative spill-over effects beyond national borders — associated with domestic policy developments, and that will mean that there are globally suboptimal outcomes if each country tries to determine its policy in isolation of other major players. Hence there is a need for a mechanism to allow individual countries to coordinate policy in all areas where there are significant global externalities.

The task is to identify those areas of domestic policy where the international externalities are most significant. Because of the scale of trade and financial flows today, as well as the powerful interactions among investors and consumers globally, macroeconomic policies in one country have large effects on other countries, through the effect on the domestic country's exports and imports, investment and spending decisions. In times of recession, the risks become particularly acute, both of countries pursuing policies with large negative externalities and of inaction in areas of policy where large positive externalities make collective action desirable.

The growth of financial flows has made it clear that a financial crisis in a large financial centre is no longer a domestic problem. The strong connections between financial markets mean that poor regulation in one jurisdiction, increasing the risk of a crisis, creates a negative externality for the rest of the world. As the global financial crisis has demonstrated, this externality is potentially significant, making regulation of financial markets the second important area of policy where international coordination is needed.

Another that might be added to this list is climate change, although that thus far has been dealt with in other forums. A single large country failing to act in the area of climate change imposes a significant negative externality on other countries; conversely, if several large countries act together, this creates a positive externality for those countries which don't act, creating a free-rider problem.

Not all problems which are considered of global significance are the consequence of a lack of coordination between individual countries. There is pressure to include problems relating to development and international aid on the G20 agenda. The problem here is to determine whether wealthier countries are doing enough to promote development, and, if not, whether and in what way

[9] IMF (2012a)
[10] Cecchetti, S. (2011)

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this failure is the direct result of some externality. In truth, there are many positive externalities associated with the development of poorer countries. However, the failure of developed countries to do more to promote development is unlikely to be the result of a lack of policy coordination; rather, it is more likely a reflection of these countries' own social or public policy choices. To the extent to which there are externalities, these are probably less substantial when compared to those related to macroeconomic policy coordination or financial market regulation.

How the G20 should operate

Granted that there are cases in which a lack of coordination will lead to countries following globally suboptimal policies, how can policy coordination remedy this? The situation where individual actions impose externalities on others is equivalent to a coordination game where the Nash equilibrium of the game is not Pareto optimal[11]. We know, by the Folk Theorem,[12] that when such games are infinitely repeated and played with perfect information by players who do not discount the future too heavily, any outcome can be supported as a Nash equilibrium by a particular set of strategies.

International policy coordination is indeed a repeated game. Changes in political leadership might make it questionable whether the game is infinitely repeated; but if one takes as the players the countries themselves, and treats GDP levels as the countries' payoffs, the argument is at least plausible. It is clear, however, that information on the nature of this game is imperfect: players do not necessarily know what the other players' payoffs are; indeed they are even unlikely to have perfect information about the effect of certain domestic policies on their own payoffs.

This is the first effect of international cooperation. Meetings between officials, ministers and leaders allow these representatives to exchange views on each the others' economies, their assessment of what the effect of other countries' proposed policies would be on the representative's own country, to propose a course of action they plan to follow or think other countries should follow and share the policy experience which informs their thoughts about policy strategies and outcomes. This exchange of information allows different countries to get closer to a situation in which the Folk Theorem holds, and superior policy outcomes are likely to follow. Once the conditions for the Folk Theorem hold, countries still need to coordinate their decisions an optimal set of policies. Providing an opportunity to do this is the second effect of international cooperation.

More often than not, the G20 summit itself will not be the forum in which this cooperation takes place. Instead, macroeconomic policy coordination will take place among officials (the sherpas to the summit), at the G20 finance ministers' meetings and with the IMF. Coordinating financial regulation takes place through the Financial Stability Board (FSB) and the Basel Committee on Banking

[11] One example of this equivalence is in the work of Cornes & Sandler (1985) and Bergstrom et al. (1986), who explore the strategic nature of individual decisions about how much of a public good to consume.
[12] See, e.g. Binmore (2005)

Supervision (BCBS). Coordination on trade policy largely takes place in the WTO, among ministers and representatives. The G20 leaders' meeting allows countries to agree on the structure and *modus operandi* of the forums in which they will actually coordinate policy and most importantly to set strategic direction and targets. The importance of getting the right agreement must not be overlooked. A large part of the current economic crisis can be imputed to a failure in international policy coordination. This can be traced back to the fact that the organisations responsible for coordinating policy had their organisation and their agenda set by a forum which represented too small a share of the world economy, the G7, or were not adequately advised in other ways. It is partly for this reason that the G20 represents an important and necessary progress in international policy coordination and governance.

