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INTERNATIONAL AND REGIONAL COOPERATION: ASIA'S ROLE AND RESPONSIBILITIES

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International and Regional Cooperation: Asia's Role and Responsibilities

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Abstract

Asia has emerged from the global financial crisis as an important stabilizing force and engine of global economic growth. The establishment of the G20 gives Asian economies the global forum that they have needed to both represent their interests in global governance and to deliver on responsibilities concomitant with their growing weight in the global economy. The region has a host of cooperation arrangements in APEC, ASEAN+3 and EAS, all with ASEAN as the fulcrum. They are huge assets but they need to be re-positioned to relate effectively to the G20 process and other global arrangements. They also need to comprehend the politics of the changing structure of regional power. This paper discusses the challenges that Asia faces in aligning regional and global objectives in financial, trade and other areas of cooperation, such as on climate change and on foreign investment. It argues that Asia is now a critical player in the global system and has a central contribution to make in strengthening global governance and international policy outcomes. Currently, there is a disconnect between the regional cooperation and the global agenda. The paper sets out ways to address this problem through filling gaps in regional cooperation and linking the agenda for regional cooperation more effectively to Asia's new role globally. That is essential to sustain Asia's superior growth performance, correct imbalances and support the global economic system.

Key words: economic integration; financial cooperation Asian economic cooperation; Asia Pacific community; global governance; trade policy; foreign investment regime; climate change.

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International and Regional Cooperation: Asia's Role and Responsibilities

Until the collapse of world financial markets and world trade in the global financial crisis of 2008, the East Asian region was preoccupied with managing all aspects of the China boom – the pressure on energy, resource and food markets, the macroeconomic pressures, the looming foreign direct investment and commercial presence – and beginning to think about its long-term political consequences. India too was more and more caught up in the wave. All this was premised on the continuing strength of North American and European markets.

Regional cooperation efforts, after the Asian financial crisis, were reactive and inward-looking, focused on establishing a measure of independence from American dominance in the global financial system and attempts at building regional trade arrangements. East Asian policy leaders should have been more conscious of their role on the world stage and the need to re-position quickly to manage the global consequences of their own economic success and the dangers presented to its sustainability that the huge external imbalances between East Asia and North America had created along the way. But there was neither the inclination nor the vehicle from which to develop that role.

In East Asia, as elsewhere in the world, the risks that we now face in recovery from the global financial crisis, not only economically but also politically, are a consequence of failure in the architecture of international governance, including regional architecture, that frustrated a coherent East Asian and international response to the big problems of the day in their global context.

The global financial crisis and the emergence of the Group of 20 (G20) has changed all this dramatically and gives the G20's Asian members the opportunity to assume a new role and their proper responsibilities in managing the world economic order. ASEAN is the fulcrum of Asian cooperation arrangements, including APEC, ARF, ASEAN+3 and the East Asian Summit (EAS) but, with the rise of the bigger powers in Asia, and the G20, this is changing.

How can regional architecture be restructured to relate effectively to the new global arrangements?

The idea that regional architecture in Asia and the Pacific is not up to the tasks it now needs to serve has been around for some time. It has been inspired in part by worries about the untidiness in the competing structures — across the Pacific, of APEC, and within East Asia, of ASEAN +3 and ASEAN +6 or the EAS. There has also been a hankering after 'robust' regional institutions modeled on the arrangements in Europe or North America, however unsuited they are to Asia Pacific circumstances.

Two factors need to be considered to respond to these concerns.

First, Asia's growth is changing the structure of the world economy and shifting global economic power, and ultimately, strategic weight towards Asia, in particular China and India. Economic and political changes in Asia and the Pacific challenge the primacy of some dimensions of American power. These developments underline the gap in the

framework for regional political and security dialogue in Asia and the role that such dialogue could play in helping to manage the long-term change in the structure of Asian economic and political power and political security relations between Asia and America.

Second, the scale of Asia's impact on the global economy means that it is urgent to mobilize regional efforts to deliver on Asia's global responsibilities – in the financial and macro-economy, in trade policy and on climate change – and how that might be managed through regional structures.

The paper briefly describes the evolution and state of play in Asian regional cooperation. It identifies the priorities in international cooperation on financial arrangements, trade and the global commons on which Asia's interests and responsibilities are heavily focused. It asks whether established regional institutions and architecture are up to the task of managing Asia's interests and responsibilities in global affairs. And it concludes with some ideas about how regional arrangements might be more effectively turned to these tasks.

Asia's changing position in the world economy and regional legacy

Asia¹ is now an engine of growth and has been a stabilizing force in the world economy through the global financial crisis. This is despite the risks the region faced because it was associated with deep exposure to industrial country markets, at once dispelling the decoupling thesis but underlining Asia's resilience to external shocks. Measured in real terms, the Asian economy already has a sizeable share of world output and trade. Our conservative projections to 2020 (Drysdale et al, 2009), and the forecasts of other analysts (Maddison, 2006; Garnaut, 2007), suggest that within the next decade the Asian emerging economies will have a weight in global economic activity roughly equivalent to that of Europe or North America.

