



# Policy Recommendations to Secure Balanced and Sustainable Growth in Asia

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**To Asian Leaders:**

**Policy Recommendations to  
Secure Balanced and Sustainable Growth in Asia**

The global economy is now recovering from the global financial crisis, and Asian economies have been leading the recovery, thanks to strong economic fundamentals and aggressive monetary and fiscal stimulus measures. Nevertheless, in light of the weak recoveries in the United States (US) and Europe, a sustainable recovery does not yet look assured. New concerns have arisen, including the sovereign debt crisis in southern Europe, lingering worries about a double-dip recession in the developed economies, uncertainties about the appropriate timing of the withdrawal of monetary and fiscal stimulus programs around the world, renewed large short-term capital inflows to emerging economies, currency appreciation pressures and “currency wars.” Asian leaders urgently need to formulate and implement economic and financial policies to offset these risks, and to secure sustainable long-term growth that is socially inclusive and environmentally friendly. Progress in these areas can be achieved in both global forums, especially G20, and in regional forums such as the ASEAN+3, East Asia Summit and APEC processes. The undersigned have developed and support the broad thrust of the policy recommendations presented in this document. In principle, the recommendations are intended for Asian economies; although, in some cases, they may only be relevant to the ASEAN and/or ASEAN+3 economies. Through the Asian Policy Forum, an entity supported by the Asian Development Bank Institute (ADBI), ADBI has facilitated the development and compilation of these recommendations, including organizing workshops and conferences to discuss the recommendations, soliciting individual contributions, and updating with recent developments. However, this document reflects the individual opinions of the signatories, and should not be construed as the official position of either the institutions they represent, the Asian Development Bank or the ADBI. Furthermore, the individual authors retain some differences of view on the details, while joining to recommend decisive action by leaders.

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# Policy Recommendations to Secure Balanced and Sustainable Growth in Asia

## Executive Summary

**Introduction.** This paper summarizes our recommendations for economic and financial policies of Asian economies to offset various risks to the durability of the current economic recovery, and to secure sustainable long-term growth that is socially inclusive and environmentally friendly. The rise of the Group of Twenty (G20) as the premier forum for global economic policy coordination has also given Asia an increased opportunity to play a more important role to effect change in the global economic and financial architecture and to promote economic rebalancing, while Asia's successful economic recovery program has given it unprecedented prominence. In addition to a stronger Asian voice in world forums, we believe that strengthening and developing institutions for regional cooperation can make a significant contribution to achieving these goals. These include the ASEAN+3, East Asia Summit (EAS), and APEC processes.

### ***The Role of Asian Regional Bodies in Global Macroeconomic and Financial Management.***

- Address the following areas: timing and pace of exits from macroeconomic stimulus policies; the need to avoid competitive currency devaluations; the need to implement financial safety nets; and reforms of international financial institutions (IFIs);
- Form a caucus to develop common Asian positions on some important issues;
- Hold the ASEAN, ASEAN+3, and EAS meetings, as well as the South Asian Association for Regional Cooperation (SAARC) meeting, before the G20 meetings to institutionalize communication between G20 members and non-members; and
- Involve regional development banks in the G20 process to help non-G20 developing countries to respond to the global financial crisis and achieve inclusive and sustainable development.

### ***Policies for Reducing the Global Current Account Imbalance.***

- Pursue both economic structural reforms that can expand regional trade and final demand and real exchange rate adjustment;
- Develop stronger regional and global financial safety nets to reduce the need to accumulate foreign exchange reserves; and
- Promote greater use of Asian currencies to reduce dependence on the US dollar.

### ***Policies for Inclusive and Green Growth.***

- Increase the share of labor income in GDP in some countries to improve inclusiveness and raise consumer spending;
- Implement labor market reforms to increase employment growth during economic upturns;
- Improve the coverage and quality of social protection to reduce vulnerabilities among the poor and low-income people and support increased consumer spending by reducing the precautionary demand for savings;
- Promote the use of market-based mechanisms to enable firms and households to internalize social environmental costs and to encourage the diffusion and deployment of green technologies; and

- Commit to end pervasive subsidies and other distortions that lead to excessive energy consumption, pollution, and high greenhouse gas emissions, complemented by measures (such as targeted, conditional cash transfers) to mitigate the adverse social impacts.

