Defining an Asian Agenda in the G-20

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East Asia, as elsewhere in the world, continues to face risks—both economic and political—in recovering from the global financial crisis. These risks are a consequence of past failure in the architecture of international governance, including regional architecture, that frustrated a coherent international response to the big problems of the day in their global context.

The global financial crisis and the emergence of the G-20 has changed all this dramatically and gives Asia, of which Australia is an integral part, and the G-20's Asian members the platform from which to assume a new role and proper responsibility in managing the world economic order. Korea led the way by hosting the first G-20 summit in Asia in November 2010. As the G-20 turns now to deal with the vulnerabilities in global recovery and develop a framework that might secure more effectively against future financial and economic shocks, Asia's response will be critical to its success.

Asia's position in the world economy now puts it in the spotlight in terms of what is at stake in managing the global trading system and who needs to shoulder the responsibility. Not so long ago, Asia could afford to be a free-rider in trade and economic policy leadership. This is no longer the case. China is now the largest exporter and second largest economy in the world, largest destination for foreign direct investment and the sixth largest source of foreign direct investment. Asia is already the second largest center of world trade; by 2020, it will likely be the largest.

Asia now has a platform at the global level to deliver on its growing international responsibilities, in the form of a G-20 process that includes China, Japan, Korea, India, Indonesia and Australia.

The immediate goal is to build on the process of, and give substance to, strengthening international macroeconomic policy coordination, which the G-20 has begun. How can Asia contribute best to this goal?

The G-20 finance ministers' meeting in Paris clinched an agreement on which economic indicators should be used to evaluate and tackle the economic imbalances at the heart of managing global recovery. Importantly, China signed on to the deal, which will see trade balance and investment flows monitored and take due consideration of exchange rate, fiscal, monetary and other policies. As China has always insisted in response to Western pressure on its exchange rate, exchange rates will only be considered in a wider policy context.

This accord marks an important first step toward dealing with the imbalance problem and putting the global economy on track toward more viable growth and prosperity. But this is only the first step. The Mutual Assessment Process (MAP), which involves review of G-20 members' national policy strategies with the assistance of the International Monetary Fund, will appeal to these indicators in the first stage of a two-stage process. That will assist in identifying weaknesses and inconsistencies in national policy strategies that are a consequence of deeper structural problems. Success in the process will depend much on how G-20 and other states approach it and how the process helps in shaping domestic policy strategies to achieve global macroeconomic outcomes that are viable in the longer term.

Many countries are trying to get out of the global economic trough by pushing exports. The United States' huge current account deficit requires it to lift exports, lift savings and spend within in its international means. China's current account surpluses persist and are the focus of U.S. Congressional angst and draft legislation that seeks to impose penalties for "undervaluation" of the Chinese currency. While the debt-burdened European economies, from Ireland to Greece, are constrained by commitments to the euro, all are striving to get growth through exports. And Germany, in holding back on domestic demand expansion, has become more and more competitive within the EU; and its increasingly competitive position is lifting its export surplus both within Europe and with the rest of the world.

Something has to give to resolve these inconsistent macroeconomic policy strategies. Not all countries can have export-led growth, if that is defined to mean a faster growth of exports over imports in all major economies. This is what has made the focus on the need for currency re-alignment —and pressure on China to lift its exchange rate — so intense. After the 2008 crisis and the collapse of the U.S. and European economies, an urgent priority is to restore industrial country growth and absorb the unemployment it created. Before the crisis, real exchange rates (set in East Asia) and real interest rates (set in New York) underpinned strong growth both in East Asia and the industrial world. But this arrangement also gave rise to global imbalances. It created the financial fragility, and the vulnerability to financial crisis, that was the context in which crisis occurred.

The U.S. can lift growth in the short run if it continues to over-spend relative to its long-run capacity. There are signs that this strategy is having some success. But this growth trajectory will only be sustained if global imbalances worsen again—if the current account surpluses in China (and Germany) expand and the U.S. current account deteriorates further. In this trajectory, there are large risks, at some point in the medium term, of a collapse of the U.S. dollar and risk of a dollar crisis. These policy strategies over time will collectively push the world toward another low-interest-rate bubble. That will be bad for China, and for Asia generally, for which the current level of interest rates is clearly too low and quantitative easing presents problems. Further, international regulation is not yet strong enough to protect against the potential fall-out from that.

These are the policy dilemmas that the G-20 faces this year. They were put on the table in Seoul last November and the G-20 has begun to confront them by putting the MAP in place, with an aim of ensuring that national policy strategies are more closely integrated and sensitive to the global outcomes they might deliver. Although it is still a work in progress, it is one that has moved forward in Paris. More importantly is commitment by national leaders to define how they will re-jig policy strategies so as to take the pressure out of the strains in the international economy.

The Chinese leadership openly accepts that change is required in the exchange rate regime but argues, with justification, that shifting nominal exchange rate change alone will not prevent the re-emergence of the imbalance problem. China is therefore committed to putting in place structural reforms that are essential to delivering a domestic demand-led model of growth. There are complementary commitments in America and Europe that will also take time to deliver.

The MAP offers opportunity for China and Asia to define a constructive agenda of structural reform that will help break the impasse in medium-term macroeconomic policy coordination. The G-20 model is one that is familiar and valued in Asia from its experience in APEC of bringing national reform strategies forward for collective consideration, retaining independent national commitment in carrying them forward. It is a model that offers respect for national initiative and encourages responsibility for collective interests.

Behind the push for rebalancing regional and global growth is the recognition that continuation of "growth as usual" will no longer deliver on these objectives. The old open trade, open investment strategy is not enough. Global markets will find it very hard to absorb the pressures of Asia's growth because of how large China and India already are and how much strong growth potential they have. The pressure of current account imbalances is only one dimension of this and a symptom of the problem, but it is not the most important dimension that needs to be dealt with in achieving a better balance in regional and global growth.

The imbalances that have emerged in our economies, at their core, are a product of the whole range of structural and institutional impediments to efficiently mobilize resources for production and investment and deliver output so that the benefits of growth are spread widely across our communities; they are not the product of savings imbalances or exchange rate misalignments but they underlie them. On these issues—how best to make progress in opening markets through regulatory and institutional reform—Asia, from Japan to China and India to Australia, has a constructive agenda to set out and will be expected to display it.

The G-20 has opened the space for a cooperative process that can deliver the global policy coordination we now so desperately need. If it works, the process will institutionalize, globally, a new shared responsibility for managing the global macro-economy.