Information sharing is not the only way to overcome the problem presented by externalities. International coordination organisations also create an opportunity for countries to internalise international externalities, in the spirit of a Pigouvian tax, by creating a system of punishments for failing to act in the globally optimal manner. These punishments can be explicit, as in the case of WTO sanctions. They may also be implicit. By drawing countries and leaders into making commitments to implement recommendations of policy-coordinating bodies such as the IMF, G20 leaders' summits create a non-material cost for failing to see these commitments through. These non-material costs principally stem from the effects on a country's or a leader's reputation if a commitment is not honoured and the political damage that such reduced standing can impose.

Here there is an analogy with the way the legal system and the tax code are often designed to internalise the costs of an externality. The cost to a local community of, say, a factory polluting the local stream might be internalised by the factory through a set of fines that the factory must pay if it does pollute the river. Yet this analogy should not be taken too far. International organisations such as the G20 or the IMF do not have the authority over nation states that a nation's legal system has over its citizens.

The costs, both explicit and implicit, of failing to act in the globally 'responsible' manner should therefore not be overstated. The only costs that can be imposed on a country for acting in a globally irresponsible manner are those costs that other countries actually have it in their power to impose. These might include retaliatory measures, such as trade sanctions or currency devaluations. Costs such as fines, on the other hand, provisions for which are included in the European Fiscal Compact for countries in breach of the their obligations, cannot be imposed; a country would not pay these fines unless a credible threat of greater costs existed in the case of non-payment. The existence of international organisations like the G20, the IMF, or the WTO, does not therefore create a new set of sanctions that can be imposed on participating countries in violation of their obligations. Rather, it

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simply formalises and makes more predictable the forms of punishment which are already available to individual nation states.

Because the G20, and the organisations that report to it, is not a global government with supra-national authority, the most important mechanism by which the G20 allows for coordination therefore remains through the exchange of information, particularly by sharing policy experience. The G20 will work best when individual countries bring forward domestic policies, discuss and agree on what these policies' effects on other countries will be, but where the responsibility for implementing policies, and the costs of failing to do so, lies squarely with the individual countries. But giving individual countries buy-in to the process does also create incentives and an environment in which the chances of the responsibilities towards the public good and collective action are enhanced.

What has the G20 done and what is to be done?

The story so far

The first and, to this day, most important task of the G20 has been resolving the financial crisis and its economic consequences, particularly the widening gap between capacity and effective demand, which has created a risk of deflation and depression, and eliminating the conditions that caused the crisis.[13] This started with the crisis management of the Washington and London summits and the agreements to coordinate fiscal and monetary policy and refrain from trade protectionism.

There has also been some progress in reforming the international financial institutions to make them more representative of the changing global economy and, thereby, better able to fulfil their role in coordinating domestic economic policy. The Financial Stability Forum has had its membership enlarged, becoming the Financial Stability Board. An agreement has also been reached on reform of IMF quotas, but this reform has not yet been implemented. US recalcitrance on this matter has not yet been overcome and the leaders' optimistic pledge at Los Cabos that it would be passed in time for the Fund's 2012 was not honoured.

The G20 has also met with some success in reducing the imbalances that led to the crisis. Notable successes in this area was the Pittsburgh summit's *Framework for Strong and Sustainable Growth*, which includes the Mutual Assessment Process and the system of Action Plans that subsequent summits have produced, and the agreement at the Toronto summit on deficit reduction targets to be reached by 2013, and target debt to GDP ratios for 2016. These measures need a common approach to measuring progress of macroeconomic policies against previous commitments, taking changing economic circumstances into account, if they are to be taken seriously. The Los Cabos *Accountability Assessment Framework* is a step in this direction, but only a step.

[13] For a more detailed review of the achievements of the G20 to date, see Pisani-Ferry (2011).

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At the time of the Seoul summit, the feeling was that the worst of the crisis had passed and the world could now turn to addressing less pressing but important problems, such as underdevelopment or food and energy security. Since then, the events of the Euro crisis have overtaken the G20, which finds itself both straddled with an ambitious development agenda, set out in the Seoul multi-year action plan and faced with a major international crisis which cries out for a coordinated solution. The G20 needs to prove itself up to managing this crisis by returning its focus to international economic policy coordination to make the present crisis as short and mild as possible.