***Trade and Investment Integration in Asia.***

- Renew efforts to complete the World Trade Organization (WTO) Doha round to support liberalization of goods and services trade and investment;
- Rationalize and harmonize rules of origin (ROOs) and product standards, and implement mutual recognition of the qualifications of service providers;
- Support trade integration via consolidation of bilateral and plurilateral agreements into a region-wide agreement, in ways that are open, as non-discriminatory as possible, and WTO-consistent;
- Promote infrastructure investment; and
- Address issues of food and energy security without jeopardizing free trade.

***Financial Regulatory Reform in G20 Countries.***

- Ensure that tighter standards, such as higher capital and liquidity requirements, do not choke off the global recovery;
- Support the development of a global mechanism for managing volatile short-term capital flows, and development of macroprudential surveillance and regulation at the national and regional levels; and
- Establish an effective regulatory framework for macroprudential supervision and regulation at the national and regional levels.

***Regional Economic and Financial Cooperation.***

- Enhance the Chiang Mai Initiative Multilateralization (CMIM) further to develop it into a full-fledged Asian monetary fund;
- Establish a regional Asian financial stability dialogue that is consistent and coherent with global institutions; and
- Consider further measures to enhance the deepening and integration of Asian financial markets, especially local currency bond markets, to facilitate the recycling of Asia's high levels of savings to finance investment and consumption in the region.

***The IMF and the World Bank: Reform of Operations and Governance.***

- Set a concrete target of a quota share, such as one third for Asia (compared with just over 20% now) by 2016;
- Adjust the process for selecting the chairs of the executive board;
- Support selecting an Asian as the managing director of the International Monetary Fund (IMF) in the near future; and
- Review the international financial architecture on issues such as measures to manage short-term capital flows, and balance the adjustment process between capital exporting and capital importing countries.

# **Policy Recommendations to Secure Balanced and Sustainable Growth in Asia**

## **Introduction**

The recent financial crisis and global economic downturn did not originate in Asia, but Asian financial markets and economies were severely affected, mainly via the export channel, and also, in some cases, due to shortages of foreign exchange. Fortunately, as a result of a combination of strong economic and financial fundamentals and aggressive implementation of monetary and fiscal easing policies, Asian economies are strongly recovering. It is no exaggeration to say that they are now leading the global economic recovery at a time when the advanced economies, mainly the United States (US) and Europe, still face uncertain prospects.

In March 2009 the Asian Policy Forum, with the support of the Asian Development Bank Institute, published a document entitled “Recommendations of Policy Responses to the Global Financial and Economic Crisis for East Asian Leaders.” This document received wide recognition as an Asian-wide statement of not only regional but also global significance. Much has happened over the past year and a half, so that we believe it is appropriate to review these developments and update our policy recommendations. In some cases, the previous recommendations were adopted, such as those for aggressive monetary and fiscal stimulus, which clearly contributed to the rapid and strong economic recovery in Asia. In other cases, such as financial sector regulation and reform, the international agenda has been dominated by the viewpoints of the US and Europe, and Asian economies need to articulate and express strongly their concerns and views in this area. Regarding regional cooperation, initiatives such as the multilateralization of the Chiang Mai Initiative and the establishment of an ASEAN+3 Macroeconomic Research Office (AMRO) have made some progress, but further work needs to be done. Trade liberalization measures are progressing, but at a varied pace. Changes in other areas—such as the need to reduce the global imbalance and to rebalance growth in Asia to a new and sustainable pattern, characterized by reliance primarily on regional and domestic demand, and with greater social inclusion and environmental sustainability—have barely started.

