Opportunity for Asia and the G-20

Peter Drysdale — *Emeritus Professor of Economics, Australian National University; Head of the East Asian Bureau of Economic Research; Co-editor, East Asia Forum*

Soogil Young — *President, Korea National Strategy Institute; Chair, Korean National Committee for Pacific Economic Cooperation; Chair, Presidential Committee on Green Growth, The Republic of Korea*

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The most important outcome of the Seoul G-20 Summit will be reassurance from G-20 leaders of strong commitment to macroeconomic recovery strategies and structural changes needed for long-term balanced growth and sustained development. As the most dynamic in the global economy, Asian economies have an especially important role in setting the course ahead for rebalanced and sustainable growth.

The recovery of some industrialized economies is still fragile and will require continuing expansionary measures, within the bounds of debt sustainability (which are a greater constraint for Europe). IMF projections show that global imbalances will rise for some time as growth recovers in the period to 2015. With U.S. unemployment still above 9 percent, Asian economies must rely less on the U.S. consumer for final demand and more on domestic and regional demand as Asia continues to increase in importance as a growth pole in the world economy. In much of Asia and the other emerging economies, strong growth will require moderation of government spending to allow private spending to accelerate without inflation.

Worldwide depression in 2008 was averted due in part to the major economies working together to re-start their financial markets and refraining from systematic resort to protectionism or competitive devaluations. Their actions created the confidence needed to stimulate demand sufficiently to avoid a depression by setting fiscal and monetary policy appropriate to national economic conditions.

In 2010, leaders can agree to continue the coordination of policies, informed by the work they commissioned from the IMF. The IMF's Mutual Adjustment Process scenarios set out two vastly different prospects for employment and living standards in the next five years:

- *either* weak recovery, and a second wave of recession, with poor coordination of macroeconomic policy settings;
- *or* a sustained recovery from the global financial crisis with rising employment, if G-20 governments adopt an approach that is coordinated around rebalancing growth.

Sustained and balanced growth will need to be backed by commitment from leaders to carefully calibrate macroeconomic policies, including exchange rate policies and structural change policies that maintain confidence in markets at the same time as they address the fundamental causes of imbalance in national economies as well as the global economy.

Correcting imbalances will require continued macroeconomic policy adjustment and fiscal and structural reform in both countries with current account deficits and those with current account surpluses. In countries with current account surpluses, of which there are several in Asia, the priority should be on substantial restructuring, which is important for national development and made easier given a strong capacity for growth. While current account surpluses are falling in key Asian economies, it will be important to prevent these surpluses growing again. Asian members of the G-20, drawing on their own past experience and success, can help to set ambitions for structural reform and change that are crucial to achieving more balanced and sustainable global growth.

There are two key lessons here: first, rebalancing strategies will not succeed if they are one-dimensional—they need to involve a suite of complementary policy measures; second, they take time to implement. There are no simple measures that can make large imbalances disappear rapidly. But establishing confidence in the direction of change will restore the confidence of investors, consumers and bankers that the recovery is sustainable.

One vital component of policies for rebalancing growth is structural reforms that strengthen domestic demand and improve productivity through measures such as:

- strengthened social safety nets including pension and health insurance programs;
- enhanced physical infrastructure that reduces supply bottlenecks to sustainable growth;
- reform of factor markets to remove distorting subsidies to industrial production; and
- investment in the engines of sustainable long-term growth, such as energy and resource efficiency, renewable and clean energies, green transportation and cities, and quality-of-life services like health care and sanitation.

Household demand can be expected to expand as wages rise, labor mobility is enhanced and households are provided with capital income-generating opportunities. The structure and timing of particular reforms will depend on each country's economic circumstances and institutions.

A second important component is exchange rate policy and greater exchange rate flexibility. Increased exchange rate flexibility is necessary in order to encourage relative price shifts between tradable and non-tradable activities and economic rebalancing. Exchange rate flexibility will assist in shifting the economy toward more productive use of resources and make it easier to control inflation and manage external shocks. The Asian experience in the 1980s and the 1990s shows that major Asian economies have a strong national interest in deploying increasingly flexible exchange rate adjustment for these tasks along with supportive monetary policy. The structure and timing of such reforms will depend on each country's economic circumstances and institutions decision.

Recent suggestions for a multilaterally-agreed upon exchange rate re-alignment do not suit present circumstances. Indeed, very large one-off exchange rate changes would likely disrupt trade and currency markets and could threaten the stability of the international monetary system.

The idea that exchange rate re-alignments should alone carry most of the burden of correcting national and global economic imbalances is seriously misguided. Reform of structural impediments in national financial, factor and commodity markets will also be needed. Sustained recovery needs flexible exchange rate regimes, not a series of negotiated adjustments. Exchange rate flexibility will sensibly constitute one part of a package of policy measures available to governments.

Effective coordination to underpin future stability of the international monetary system could be undermined by asymmetrical adjustment between deficit and surplus countries. While current account deficit countries cannot sustain their deficits and are forced to run down their reserves or depreciate their currencies, surplus countries can find it politically convenient to maintain nominal values of exchange rates and run up foreign exchange reserves. Cooperative action to avoid this is highly desirable and it will depend on surplus countries having more say and confidence in international monetary arrangements. IMF governance reform is essential to building this confidence.

On the question of making financial market regulation more effective and robust, Asia could make a positive contribution to strengthening global financial system governance by establishing a functioning Asian Financial Stability Dialogue that draws in the whole region and complements the work of the Financial Stability Board. This would add to the work of building confidence globally in financial market regulation.

The task of avoiding a second round of recessionary pressure on the international economy induced by trade or currency measures highlights the importance of using the window of political opportunity that exists in 2011—prior to major political transitions in a number of countries scheduled for 2012—to complete the Doha round. The Seoul agenda needs to underscore the centrality of trade policy to recovery and development.

The Doha Round has dragged on for far too long. At Seoul, leaders can agree on a balance of interests and direct negotiators to complete the Doha Round as soon as possible and no later than the end of 2011. The time has come to give trade ministers permission to conclude the Round to lock in the gains already available. They can then address the issue of WTO reform, its negotiating modalities and the problem of bilateral and regional arrangements not being subject to effective discipline so that they serve core global trade objectives at a critical time for openness. Repositioning the WTO so that it can deal with all dimensions of contemporary international commerce is central to the G-20's development agenda.

The G-20 provides the opportunity for Asian economies to address all these and other problems that need global solutions. Asian economies need to decide how best to take up these issues through the G-20, especially by putting forward options which support and complement the interests of other regions. Conscious that the G-20 process will work most effectively if there are clear priorities given to the discussion of major issues, it will be helpful to flag and position issues of importance to the region for future meetings and give fuller consideration to issues of global priority through regional meetings. An early opportunity to establish productive interaction between the global and regional processes is the Yokohama APEC leaders summit immediately following the G-20 Seoul Summit. APEC leaders can link the pursuit of their five-part growth strategy to G-20 priorities, with emphasis on rebalancing growth. Careful thought needs to be given to how Asian members can best link their participation in trans-Pacific and East Asian regional arrangements to their individual responsibilities in the G-20 and to the representation of broader regional interests. How regional structures should develop or be reorganized to serve these purposes is an important issue for further consideration.