The European Problem

The Euro crisis was several years in the making. A decade-long stimulus, caused by government spending in some countries, a housing boom in others, caused increases in prices and wages out of proportion with productivity growth. This caused unit labour costs in countries such as Spain and Greece to increase by over 20 or 30 per cent more than unit costs in Germany.[14] These countries slowly became less competitive, a fact the sudden withdrawal of the source of stimulus has exposed.

There are three possible channels for countries in crisis to adjust: a depreciation, which would require leaving the Euro, prolonged deflation, or labour migration to better match the supply and demand of labour. Estimates of intra-European labour mobility vary from year to year, but are consistently lower than estimates of inter-state mobility in the USA: in the order of 0.1-0.2 per cent of the labour force annually, compared with 2-2.5 per cent.[15] Without this adjustment mechanism functioning properly, the single currency and differences in unit labour costs will inexorably cause persistent disequilibria among countries in the European Union.

There is no sign that a relative wage deflation is about to start. Similarly, increasing labour mobility in Europe will only take effect very gradually and will require, among other things, increasing the portability of social entitlements,[16] which is currently not on the European agenda. This means that all the adjustment will have to take place through deflation in deficit countries, with continuing uncertainty about whether this will be politically sustainable or whether Greece in particular will simply take the easy option and devalue. This creates risks for the rest of Europe via the banks elsewhere in Europe which lent to profligate governments on the European periphery. European banks are therefore unwilling to lend, depressing output elsewhere in Europe. There is no easy way to ease bankers' fears. Because European governments are already heavily indebted, they are reticent to act as guarantors for southern European debt. So Europe is condemned to suffer as misalignments in real exchange rates correct themselves at the price of slow and painful deflation.

[14] Zemanek et al. (2009)
[15] IZA 2008
[16] World Bank (2012b)

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When the global financial crisis hit the U.S. and European economies in 2008, the emerging economies in Asia— with their high rates of growth, huge current account surpluses and export-oriented growth strategies— were an easy target for those in the industrial world who had difficulty coming to terms with the mess they had made of managing financial markets in an era of seemingly unlimited cheap international capital. Rebalancing global growth became the mantra for how to shape the contribution of emerging economies to ending the global recession, temporarily hiding the need to rein in structural deficits and financial imprudence in the developed world. As Europe teeters finds itself in the throes of this renewed crisis, threatening to shatter confidence in America's tentative recovery and global markets, emerging economies have come to be seen as the saviour of global economic growth rather than a culprit of the current mess.

Performance in China

Until recently, China's current account surplus was seen as a big problem but the current account surplus fell from over 10 percent of GDP in 2007 to 2.8 per cent of GDP in 2011. The International Monetary Fund's most recent prediction is that the current account balance is likely to remain at normal levels with forecast surpluses of 2.3 per cent and 2.6 per cent in 2012 and 2013 respectively.[17] In September last year, the IMF was still forecasting a 5 per cent current account surplus this year and the IMF's 2011 Article IV consultation with China identified the current account surplus as a problem that needed to be fixed.

With decreasing trade and current account surpluses, declining foreign exchange reserves and even expectations of currency depreciation late last year, estimates of the undervaluation of the renminbi (RMB) have been drastically revised downwards. Wages have in fact risen rapidly (with all the indications that a wage explosion is on the way in the industrial coastal provinces), implying appreciation of the real exchange rate in China; and while regulated interest rates did not change much, the proportion of financial intermediation subject to market-based interest rates has risen sharply. There is also growing evidence of major steps toward capital account liberalization, most obvious in the purposeful policies being put in place to internationalize the RMB. These are exactly the types of changes that are driving a rebalancing of the Chinese economy and are needed to drive recovery of consumption.[18]

The Chinese authorities may have not taken many concrete steps yet to rebalance the economy.[19] The People's Bank of China (PBOC), for example, has not yet moved to liberalize interest rates; rather interest rates that are market-based have started to play an increasingly important role in China's financial intermediation. Policy has, however, moved to make the currency more flexible and to

[17] IMF (2012a)
[18] Huang (2012)
[19] Lardy (2012)

moderate distortions in energy markets. Changes in both labour and capital markets have also impacted positively on consumption in two ways. They have increased household income and reduced what were effectively subsidies to Chinese enterprises. Rising wages and interest income also advantage low-income households and will gradually help improve income distribution.