In the meantime, new risks have emerged, most notably the sovereign debt crisis in southern Europe, lingering worries about a double-dip recession in the advanced economies, uncertainties about the appropriate timing of the withdrawal of monetary and fiscal stimulus programs around the world, renewed short-term capital inflows in emerging economies, currency appreciation pressures and “currency wars”. Now that the near-term recovery targets have been achieved, Asian policymakers need to focus on ways to make the recovery sustainable and enduring. This means a growth pattern in Asia that is consistent with sustainable current account surpluses, relies more on regional and domestic demand, leads to greater social inclusion, and is environmentally sustainable.

The need for a strong, unified, and clear Asian voice is obvious. The success of Asian recovery measures, together with continued weakness and fragility in the US and Europe, has given Asia new prominence and authority in world forums. The rise of the Group of Twenty (G20) as the premier forum for global economic policy coordination has also given Asia an increased opportunity to play a more important role for effecting change in the global economic and financial architecture.

In addition to a stronger Asian voice in world forums, we believe that strengthening and developing institutions for regional cooperation can make a significant contribution to achieving these goals. These institutions include the ASEAN+3, the East Asia Summit (EAS) and the Asia-Pacific Economic Cooperation (APEC) processes. We support the development of the Chiang Mai Initiative Multilateralization (CMIM), under the auspices of the ASEAN+3 finance ministers, into a full-fledged Asian monetary fund. New regional institutions, such as an Asian financial stability dialogue (AFSD), could play an important role in macroeconomic and financial stabilization efforts in the future. Moves to integrate regional financial markets, including more harmonized regulation and mutually recognized standards, could facilitate the development of intraregional financing to enable the high savings in the region to be recycled to finance attractive investment projects, which in turn would reduce the regional current account surplus.

Asian leaders need to meet and enunciate an Asian program to achieve balanced and sustainable growth. The articulation of such a program will boost confidence and position the region as a leading center of the global recovery. This will require intensifying the process of economic and financial cooperation in Asia. This report presents our policy recommendations in the following areas: the role of Asian regional bodies in global macroeconomic and financial management; policies for reducing the global current account imbalance; policies for inclusive and green growth; trade and investment integration in Asia; financial regulatory reform; regional economic and financial cooperation; and reform of international financial institutions, particularly the International Monetary Fund (IMF) and the World Bank.

## **I. The Role of Asian Regional Bodies in Global Macroeconomic and Financial Management**

### **Basic principles**

G20 has emerged as the premier forum for global policy coordination. The fact that it includes both advanced and emerging economies represents a major paradigm shift. Asian members can make G20 more effective by bringing new ideas and viewpoints to the table and contributing to a dynamic dialogue. Asian economies need to bridge G20 with other intra-Asian and trans-regional policy forums in an effective way. Two principles should guide participation of Asian economies in regional and global forums:

First, Asian members of G20 should form a caucus to develop common positions on some important issues, without constraining non-members to support particular positions. They should be proactive rather than reactive. Holding the ASEAN, ASEAN+3, and East Asia Summit (EAS) meetings, as well as the South Asian Association for Regional Cooperation (SAARC) meeting, before the G20 meetings to exchange information would be desirable in order to institutionalize communication and information sharing between G20 members and non-members.

Second, Asian G20 members should be cautious about claiming to speak for the region as a whole, but need to be aware of regional views. The G20 should use a number of Asian institutions as delivery mechanisms and consultation vehicles when appropriate. More generally, regional and trans-regional forums like ASEAN, APEC, and the Asia Europe Meeting (ASEM) should engage more with the G20 process.

The consultation process should be two-way. It is important to identify what additional regional infrastructure would be needed to enhance this process. The ASEAN chair can play a role in communicating to the G20 the views of ASEAN members that are not members of G20. Regional multilateral development banks should also be invited to the G20 process as they can both facilitate communication with non-member developing economies and address issues of economic development, inclusion, and green growth. These banks may also support fiscal stimulus efforts in economies where local finances are constrained.