Measured in purchasing power parity (PPP) terms, Asia's share of global GDP will amount to around 23 per cent in 2020, of which China alone will account for over 14 percentage points.² This is more than either North America (21.6 per cent) or the EU (22.4 per cent) are projected to have. China's share of world output on these projections for the same year will be more than double the share Japan.

These projections are an important reference point for thinking about the arrangements for international and regional cooperation in the years immediately ahead. The global financial crisis has accelerated the shifts in weight of the Asian economies in the global economy that these projections foretell, with China and India and the region (Japan excepted) continuing to outstrip growth and the lagging recovery of the industrial world through the crisis. Asia now has a platform at the global level to deliver on its growing international responsibilities, in the form of the G20 process. But it is not clear how or whether established regional arrangements can relate to that process and be engaged to strengthen the region's role in the international economic system.

The G20 includes China, Japan, Korea, India, Indonesia, and Australia. These are the most important economies in the region and individually and collectively they represent

an important new voice in global affairs. They are already exercising a measure of influence globally and the first G20 Summit in Asia in Seoul in November offers the chance to cement their role as constructive players in the G20 process³.

But there are other significant economies in Asia and growing regional integration also requires that their interests and policy approaches be brought on board if there is really to be both economic and political coherence in bringing Asia's weight to the global table credibly and effectively. Regional arrangements have to be able to serve that purpose as a priority, as well as the other purposes for which they may have been established.

How well can the established arrangements for regional cooperation in Asia be co-opted to support Asia's participation in building a global economic system that is more capable of dealing with the big policy problems today and in the decades ahead as well as dealing with regional issues more effectively?

The framework for regional economic cooperation in Asia is still at an early stage of development and is not heavily institutionalized like that in the European Union or even North America.

APEC signaled the emergence of a new economic and political order in East Asia and the Pacific in the late 1980s. APEC committed to the priorities of trade and investment liberalization and set out to promote regional community building. This approach to creating a regional order in East Asia and the Pacific was a response to the end of the Cold War. The Cold War regional order was imposed upon Asia, and it was largely structured around the East–West divide. The new approach went beyond the traditional concept of balance of power and was ordered around Asia's economic development interests in an open global economic system.

The Asian financial crisis of 1997 saw a fundamental fracture of confidence in American commitment to the enterprise of building an Asia-Pacific community. The flaw in the conception of Asian regionalism as a community-building enterprise that included North America was then exposed by Washington's response at the time of the crisis and there seemed little prospect that this was likely to change in the medium, perhaps even the longer, term future.

The emergence of ASEAN+3 and the idea of an East Asian economic community gained traction within East Asia through that realization. The initial agenda was regional financial cooperation, but that was simply the hook on which to promote high-level dialogue towards re-establishing a measure of influence for the projection of broader East Asian interests. The ambition was to build a sense of community among the countries of East Asia and to assert a distinct Asian identity internationally as a basis for closer regional cooperation. The vision broadened with the inauguration of ASEAN+6 or the East Asian Summit (EAS) and its incorporation of trans-regional dialogue with India into the East Asian process. Australasia is also included in the EAS. Its formation has encouraged the idea that the intensification of regional cooperation in East Asia might gradually expand to include South Asia, and ultimately the formation of an Asian Economic Community (Singh, 2005).

Trans-Pacific and East Asian regional cooperation arrangements have overlapping agendas and there are elements of competition among them. While there is an increasingly dense network of meetings and activities, within APEC across the Pacific and around ASEAN in the ASEAN+3 and ASEAN+6 processes, their institutional anchors are ad hoc and incomplete. There is diversity in their memberships: India is a member of EAS but not a member of APEC. Not all ASEAN members are members of APEC but Russia and some of the littoral states of Latin America are.

How can this regional architecture be restructured to relate effectively to new global arrangements?

The starting point is to understand that, while they may have failed to connect Asia's regional with its growing global interests and responsibilities and they have other weaknesses, the regional arrangements we have in place are huge assets in going forward. APEC is entrenched as the primary trans-Pacific arrangement. ASEAN+3 and the EAS have assumed an important role in developing the Asian regional agenda.

On the economic front, the areas in which there is an immediate priority in strengthening institutional arrangements and policy strategies that connect more effectively regional action to the global action are in financial cooperation and trade policy. We first look at financial cooperation.

Financial and monetary cooperation

The financial crisis of 2008 exposed the weakness in global financial arrangements and governance, as well as the under-development of Asian financial cooperation. It also highlighted Asia's role and responsibilities in the global financial system.