Some argue that the declines in China's external surpluses are in large part the result of a weak global economy and a modest appreciation of the RMB, not a fundamental rebalancing.[20] The underlying drivers of the surpluses that emerged during the boom years — negative real interest rates on deposits, cheap credit for corporations, and subsidized land and input prices — are all still in place. But the pressure through the market for policy change is powerful and the current consensus is that the external surpluses are unlikely to return once the global economy recovers.

The Asian solution?

Returning government budgets to surplus and waiting for structural reforms to eliminate disequilibria will take years, and will take longer the lower growth is in the short-run. And while emerging economies in Asia and elsewhere have held up reasonably well during the crisis, it is clear that these economies will suffer too if advanced economies do not start growing more rapidly. The current outlook for both China and India is weak. There is real need for a concerted stimulus to the global economy and the G20 is the place through which to make this happen. Close to five years of crisis mean that fiscal and monetary stimulus is no longer possible to sustain for many G20 members, so another source of short-term economic growth is needed.

Emerging economies are in a position to increase domestic demand by investing a greater part of their large savings at home rather than abroad. The emphasis thus far has been on expanding consumption. But investing in infrastructure also presents a golden opportunity for doing this.[21]

The need for better infrastructure in emerging Asian countries is undeniable. With booming populations in some countries (India, Indonesia) and rapid urbanisation in all of them, particularly China, existing infrastructure is inadequate. The Asian Development Bank (ADB) has estimated that approximately $8 trillion is needed in national infrastructure in Asia between 2010 and 2020 alone.[22] This estimate does not take account of the huge demand for trans-national infrastructure within in the region, and on the drawing boards in regional agencies.[23] The estimate of Asian infrastructure requirements stands next to the OECD's estimate that global infrastructure requirements over the next

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[20] Yu (2012)
[21] Elek (2011a)
[22] Asian Development Bank (2009)
[23] See the list of prospective projects in ERIA (2010)

two decades will be around $50 trillion,[24] highlighting the importance of Asia in global infrastructure demand.

There is a particular need for trans-border regional infrastructure projects, to connect the disparate Asian economies. This will deepen economic integration between rapidly growing proximate economies and extend regional production networks, allowing poorer countries in the region to benefit more from the region's booming economies. The ADB has estimated that $290 billion in spending is needed on regional infrastructure projects on top of the already identified national projects.[25] The most pressing focus is on connecting the different Asian subregions, improving overland and sea links between South Asia, East Asia, and Southeast Asia. The importance of these links is at the heart of ASEAN's *Master Plan on ASEAN Connectivity* and recent work of the Economic Research Institute for ASEAN and East Asia (ERIA), which has identified $390 billion of prospective projects which would improve these links.[26]

Not only would investing in infrastructure stimulate activity in emerging economies, but the long-run benefits would be large. The ratio of capital to output in countries like China is low,[27] so the returns from investing in infrastructure, the increase in productivity of other factors of production and the increase in output resulting from such investment, will all therefore be high. Lower transport costs across Asia and further integration of the Asian economy will lead to further increases in Asian output and growth.

Investing in infrastructure would also provide a much-needed stimulus to developed economies, one their governments are not currently in a position to deliver. The reasons for this are discussed and reviewed by Lin & Dömeland (2012), who estimate that 35 per cent of investment expenditure in developing economies goes towards capital goods imported from advanced economies.[28] These imports largely consist of manufactured goods. Given that the manufacturing sector in advanced economies has been deeply affected by the current crisis, there is spare capacity in this sector to absorb an increase in demand from emerging economies, so an increase in demand will lead to little crowding-out of existing activity.

Infrastructure investment in emerging economies is therefore an ideal global stimulus. It will lead to little crowding-out of existing or planned private activity in emerging and developed economies, not only stimulating activity in emerging economies in the short run but also increasing their output in the long-run too, as well as lifting capacity utilisation in industrial economies.