## **G20 issues**

*Asian perspective:* The center of global economic gravity is continuing to shift toward Asia, both in terms of economic size and growth potential. This should be reflected both in the voice of Asian members in the discussion and the perspective from which issues are framed. Asian members should increasingly become agenda and rule setters, not just followers. From the standpoint of Asian (and all) emerging economies, the following issues need to be given due attention:

- appropriate timing and pace of exits from macroeconomic stimulus policies in light of short-term capital inflows and currency appreciation pressures;
- the need to avoid competitive currency devaluations (“currency wars”), while facilitating currency adjustments consistent with macroeconomic and financial-sector stability;
- implementation of financial safety nets (reliable access to hard currency liquidity), especially to reduce the risks of “sudden stops” or capital flow “reversals”; and
- reforms of international financial institutions (IFIs).

*Policy coordination:* In the current economic environment of diverging economic performance, global policy coordination is becoming more difficult among the G20 members. The formula of “credible, properly phased and growth-friendly plans to deliver fiscal sustainability” (Toronto G20 Summit) represents an uneasy compromise between European and US views, and it remains unclear how to implement this. Asian leaders need to consider how Asia can contribute to achieving a sustainable global economic recovery when growth in advanced economies remains weak. Asian leaders need a more substantial dialogue regarding the US proposal for a framework to achieve strong, sustainable, and balanced growth. There is a case for thinking that current-account deficit countries should tighten fiscal policy relatively early while surplus countries should pursue structural reforms to support a private-sector-led economic expansion. However, any fiscal tightening should be pursued cautiously so as not to risk jeopardizing the global recovery. The risks of a double-dip recession and associated policy responses need to be considered. Asian leaders need to ensure that G20 has the capacity to carry out fiscal and monetary policy coordination, in cases where there is a decoupling of growth prospects in advanced and emerging economies and policy divergence between the two. Lack of policy coordination also has potential implications for exchange rates, which implies a greater need for a policy dialogue to monitor and respond to market conditions.

*Institutionalization of G20:* There should not be a premature institutionalization of G20, such as establishing a permanent secretariat. G20 should develop slowly as a global governance body by building on consensus, gaining authority and legitimacy, and achieving positive results. Informal discussion groups of all kinds, including G7/G8 and BRICs, are entirely legitimate, but they should aim to strengthen global governance by providing broad-based solutions to the problems the global economy is facing.

Ultimately, G20 may have to engage with the United Nations in order to be inclusive and secure legitimacy for any actions which claim a basis in international agreements. But much can be gained from relying on consensus rather than legal status. The objective should not be discussion for its own sake but agreement and implementation. This will often require interaction with regional forums and regional multilateral development banks in the G20 process.

### **Expansion of the East Asia Summit**

We welcome the initiative of ASEAN to invite the US and Russia as part of the East Asia Summit group. This extended group should primarily address wider issues such as the environment, energy, food, and security.

## **II. Policies for Reducing the Global Current Account Imbalance**

### **Basic principles**

Resolving the global current account imbalance is desirable to support global economic recovery and sustainable growth. In view of the uncertain growth prospects of the US and Europe, Asia needs to take a leading role to fill the global demand gap. The adjustment process has to be equitable—there should be a focus on what both current-account deficit and surplus economies need to do.

A distinction should be made between issues related to current account surpluses and foreign exchange reserve accumulation. The former reflects imbalances between production and spending, whose solution would require increased spending relative to production, along with corresponding shifts in the production mix, with an increased focus on services and non-tradables. A current account imbalance also reflects an imbalance between savings and investment, and its narrowing would require an increase in investment relative to savings. Foreign exchange reserve accumulation has been driven partly by the desire for currency stability at undervalued exchange rates, but the major driver has probably been the motive of self-insurance against crises. These efforts have tended to exacerbate the global imbalance. Therefore, Asian economies need to reconsider the pros and cons of currency stabilization policy, particularly from national and global macroeconomic perspectives. There is also a need to strengthen global and regional financial safety nets and crisis management mechanisms to reduce the need for self-insurance. Well-functioning financial markets which facilitate management of currency risk and the evolution of a range of international reserve currencies are needed as well.

We are very concerned about the risks of growing short-term capital inflows and currency appreciation pressure in emerging economies, and competitive currency devaluations (“currency wars”). These could jeopardize the global economic recovery, disrupt international trade, and run contrary to orderly adjustment of the global current account imbalance. G20 nations need to oppose unilateral devaluation moves and support currency stability, while allowing for adjustments where needed.