In Asia, the catalyst for promoting financial cooperation during the Asian financial crisis in 1997/98 was the inadequate response of the international financial institutions (IFIs), especially the IMF and World Bank, to dealing with the problems faced by crisis-affected economies. Asia lost confidence in the IMF and Washington dominance in managing the international financial system (Takagi, 2010). While Japan's call for setting up an Asian Monetary Fund was rejected, financial cooperation rapidly became a regional priority. By 2000, the Chiang Mai Initiative (CMI) put in place a set of bilateral currency swap arrangements among ASEAN+3 countries, and attention was directed to the development of regional bond markets – the Asian Bond Markets Initiative (ABMI) and the Asian Bond Funds (ABF).

At the onset of the global financial crisis, Asian regional financial cooperation had not progressed very far, illustrated by the vast accumulation of foreign currency reserves -- initially a response to the Asian financial crisis to guard against capital withdrawal and speculative shocks. Reserve accumulation was a plus in navigating the global financial crisis without too much exchange rate volatility but these reserves carry significant costs and risks and are a second best solution to dealing with external financial risk.

Surveillance, supervision and dialogue arrangements necessary to extending and multilateralizing CMI swaps were not yet established. There was some progress on

financial reform under IMF programs at a national level but financial markets remained under-developed. There was no comprehensive dialogue or cooperation on financial market developments nor on building institutions for better regulation of financial markets, both of which are important to encouraging the investment of more Asian savings productively within the region instead of via intermediation in distant markets (ADB, 2008).

There are some frameworks in place in Asia for dialogue on financial and monetary issues, among them the long-standing Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) and the more recently established Economic Review and Policy Dialogue set up through ASEAN+3. But they are incomplete. Neither include the participation of institutions across all countries in the region nor cover all the issues that are important to regional financial stability and efficiency (ADB, 2008).

The reform of global financial architecture is still far from complete though it is now a priority following the global financial crisis. The London G20 meeting saw additional resources committed to IFIs and the transformation of the Financial Stability Forum into the Financial Stability Board (FSB). The reform of IMF and World Bank quotas and voting rights has increased Asia's voting power to better reflect its economic weight in the global economy. But reform remains incomplete with Asia still under-represented and Europe over-represented in the IMF, for example. In addition to the World Bank's playing a more active role, the Asian Development Bank, was also active during the global financial crisis, mobilizing additional funding and tripling its capital base to US \$165 billion at the beginning of the crisis.

The participation of key Asian economies in the G20 leaders meetings has changed Asia's involvement in, and collective ownership of, reform of international financial architecture and the way in which the region relates to it. The G20 has no supra-national authority but it presents Asian economies with the opportunity to engage on, persuade and influence policy and institutional outcomes in a way that has no precedent. A crucial feature of the G20 process is that it was built on the foundations of the G20 meetings of finance ministers set in motion after the Asian financial crisis. It is serviced by finance ministries and the international financial infrastructure on which they can draw. It is institutionally anchored by its ability to access these capacities. This is a significant asset for the endeavors in global financial and economic dialogue going forward.

There are two inter-related dimensions of international and regional financial and monetary cooperation. The first is to protect international financial and economic stability in the face of financial and other shocks, through macro-economic cooperation. The second, among deeply financially inter-connected economies, is to maintain the integrity and improve the efficiency of financial markets in their role in mobilizing investment and promoting growth and development. This second dimension relates to how well financial markets are able to allocate savings to their most productive uses and whether financial regulations are designed so as to facilitate this at the same time as managing attendant risks and maintaining financial stability.

On the first dimension, the CMI is the most concrete step towards regional financial cooperation (Fan, et al., 2006). The CMI is bilaterally activated with no overall coordinating body. At this stage it is more symbolic than effective but it has the potential to provide a mechanism for policy dialogue and coordination (Sussangkarn, 2010). After much delay and negotiation, the political barriers to multilateralization of the CMI (CMIM) have now been overcome⁴. Yet no currency swap has ever been activated through the CMI. There is no independent and credible regional body with political backing to oversee lending, surveillance and provide technical assistance for the CMIM (Henning, 2009). It is difficult for the IMF to serve in that role because IMF conditionality does not have a good history in the region. The global issue of representativeness, and European dominance of, the IMF plays into these regional diplomacies (de Brouwer, 2007). A well functioning CMIM would make a positive contribution towards global financial architecture (Henning, 2009). This will need effective and independent surveillance and globally transparent arrangements (Henning, 2009) and more needs to be done on commitments to pool reserves (de Brouwer, 2009; Sussangkarn, 2010).

With growing economic interdependence in Asia and risks around the long term stability of the USD as a reserve currency, there is a search for exchange rate stability in Asia (Eichengreen, 2007; Kawai, 2008, Huang, 2010). Some advocate a formal and rigid exchange rate arrangement and a vigorous discussion of the idea of an Asian currency emerged after the Asian financial crisis led from Japan (de Brouwer & Kawai, 2004; de Brouwer, 2007; ADB, 2008). But the region lacks the political cooperation that would be necessary to establish a currency area and there is, no desire to pool monetary sovereignty in the face of the large shifts in the economic weight that are taking place within the region. While exchange rate coordination and a currency basket seek to protect against surges of capital through moving the region closer towards a common currency or monetary union, dialogue and cooperation is a more practical way forward in the medium term. Dialogue and cooperation can help to reduce exchange rate uncertainty and the likelihood of beggar-thy-neighbor exchange rate policies (McKinnon, 1999). It will also assist in exchange regime management in the face of pressure for appreciation of exchange rates, especially focused on China.