[24] OECD (2011)
[25] Asian Development Bank (2009)
[26] ERIA (2010)
[27] Elek (2011a)
[28] Lin & Dömeland (2012)

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In spite of the high social returns, there is a shortage of private finance available for investment in infrastructure projects. Classic distortions in goods and factor markets in emerging economies are the first impediment to a better allocation of savings. Fuel subsidies, corrupt government officials, government monopolies and the like all lower the private return from investing in infrastructure well below the social return.

The second impediment is the underdeveloped nature of capital markets in emerging Asia. Much of the large savings of these economies are intermediated through state-owned banks, as in China, where they are not always subject to market disciplines, or through financial institutions in advanced economies, which are shy about investing in emerging economies. The result of this is that Asian savings end up fuelling the deficits of advanced economies.[29] In 2007, the ratio of debt to equity in China's foreign assets stood at 8.2, India's was at 2.6 and Indonesia's was 3.4. This compared with a ratio of 0.7 for Australia or 0.9 for New Zealand.[30]

This leads to the third impediment, namely that infrastructure projects in emerging economies are not always attractive investments for financiers, even when the returns are high. Physical infrastructure is a very illiquid asset and returns take time to come. Investors are also turned away by perceived risks in emerging economies stemming from poor regulation, governance or macroeconomic policies. While these impediments make for a powerful and stifling combination, they are problems that can all be fixed.

What is the role of the G20 in Asian infrastructure investment?

Although the reforms needed to overcome the impediments to expanded infrastructure investment in emerging economies are largely domestic, the G20 needs to make them its concern for the sake of the global economy. The stimulus from increased demand for exports of capital goods from advanced economies is just what the world economy needs to ride out the difficult process of structural adjustment in Europe and the United States.[31] Finding an alternative use for emerging economies' savings is also an integral part of the G20's task of rebalancing the global economy. In the context of the *modus operandi* of the G20 discussed above, where officials of different countries share policy experience, officials from advanced economies would have much to contribute to help emerging economies remove the impediments to more market-based investment in infrastructure.

Australian businesses and policy-makers in particular have much to contribute, particularly to designing reforms to attract private funding for infrastructure projects. Not only are Australian governments experienced in developing public-private partnerships, but Australian pension funds (superannuation funds) devote up to ten times more of their portfolios to infrastructure projects than

[29] Elek (2011b)
[30] Lane (2012)
[31] Elek (2012)

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their international peers.[32] The lessons of the Australian experience could be extremely useful in reforming regulation in emerging economies that inhibit infrastructure investment and in identifying other reforms liable to increase the supply of private finance.

Some good work has been done through the G20 to promote infrastructure investment, but not enough. The multi-year action plan on development agreed to at the Seoul summit saw the creation of a high-level panel on infrastructure, made up of businessmen and private financiers. They collaborated with a working group from the multilateral development banks to '[overcome] obstacles to infrastructure financing,'[33] with particular reference to low-income countries. Two complementary reports were presented to the Cannes summit, one by the working group, one by the panel addressing these problems.

The report of the panel and the multilateral development banks' action plan contained some useful analysis of the obstacles to greater private financing of infrastructure projects and some helpful suggestion to overcome these. But the focus of the groups' terms of reference on low-income countries, particularly sub-Saharan Africa was too narrow. While that region undeniably needs better infrastructure, the report highlighted that many African countries currently lack the capacity to develop large projects to a stage where they can attract private finance. In addition, the contribution to growth of infrastructure projects in Africa would likely be less important to global recovery than those in Asia, as low population densities and lower incomes would mean a smaller scale of, and a lower return on, investment. Not only was the focus of the reports too narrow, but the recommendations more relevant to middle-income countries have not yet been implemented, particularly the launch of a global infrastructure benchmarking initiative and improving incentives for staff of development banks to engage in PPPs and develop regional projects.[34]

Independently of the G20, Asian countries have already started to address their infrastructure needs. Regional funds, including the recently launched ASEAN Infrastructure Fund, which has funding of $485 million a year from ASEAN governments and the Asian Development Bank (ADB), or the Asian Infrastructure Financing Initiative, which brings together several development banks in the region, are aimed at increasing the funding for regional projects. There are also regional initiatives to increase private funding, notably the ASEAN+3 Bond Market Initiative, a collaborative initiative with the ADB which aims to improve capital markets. These initiatives do not, however, address the distortions or the institutional and regulatory deficiencies which are keeping more private finance from being invested in infrastructure projects. Here, the experience of the developed G20 economies could prove invaluable.