Export-led growth itself should not be rejected as it enhances dynamic efficiency of the economy; the key point is to liberalize import markets and diversify export products and destinations. Excessively large trade surpluses can be reduced by opening up import markets and promoting domestic demand drivers.

## **Structural approach to reducing current account imbalances**

Correcting current account imbalances requires Asian economies to develop a new growth strategy based on regional and domestic growth. This requires structural reforms to be made such as reducing factor and resource market distortions, stimulating household consumption, investing in education, promoting the integration of Asian markets for goods and services, and deepening integration of financial markets to mobilize Asian savings to fund investment needs in the region. However, we are very cautious about adopting numerical targets for current account balances.

*Greater focus on structural reforms:* Asian leaders should seek to make a positive contribution to the international debate on imbalances by describing how Asia is addressing this rebalancing issue by emphasizing structural reforms, rather than simply focusing on the People's Republic of China (PRC) yuan-US dollar exchange rate. The role of the PRC is important, but the global imbalance is not simply a bilateral issue between the US and the PRC. Also, it should be recognized that the large size of the PRC trade surplus partly reflects its position at the end of the Asian supply chain.

The approach on structural reforms should focus on removing biases that tend to create large net exports, including export subsidies, import restrictions, and other factor price distortions that contribute to large corporate savings. The global economy will benefit as the PRC removes these distortions by increasing the share of wages in value-added, by allowing energy and resource prices to rise to levels consistent with international prices, or by promoting investment by small- and medium-sized enterprises (SMEs). Measures to facilitate household consumption, such as stronger social safety nets and more inclusive provision of financial services, would be desirable. Liberalization of regional trade and investment in goods and services can contribute to this goal as well.

Steps need to be taken to expand the effective size of final regional demand, taking advantage of such developments as the rise of the Asian middle class. These steps would include measures to liberalize trade, investment, services, and factor flows within the region and to improve the infrastructure for trade. Along with this, development of financial markets in Asia can reduce both the incentive to invest Asian savings in the advanced economies and the exposure to volatile short-term capital flows.

An important principle is that real exchange rate appreciation can be achieved either by nominal foreign exchange rate appreciation or by increases in prices and wages to facilitate rebalancing. Structural reforms that raise nominal wage levels in Asia can play an important role in this. However, given that rapid wage increases can be translated into high consumer price inflation, prudent macroeconomic management would require some adjustment of nominal exchange rates.

*US adjustments:* Asian economies may also want to advise the US to raise productivity to stimulate exports, rather than through US dollar nominal depreciation, to pursue gradual fiscal consolidation, and to reduce excessive spending, including consumption of fossil fuels.

## **Financial safety nets to reduce the need for foreign reserve accumulation**

Asian surplus economies' export-led strategies, which have been accompanied by large-scale reserve accumulation, need to be reconsidered. Asia needs stronger financial safety nets to reduce the need to accumulate foreign exchange reserves, both at the global and regional levels. The CMIM needs to be strengthened further, so that the IMF linkage to lending conditionality can eventually be removed. The current reliance on the US dollar as a reserve currency may have contributed to instability because of the need for Asian countries to increase their holdings of US

dollar foreign exchange reserves which help to finance the US current account deficit. There is a need to lessen such dependence. Asian economies should promote greater use of Asian currencies, including internationalization of the PRC yuan.

### **III. Policies for Inclusive and Green Growth**

#### **Basic principles**

Asian economies should commit to achieving more equitable and sustainable growth, i.e., inclusive and green growth. Even during a period of fiscal consolidation, advanced economies should commit to maintaining levels of official development assistance (ODA) and other official flows to help promote inclusive and green growth in developing countries. In particular, there is a key role for long-term ODA investment in strengthening institutions and building capacity in national government agencies, the private sector, and policy research institutions in developing countries.