On the second dimension — cooperation on financial market developments and stability — there is no effective regional arrangement in Asia. East Asia can contribute towards building a stronger international financial system through financial market reform, especially in the large Asian emerging economies, China and India. It is important to make Asian capital markets stronger and maximize the productive use of Asian savings in each country and throughout the region (ADB, 2008). The question is whether it is possible to use regional arrangements and what particular regional mechanisms might help take reform forward.

Regional economies are in very different stages of development and information and experience sharing can help the process of reform. China and other emerging market economies can learn from experience in Japan, South Korea and Australia, for example, with capital account liberalization and reform sequencing. Information sharing and dialogue will give policy makers a better grasp of domestic and regional financial developments and the scope for lifting financial efficiency. Domestic reform agendas

can be informed by regional dialogue on best practice and experience elsewhere although political battles over reform agendas are deeply domestic in nature and a national prerogative (Dee, 2009).

Priorities are for finance ministers' dialogues to be institutionalized and a regional initiative to create an Asian Financial Stability Dialogue (AFSD) (ADBI, 2009). The AFSD would relate to finance ministers, and comprise finance ministry representatives, central bankers, financial market regulators and supervisors. An initiative of EAS, it would sensibly involve India, Australia and New Zealand as well as the ASEAN+3 group. An AFSD could serve as an agent of policy dialogue, policy development on financial reform and regulation, financial policy management and contribute to consistency of targets for fiscal and monetary policies for stabilizing long term interest rates and dealing with the adjustment, or stabilization, of real exchange rates. It would help in developing mechanisms for the coordination and conduct of early warning system analysis and discussing more openly national and regional policy interventions and would fill what is presently a big gap in regional financial cooperation (ADBI, 2009).

The articulation of measures to promote financial market development and resilience in East Asia will boost confidence and position the region as a leading centre of financial innovation supportive of global recovery and growth (Drysdale et al., 2009; ADBI, 2009). The AFSD could connect to the work of the FSB, widening its influence and utility and making a useful contribution to the global agenda for sustaining recovery and growth through the G20 process.

Two conclusions follow from this discussion.

The first is that an inward looking set of financial cooperation arrangements that are de-linked from the IMF are not in Asia's interest. Asia is already too prominent a part of the global system. Yet the region does not have either the technical capacity or the political trust necessary for effective surveillance, monitoring and credible implementation of large scale support programs. The EU, where surveillance, cooperation and analytic capacities are well developed, cooperates closely with the IMF in rescue packages for European economies (Henning, 2009). Regional surveillance has to be undertaken in conjunction with surveillance at the global level to better assess external risks, and also provide information and early warning of East Asian shocks to the global system. Stronger regional institutions can be useful for regional surveillance and collaboration and would ideally mimic the functions of global institutions (de Brouwer, 2007). Even if the region was better endowed with these capacities and there was sufficient political trust in them, it would still make sense to draw upon well-established international capacities

The Asian financial crisis reinforced the idea that cooperation outside the IMF is perfectly consistent with using the infrastructure of the IMF (de Brouwer, 2007). De-linking regional surveillance from the IMF may seem attractive in furthering regional cooperation but it would be better to link to and engage the IMF. The IMF is undergoing reform and Asia should participate in the process. The enhanced role of the IMF and World Bank, backed by a significant increment in resources, is compatible also

with the growing role of the ADB. Asia could make a positive contribution by establishing a functioning AFSD that draws in the whole region and complements the work of the FSB.

Regional solutions have to be progressed with the global system in mind and recognition that the Asian region is a large and growing part of a very interdependent global system. There are no confident predictions about macroeconomic shocks but it is quite probable that the next global shock could be a Chinese recession, and that will take the region, including Japan with it. Something the region has not come to terms with, moreover, is that reserve accumulation, pooling reserves and the CMIM only cover against own currency risk but do not protect against reserve currency risk. With a large US government deficit and expected slower growth in the industrialized economies, the region will have to grapple with managing both own currency risk and reserve currency risks.

The second conclusion is that while global reforms and institutions are critically important, Asia should develop its own institutions for regional cooperation. It has only just begun this process and progress has been painfully slow. However successful the reform of global institutions, it is unlikely to be sufficient to protect all Asia's interests. Even if what has been done so far in Asia is inadequate, markers have been established. That is more important in many ways than the scale or scope of what has been so far achieved because it provides a platform for action, an institution to which there can be recourse when needed and in which there can be growing political trust. The creation of a framework for support allows support to be mobilized more readily and of sufficient scale to deal with crises as they occur. None of the programs of support extended within Asia during the global financial crisis were delivered via the institutions put in place since the Asian financial crisis, but they would probably have been less readily delivered without all the work and dialogue that has taken place over the last decade.