[32] OECD (2011)
[33] 2010 Seoul Multi-year action plan on development
[34] 2012 Progress report of the G20 Development Working Group

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By sharing their policy experience, leaders and policy-makers within the G20 group are equipped to identify and remedy existing failings in regulation and governance as well as distortions in product and factors markets. This will only happen if the G20 concentrates more specifically on infrastructure investment, not as merely one component of a development agenda which will always be sidelined by macroeconomic developments. The G20 needs to recognise the importance of infrastructure as the source of growth, both in the short- and medium-term, an element in global recovery that cannot be delivered without deep structural reform and which the global economy urgently needs.

Getting the logistics right

There is also the question of how to link this global agenda to action locally, at the regional level so that it takes more account of, and connects with, Asia's role in setting new policy directions and global economic governance.

A top-down approach to such initiatives is bound to fail. Global leadership needs to be connected at the hip to the locus of action in regional architecture as well as in national policy development. Insufficient attention has been paid to how to connect evolving global arrangements, including the G20 process, to theatres of regional action.

Success in relating the G20 to these theatres will turn heavily upon the logistical detail. Indeed, the legitimacy of the G20 will depend on how the interests and views of non-G20 members are brought to the G20 process. Structuring the timing and agendas of Asia's regional meetings so as to give the regional non-G20 members input to and ownership of G20 initiatives could be an important start.

The G20 in future

The formation of the G20 represents a major achievement, perhaps even the most important achievement of international diplomacy in recent times. The focus of the G20 to date has been almost exclusively on domestic economic policy; countries have brought forward and debated each other's policies. They have examined them through the lens of their policies' effects on growth and employment in other countries before reaching decisions and then, in a spirit of mutually beneficial cooperation, followed up those decisions with independent action. This domestic focus, and this *modus operandi* — where countries agree on domestic policies but the responsibility for implementing them lies exclusively with the respective countries — is precisely the strength of the G20. The alternative, to expect the G20 countries to bind themselves to a grand bargain which will solve all the international problems of the day would only lead to stalemate and deadlock.

Beyond domestic policy coordination, there is still a need for rules to govern international economic interactions, such as trade or financial flows. These rules do not only include black-letter law, such as that contained in WTO agreements, but also norms of international behaviour, like the expectation

implicit in the IMF that countries will act in accordance with the Fund's recommendations to control international imbalances.

The emerging Asian economies have benefited enormously from the existing rules of the game, but as their importance continues to grow over the coming years and decades, they must be better included in the international rules-setting organisations. The creation of the G20 has begun this process, and that is why it represents such an important change in global governance. But the process of adjusting the division of international power to better reflect international economic weight has only begun and many important reforms to international institutions, among them the IMF, remain to be done.

The process of adjustment will be difficult, and the G20 will be challenged more fundamentally as it confronts the reconciliation of economic and political systems that have their roots in different values and principles — the underlying clash over how the norms and rules of global markets should work that is still to be played out between the established powers (led by the United States) and the emerging powers (quintessentially represented by China). Ultimately though, the emerging economies will need to accept and take on their responsibilities in managing the global economic system.

This will be a time that calls for the emerging economic powers to assume their responsibilities in international initiatives as Europe and America struggle to stay on course. It will be a time in which there is more uncertainty about how exactly those responsibilities ought to be exercised. It will also be a time to think actively about how to reinforce global institutions, like the World Trade Organization, that remain so central both to international prosperity and cooperative international politics. It will be a time for taking initiatives on new problems, such as energy security, food security, climate change and the environment. The G20 itself cannot do all the work that will be required across these areas, but it can, and will have to, initiate much of it and to set the course.

This global transition is to an extent inevitable, even as growth in Asia needs to take a different path. As the world emerges from recession, as the arithmetic of growth dictates, the Asian economies will grow in relative importance to the world economy. It is not inevitable that this transition will be successful and peaceful. That will depend on convincing nations, and entrenching an understanding of, the fact that future global prosperity will depend on international cooperation. Future prosperity depends on a sense of collective responsibility and a robust framework of global governance
The opportunity to do this is here, to create both, including through the agenda for establishing the centrality of productive and efficient infrastructural investment for sustainable global recovery. By grasping it, Asia and the emerging economies can help the global recovery, create a sounder basis for long-term growth and a more secure and robust framework of global governance.

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