#### **Inclusive growth**

Asian economies need to create opportunities for individuals to share in the fruits of economic growth within an economy, and for individual economies to share in the fruits of growth in the global economy. Support for agriculture, SMEs, and micro enterprises is an important aspect of this. The key is to facilitate the process of economic change by making it feasible for people to cope with the effects of those changes. Sharing in global economic growth is best promoted by economic and technical cooperation driven by mutual self-interest and external assistance.

*Employment and productivity:* Employment and productivity growth are the chief vehicles for raising incomes and economic participation. Increasing the share of labor income in GDP can make a major contribution in some countries to improving inclusiveness and raising consumer spending. The negative impacts of the global financial crisis on employment need to be addressed. Public investment spending should aim toward maximizing job creation, especially for the poor, including in agriculture and SMEs, in a way that is consistent with green growth objectives. Labor market reforms can contribute to increasing employment growth during economic upturns. Improvements of labor rights and corporate governance can contribute to increasing the share of labor in GDP.

*Social protection and other public expenditures:* Levels of social protection in Asia generally remain low by international standards, contributing to social vulnerabilities among the poor and low-income people and a high precautionary demand for savings. Improving the coverage and quality of social protection can reduce such vulnerabilities and, at the same time, support increased consumer spending by reducing this precautionary demand. Improved quality and affordability of public services can also benefit the poor a great deal. Social protection programs should be well-designed so that they do not unduly add fiscal burdens or change incentives in ways that may undermine social objectives.

*Infrastructure investment:* Increased infrastructure investment for rural sector development and urban development, such as in transport, water, and sanitation systems, can promote economic inclusion as well. Asian economies should support development of a regional infrastructure fund to help strengthen cross-border connectivity, especially in countries that are fiscally constrained.

*Support for SMEs and micro enterprises:* Support of SMEs and micro enterprises is important, in view of their important roles in economic activity and employment in Asia. SME support measures can make an important contribution to creating and stabilizing employment. Policies to encourage clustering and cooperation with large firms need to be pursued, since these are probably the most important drivers of SME vitality. Financial inclusion, such as establishing SME credit databases, can make an important contribution to increasing the transparency and productivity of financial services received by SMEs. Expanding the access of individuals to financial services via innovations in microfinance is also a key aspect of inclusion.

### **Green growth**

We support measures to encourage cleaner and greener economic development in various sectors, such as manufacturing, transport, and agriculture, and in urban areas. “Green” growth—made possible through a growth agenda that internalizes the environmental costs in resource use—would require regional coordination because of spillover effects of policies. Coordination should include commitments to end pervasive subsidies and other distortions—for both final consumption and production activities—that lead to excessive consumption of energy and materials, cause serious environmental contamination, and accelerate greenhouse gas emissions.

*Policy measures:* The calls for a “green new deal” as part of large-scale public sector support have generally not yet been heeded. As the largest consumer, governments should take the lead in purchasing green goods and services. We support the use of market-based mechanisms to enable firms and households to internalize social environmental costs and to encourage diffusion and deployment of green technologies at a scale required. Tax incentives can be given for the production and consumption of green products and services. There are opportunities for innovation and experimentation, such as the use of cap and trade mechanisms and carbon taxes in economies that are ready for them. Also, environmentally harmful energy subsidies need to be reduced, after careful introduction of targeted, conditional cash transfer programs to minimize adverse impacts on the socially vulnerable where needed.

*Technology transfer:* We support measures to encourage renewable energy development and green innovation as one of the engines for future growth. Research and development (R&D) support through public and private financing and facilitation of technology transfers to maximize diffusion of available and emerging new technologies should be encouraged, particularly those that are employment-intensive. Protection of intellectual property rights (IPR) plays an important role in this, and more innovative thinking is required to reduce costs where possible, such as Japan’s program of “green aid.” There is a need to distinguish between publicly funded non-commercial and privately funded commercial technologies, where treatment of IPR is different. More generally, there is a need for promoting international consensus on balancing incentives to innovation against permitting access to knowledge.

*Liberalizing trade in environmental goods and services:* There is a need to promote the rapid diffusion of eco-friendly technologies across sectors and economies. This could proceed in a manner similar to the Information Technology Agreement.