Global and regional trade agendas

Regional trade cooperation is not heavily institutionalized in Asia as it is in Europe or North America, yet intra-regional trade shares are high, with high levels of trade in resources and intermediate goods, alongside large exports of final goods to the global market. The high levels of regional trade and commerce are a product of the growth in the scale and structure of the economies in the region, their geographic, political and institutional proximity and the openness of these economies to trade, investment and commercial participation by outsiders (Drysdale, 2009).

East Asia's deep specialization in the international economy, most efficiently and intensively with other economies in the region but also through access to global markets, was a necessary condition for successful East Asian modernization and industrialization. As markets were opened and East Asian governments successively committed to these goals under a post-war international economic regime, underpinned by Article I of the GATT (Urata, 2007), there was growing confidence in international integration, a natural consequence being the growth of East Asian and Pacific economic interdependence.

Economic integration in East Asia and the Pacific was 'market-driven' integration (Drysdale, 1988), in contrast to the 'institution-driven' integration which saw the formation of the European Common Market and, ultimately, the European Union, and it has been critically dependent on an open multilateral trading system. That is why the history of regional trade cooperation in Asia and the Pacific through APEC began with a strong agenda of support for strengthening the then-GATT and pursuing trade liberalization through making the Uruguay Round of negotiations deliver for labor-intensive manufacturing and agricultural producers in the region.

The organizing idea of Asian trade policy strategy was the idea of 'open regionalism' (Drysdale, 1988, Garnaut, 1996). Unilateral trade liberalization also played a significant role in opening up East Asian economies and achieving rapid economic growth and development through trade oriented growth. The collapse of multilateral trade negotiations after the Asian financial crisis saw Asian retreat from multilateral towards preferential trade policy strategies and the negotiation of a raft of bilateral free trade agreements (FTAs) (Drysdale, 2005; Baldwin, 2008). With multilateral trade liberalization currently stalled, and the inability to complete the WTO's Doha Development Round, bilateral and regional trade arrangements have proliferated more rapidly in Asia and elsewhere (Kawai & Wignaraja, 2009).

These bilateral trade agreements are commonly preferential, inward looking, limited in coverage, and have restrictive rules of origin⁵. There is, however, little evidence of their having much impact or trade outcomes, with at most a quarter of trading firms in the East Asia region surveyed using the preferences of FTAs, in a comprehensive study by Kawai & Wignaraja (2009). Most estimates of their utilization are much lower (ADB, 2008). However incidental they are to the main regional trade outcomes, FTAs are here to stay (Baldwin, 2008). There are two possible ways forward in reconciling this reality with Asia's regional and global trade interests. The first is to make the FTAs more multilaterally friendly, by expanding the so-called WTO-plus elements in existing FTAs. The second is to try to connect them or comprehend them in broader arrangements.

Some see FTAs as a stepping stone to wider regional cooperation and as a plan B for multilateral liberalization. But the region is struggling to make progress on region-wide or even sub-regional trade agreements. ASEAN+3 leaders have proposed an East Asian FTA (EAFTA) and the EAS has put forward a Comprehensive Economic Partnership in East Asia (CEPEA) while a Free Trade Area for the Asia Pacific (FTAAP) is being considered as a long-term possibility by APEC governments. Another trans-Pacific initiative on the table is the Trans Pacific Partnership (TPP), an endeavor that is designed to have countries sign on to a small plurilateral arrangement. The TPP looks to build on its P4 membership of Brunei, New Zealand, Chile and Singapore with Australia and the United States set to join the negotiations. It aims for a high quality and a comprehensive regional trade agreement and to serve as a building block towards the FTAAP (Capling, 2009; Elek, 2009a).

The potential gains from larger FTAs are exaggerated. The potential gains are also based on the invalid assumption that sensitive products would be liberalized, rather than exempted in broader arrangements and that the rest of the world would not react to an East Asian trading bloc.

Dee (2007b) shows that much larger gains would come from completing the Doha Round and even further gains can be found in unilateral liberalization in East Asia. The scale of the gains from unilateral liberalization is significant, yielding up to five times the gains compared to an EAFTA, for example. In fact, the region is already moving beyond the trade agenda as priority shifts to the structural reform agenda, detailed below.

The evolution and success of East Asian cooperation arrangements does not depend on the success of preferential trade strategies. There is a large agenda that cannot be advanced by the pursuit of FTAs, or even a comprehensive EAFTA or FTAAP, around which the Asian integration endeavor has to be structured. The structure of regional politics and the history and dynamic of change in the structure of regional power suggests that successful regional cooperation in Asia is more likely within the framework of robust international institutions and arrangements that at once strengthen East Asia's capacity to exercise leverage globally and encourages continuing engagement with America across the Pacific, and globally in multilateral negotiations (Drysdale, 2009).