## **IV. Trade and Investment Integration in Asia**

### **Basic principles**

Asian leaders should support the process of trade and investment integration, keeping in mind that the ultimate goal is increased integration with, and openness in, the global economy to promote global growth and development. Asia offers a positive example of, and should be a force for, globalization and liberalization, and should be proud that it has not resorted to protectionist measures. Asia needs to continue to support liberalization of trade in goods and services, and investment globally. Regional and interregional institutions can also play an important role in facilitating regional investment and connectivity.

We support basing the process of Asian trade integration on the following principles: moving from the easy to the difficult; moving step-by-step; and taking a multi-pronged approach with global links. Related key goals include liberalizing trade in goods and services through rationalizing and harmonizing rules of origin (ROOs), product standards, and mutual recognition of the qualifications of service providers. Expanded investment in hard and soft infrastructure for trade can make an important contribution to promoting increased intra-regional trade and supporting secure, balanced, and sustainable growth.

### **WTO-related issues**

There should be renewed efforts to complete the World Trade Organization (WTO) Doha round. Murky protectionism, including anti-dumping measures and others that are WTO-compliant, is becoming an increasing problem. Any such protectionist tendencies need to be resisted. We support the continued use of WTO dispute resolution mechanisms in the absence of positive outcomes from negotiating rounds.

### **Role of bilateral and plurilateral trade agreements**

In addition to the Doha round, Asian leaders should continue to support trade integration via consolidation of overlapping bilateral and plurilateral agreements into a region-wide agreement, and ensure that these agreements be as open and non-discriminatory as possible as well as WTO-consistent. The keys to achieving this are liberal accession clauses and processes. However, the process needs to be pursued cautiously, and in a way that is not perceived negatively by the rest of the world. In the longer-term, key milestones in terms of progress toward achievement of Asian trade integration include: implementing the ASEAN Economic Community (AEC), achieving a free trade agreement (FTA) among the PRC, Republic of Korea, and Japan (CJK FTA), and finally connecting the ASEAN+1 FTAs with the CJK FTA and with India, Australia and other economies to forge a region-wide single FTA.

Progress toward the AEC has so far been uneven. The adoption of the “scorecard” approach may speed up implementing the commitments by individual member countries. A CJK agreement is a major missing link in the current regional trade architecture, but progress needs to be supported by increased trust among these countries. Along with these goals, rationalizing, coordinating, and harmonizing ROOs and liberalizing services with mutual recognition need to receive priority.

The principle of “moving from the easy to the difficult” suggests that the first priority should be to achieve a CJK FTA, followed by an East Asia FTA (EAFTA) based on the ASEAN+3 countries, and then, a Comprehensive Economic Partnership in East Asia (CEPEA) including India, Australia and New Zealand. The principle of “taking a multi-pronged approach with global links” suggests that agreements such as the Trans-Pacific Strategic Economic Partnership (TPP) and FTAs with the European

Union (EU) are appropriate for increasing links with the US and Europe. Nevertheless, flexibility is needed, and a number of differing approaches should be allowed to progress simultaneously.

Asian leaders in G20 should promote international rules and procedures that are consistent with Asian economic integration and the development of Asian supply chains. The key is to understand to what extent regional agreements can be made consistent with global trade liberalization, and to review WTO rules on such agreements from this perspective.

### **Services liberalization**

Asian leaders should advocate and sponsor an international thrust toward liberalization of trade in services. However, the traditional mode of trade negotiations on goods is not well suited for services. APEC's Group on Services persuaded all APEC economies to participate in the current WTO negotiations on services, albeit at a low level in some cases. The conventional offer and acceptance modality which worked for goods tariffs is not working well in services, and a new initiative is needed, perhaps putting the onus on economies to justify their refusal of requests from trading partners. It may be possible to make further progress via bilateral and plurilateral agreements with mutual recognition. Also, further progress is needed in the areas of right of establishment (mode 3) and labor mobility (mode 4) to realize the full benefit of services liberalization. Also competition policy, network effects, and network compatibility issues are important.