Indeed, it is noteworthy that the biggest economic relationship in East Asia – that between Japan and China, countries which have no bilateral free trade agreement – prospered, despite on-going low level political tensions between the two countries, precisely because they both have commitments the multilateral system in the form of the WTO (Armstrong, 2009). The trading relationship has been conducted within the framework of global commitments and arrangements that allowed them to engage each other on equal terms. China's commitment to the GATT, and the way in which accession to the WTO entrenched commitment to reform is perhaps the single most significant policy initiative in international trade in the last half century (Drysdale & Song, 2001) and a symbol of the importance of global arrangements to bilateral and regional economic integration. It allowed Japan-China trade and FDI to prosper and the development of a large complementary regional trade, by giving both sides confidence under the international rules-based system (Armstrong, 2009).

The ambition to move towards free trade on a broader front through a preferential agreement within East Asia or across the Pacific is in part a response to the limited benefits, or even the net losses⁶ and high costs of negotiating, bilateral FTAs. It is also touted as an important step in regional institution building (Lee et al., 2006; Soesastro, 2007b).

ASEAN countries have committed to an ambitious ASEAN Economic Community (AEC) Blueprint which, were it to be implemented fully, would give them a leading role in economic integration (Soesastro, 2007a). The AEC blueprint aims at ASEAN forming a single market and production base, a highly competitive economic region, a

region of equitable economic development, and a region fully integrated into the global economy.⁷

It is by no means clear that the Asian region, given where it is already at in terms of trade integration and trade openness, needs to ape Europe or other parts of the world in making a preferential trading arrangement the flagship in regional cooperation. Asia needs to be at the forefront of trade strategies and a global trade reform agenda that confronts the damage of preferentialism to the global system. Asia also needs to lead the world out of the stalemate that the WTO negotiations have got into.

Asia's position in the world trading system now puts it in the spotlight in terms of what is now at stake in managing the global trading system and who needs to share shouldering the responsibility. Not so long ago, Asia could afford to be a free-rider in trade policy leadership. This is no longer the case. China is now the second largest trader in the world and the largest destination for foreign direct investment (an issue to which we shall return shortly). Asia is already the second largest centre of world trade; by 2020 it will likely be the largest.

A related issue is how the agenda for negotiation of an open international economic system has changed and now goes well beyond purely commodity trade issues. The biggest impediments to trade and integration are no longer border barriers to trade, which are already low except in agriculture and sensitive items, but behind-the-border domestic regulations and institutions that limit market contestability in markets for both goods and importantly services (Elek, 2009b; Dee, 2009).

Continuing economic growth and deepening integration of the East Asian economy requires reform of domestic institutions and regulatory systems. These regulatory and institutional reform issues are not susceptible to negotiation through traditional processes of trade negotiation, either through the WTO or through FTAs. Multilateral and bilateral agreements do not deal with reform or liberalization of communications (including ICT), transport or other areas, for example, that are central to efficient integration into the international economy. Hence the structural reform agenda is much broader than the trade agenda and delivers much higher gains than at the border trade reforms (Dee, 2007a; Dee, 2009).

Structural reform is now a high priority in Asia and is seen as an area in which Asia can contribute to the international agenda through the G20 process since structural reform is an essential element in changing the export-led growth model, correcting international imbalances and sustaining regional and global growth.

On both these issues— how to re-position regional trade negotiation strategies to serve both regional and global objectives and how best to make progress in opening markets through regulatory and institutional reform — Asia will be expected to deliver.

The multilateral system has underpinned growth and development in Asia and Asia has shown leadership at the global level, recently by South Korea committing to a standstill on protectionism at the G20 level, despite the protectionist instincts that have been let loose during the global financial crisis. East Asia has contributed by keeping markets

relatively open but there is evidence of protectionist backsliding although the region has a better record than others (Evenett, 2009; Evenett, 2010; Aggarwal & Evenett, 2010). Many Asian countries have applied tariff rates less than bound rates ('binding overhang'), meaning that tariffs can be raised to the bound rates without breaking any WTO commitments. It is important for the WTO to monitor this in the short run and to contain protectionist pressures as more and more countries introduce discriminatory measures against foreign competition despite the stabilization of the global economy (Evenett, 2010). Asia is positioned and has the interests to lead the initiative on this.

Asian G20 economies have a deep and continuing interest in the openness and robustness of the international trading regime. More immediately, the timing of the G20 meetings in Korea in November 2010 recommends re-visiting closure on the Doha Round of trade negotiations. This will be a time in the international political cycle at which this goal can be re-kindled, after the mid-term elections in the United States. In the medium term, after settlement on the Round, is an appropriate time to initiate a thorough-going review of the world trade architecture and the modalities of the WTO as they impact on future global negotiations and the relationship between regional and bilateral trade agreements and the multilateral trade rules.

The major East Asian powers have already become such important global economic players that their pursuit of trade and investment objectives, their impact on international financial market developments and the effect of their growth on the environment all have global ramifications and need to be negotiated globally. That is why, in the sphere of trade policy strategy especially, APEC's focus on the GATT and the WTO was so important to its East Asian founders, and it is why the role of the East Asian economies in global negotiations is now of central importance. Asia can show leadership, through commitment to reform of the WTO, through further opening up its markets, helping conclude the Doha round and by connecting and 'multilateralizing' its web of FTAs. Asia now has the forum at the global level, in the G20, to display this leadership.

Other issues

Two other important issues stand out as areas in which Asia and Asian regional cooperation can contribute to international cooperation. The first is in the development of the regime for securing foreign direct investment (FDI) and the second is moving forward with a global framework on climate change.

Foreign direct investment is now a very important element in shaping international economic integration. FDI has been a key driver of development and regional integration in East Asia (Drysdale, 1972; Ito & Krueger, 2000). It has played an exceptional role in Chinese industrial transformation and integration into the international economy. Yet there is no global framework that secures the benefits of an open regime for FDI as there is for trade within the WTO. China and other emerging market economies like India have also become significant new sources of FDI. FDI out of China is set to become the leading edge of the next phase of China's integration into the international economy. The role of state-owned enterprises and sovereign wealth funds in Chinese and other investment abroad raises new questions about the

relationship between the state and foreign investment activities that complicate this dimension of economic integration and raise the risk of friction and political tensions (Drysdale & Findlay, 2009).

Asia has much at stake economically and politically in promoting an open FDI regime and preventing FDI from becoming a source of contention among the emerging and established industrial powers. Asia is in the front line of China's integration with the world including through rapid growth of its FDI abroad, which almost doubled between 2007 and 2009 from US\$ 25 to US\$ 43 billion (Davies, 2009). The creation of an international investment regime has been tried and failed (OECD, 1998). Asia has every interest in working to develop a framework of principles and guidelines that might serve as a global model in securing the growing role of FDI in the integration of the regional and global economies.

The six Asian G20 members (Japan, China, Korea, Indonesia, Australia and India) also have a responsibility and opportunity to play a constructive role in climate change negotiations. China, despite being perceived by many as one of the main reasons for the collapse of the Copenhagen Summit on Climate Change, committed to lower the emissions intensity of its economy (carbon per real yuan) by between 40 to 45 per cent from 2005 to 2020 and is key to any global solution (Howes, 2009, Jotzo, 2010). South Korea and Indonesia, along with other developing countries in Asia have both assumed a pro-active role on climate change and Asia has the clout to become a 'game changer' in any international climate agreement (Jotzo, 2009; Soesastro, 2009). A practical way forward is for the region to work together in giving their domestic policy commitments international visibility and to keep the pressure on to ensure that Copenhagen commitments to carbon reductions and technology financing are met (Howes, 2009). A first task is for the region to move to implementation to give the commitments credibility.

Regional and global architecture

Whatever is done to re-position Asian regional architecture so that it takes more account of, and connects with, Asia's new role in global economic governance, as well as its implications for political and security affairs, needs to build on the foundations of established regional structures – APEC and East Asian arrangements. It needs to link to, be coordinated with, and draw on the base of all of the established trans-Pacific and East Asian arrangements (Drysdale, 2009; Drysdale & Soesastro, 2009).

None of the existing regional institutions addresses all of the key dimensions of regional cooperation that they now need to – 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 macro-economic dimensions; addressing issues of political change and security; and educating the public and opinion leaders about the region – nor should any one organization need to perform all these roles. Each of the established forums has evolved to serve some or other of these roles and they can all 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 that emerge from the discussion above. 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 East Asian Summit and other regional processes. These dialogues need to be formalized so that regional input and regional initiatives are a recognized part on the G20 process and its reach.

Getting this right in practice may be a little more complicated than it seems in principle. It will require decisions about which regional arrangements provide the most effective link between regional and global cooperation. Many of the initiatives we suggest in this paper will sensibly require strengthening East Asian arrangements (preferably ASEAN+6), via, for example, enhanced financial cooperation through finance ministry and finance agency involvement (the AFSD, for example). Others will benefit from the participation of a broader Asia Pacific group. 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. Indeed, the legitimacy of the G20 will depend on how the interests and views of non-G20 members are brought into to the G20 process. Structuring the timing of Asia's regional meetings around the G20 to give the regional non-G20 members input and ownership of initiatives is an important start.

The second issue is one that leaders throughout the region are currently struggling with in different ways (Rudd, 2009; Hatoyama, 2009; Soesastro, 2009; Soesastro & Drysdale, 2009; Bae, 2009). Australian Prime Minister Rudd has advanced the idea of an Asia Pacific Community to address this gap (Rudd, 2009). Prime Minister Hatoyama's idea of an East Asian Community would serve a similar purpose. A key difference between the Rudd and Hatoyama ideas is that the Rudd idea sees the United States as a necessary and key player in the arrangement from the beginning. The Hatoyama idea is focused on a strong East Asian arrangement, independently of, but probably involving, dialogue with Washington. It would seem prudent to proceed on both initiatives in tandem. At the core of both ideas is the development of a framework which might help to reduce the risk of a fracture in political confidence around the rise of China's (and India's) political influence alongside the established military and political power of the United States, consistent with growing East Asian economic cooperation.

This thinking points to the need for a new heads of government meeting that transcends APEC and EAS (encompassing the Rudd and Hatoyama proposals) and can 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 (Japan, China, Korea, Indonesia, India and Australia) are potential candidates to take

this initiative with the United States and Russia. All, except India are currently members of 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 EAS to its deliberations. The EAS group could form the nucleus in partnership with the United States and Russia. This summit might eventually constitute an Asia Pacific Council, underpinning the continued development of the regional community. But it does not need to have these pretensions to get moving. It would be helpful in the first instance merely to have informal discussions around the most convenient vehicle, the APEC or the G20 meetings. An informal meeting around an upcoming APEC summit would appear the most convenient way to explore the value of regularly convening to discuss trans-Pacific political and security issues. Until India becomes a member of APEC, the dialogue would in effect back-to-back an EAS meeting with the United States and Russia at the APEC summit. If a meeting such as this became institutionalized, it would not need its own secretariat but draw on APEC and the ASEAN-based groups to develop issues for consideration.

The clear message throughout the region is that ‘no one wants more meetings’ and that there is ‘no appetite for additional institutions’ (Rudd, 2009). But there is strong support for developing more effective alignment of regional strategic purpose, a sentiment that is at the core of the idea of an Asia Pacific Community or an East Asian Community. If this is an idea that seeks to anticipate and shape our regional political and economic future, it is an idea that cannot be put on hold, take a decade to implement or wait until the United States signs on to EAS, an ASEAN-based, primarily Asian-oriented and still nascent grouping.

There may be sensitivities in a meeting involving a limited number of countries, the ‘larger’ players in Asia and the Pacific. But so long as it is structured so that it is representative of, and connects to, all the regional arrangements, these sensitivities need not be important. The most practical proposal and most logical starting point is that this summit should begin by including the EAS (or ASEAN+ 6) countries and the United States and Russia and meet adjunct to the APEC summit. The initial meeting could be quite informal, such as a meeting on the sidelines of APEC meeting itself, to define a way forward. A dialogue among these countries does not entail creating an additional institution, should encompass the core players in APEC and EAS and could conveniently meet in conjunction with the annual APEC summit. These are all important considerations in taking the next steps towards developing regional architecture so that it reflects Asia's new role and responsibilities in international cooperation.

The next APEC meeting in Japan or G20 meeting in Korea, provide excellent opportunities to convene a side-dialogue of the core group, including India, on these issues. This would lay the foundations for a representative Asia Pacific leaders' group that can give leadership to taking the Asia Pacific Community and East Asian Community ideas forward and provide a strong Asian pillar in global cooperation arrangements.

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¹ Asia here is defined as the integrating Asian economies from Japan to Australia, including India. These are essentially the ASEAN+6 economies.

² These projections suggest that China and India will have an impact on the world economy substantially larger than that projected in the World Bank Report *Dancing with Giants*, where more conservative growth rates were assumed at constant prices to initial output shares. They incorporate the latest revisions (ADB 2007) to estimates of regional real incomes (in PPP terms) reducing China's and elevating India's share in real output. The case for using PPP data rather than initial market exchange rate data to project the future structure of world output rests on the likelihood that substantial exchange rate appreciations in rapidly growing economies (such as China) will more accurately reflect their weight in the world economy 15 years hence (Winters and Yusuf, 2006: 5, fn 7).

³ The G20 includes 9 members of APEC (Japan, China, Korea, Australia, the United States, Indonesia, Mexico, Russia, India and Canada) and would include 10 if and when India joins APEC, 6 members of the EAS (Australia, Indonesia, China, Japan, Korea, India) and 4 ASEAN+3 members (Japan, China, Korea, Indonesia). The chair of ASEAN has also been invited to G20 meetings.

⁴ See, for example, Rathus (2009) for a discussion of the difficulties that have arisen due to regional rivalry between Japan and China.

⁵ That is, each component or part produced in different countries requires a certificate for calculating duties on that value add component depending on the origin. With the proliferation of parts and components trade in the production networks in East Asia, calculating the tariff or duties applicable with the rules of origin can be a significant transactions cost. See, for example, Kawai and Wignaraja (2009).

⁶ See, for example, Garnaut (2002).

⁷ See the ASEAN Economic Community Blueprint at <http://www.aseansec.org/21083.pdf>, last accessed February 2010.