### **Resource and food security**

Asian leaders may consider establishing an Asia-Pacific Energy Community, which champions not only energy security but also free trade of energy products. Development of food reserves is still very important, and incentives for development are still needed in the near-term. Also, they may consider developing an East Asian Agricultural Policy—including pooling of food reserves. Export moratoriums on agricultural products, in response to high prices, should be avoided.

## **V. Financial Regulatory Reform in G20 Countries**

### **Basic principles**

The financial sector should serve the interests of the real sector, rather than being focused on simply generating profits from financial trading and other activities.

We welcome recent progress in creating stronger supervisory frameworks in the US and Europe—where the global financial crisis originated—including the focus on capital adequacy and liquidity standards, leverage ratio limits, regulation and supervision of systemically important financial institutions (SIFIs), monitoring of hedge funds, transparency of over-the-counter (OTC) derivatives, credit rating agencies, and compensation—which are important for their financial systems. We hope that their financial systems will be restored to health as soon as possible while avoiding problems associated with “too-big-to-fail” or “too-connected-to-fail”. We also welcome the moves to harmonize global accounting standards.

However, it is important to ensure that tighter standards do not choke off the global recovery or that a “one-size-fits-all” approach does not put excessive burdens on Asian financial institutions. There must be scope for flexibility in the application of

rules, and a balance between financial stability and financial development—including the capacity to innovate—must also be struck.

We support developing a global mechanism for managing volatile capital flows, and developing macroprudential surveillance and regulation at the national and regional levels. Financial reform needs to be accompanied by increased capacity building in the region.

### **Asian voice and interests**

There needs to be an Asian voice on financial reform and regulation rather than allowing the debate on issues to be dominated by a perceived choice between American and European approaches. A “one-size-fits-all” approach is inappropriate due to differences in financial systems, stages of development and banking industry practices, and may lead to excessive burdens in areas such as capital and liquidity adequacy requirements and leverage ratios. In addition, there is a risk of spillover effects from developed country regulatory changes and low-interest-rate policies that lead to migration of risky financial activities to Asia that could affect regional financial stability. Asian leaders should consider sponsoring their own research on the impacts of the new regulations on Asian financial institutions and markets.

*Rule-making process:* The issue is one of appropriate regulation rather than more regulation. This includes more technical debates, which may involve the Bank for International Settlements (BIS) and the Financial Stability Board (FSB) more than the G20. Revisions to Basel rules must not be allowed to handicap Asian banks. For example, the last G20 communiqué failed to resolve the issue of requiring derivatives to be standardized and traded on exchanges. While there is little interest in this issue in Asia now, the American approach of using an exchange for standardized derivative contracts while allowing nonstandard contracts among informed participants is preferable to the European approach. There are many unresolved issues in areas such as regulation of SIFIs, cross-border supervision, and the global financial safety net, where the implications for Asian economies need to be considered.

*Management of capital flows:* Volatile capital flows played a major role in both the Asian crisis of 1997–1998 and the global financial crisis. Asian leaders need to put their imprint on a new international financial architecture for constructively managing international capital flows, especially short-term flows, which are most volatile.

*Macroprudential supervision and regulation:* Asian economies should establish an effective regulatory framework for macroprudential supervision and regulation at the national and regional levels. This is a very important lesson from the global financial crisis. They also need to encourage strengthening the objective of financial stability in the mandates of central banks.

## **VI. Regional Economic and Financial Cooperation**

### **Basic principles**

The CMIM is a key regional liquidity support framework, and needs to be strengthened further to become an Asian monetary fund to achieve full effectiveness. There is also a need to establish an AFSD that is consistent and coherent with global institutions concerned with financial stability. Asian progress in this area can provide

a model for the rest of the world. Further measures are needed to promote financial market deepening in the region and support regional investment. Exchange rate policy coordination should be encouraged. Mechanisms for managing capital flows at the regional level need to be implemented as well.

### **Chiang Mai Initiative Multilateralization**

We welcome recent developments to implement and enhance the CMIM, including agreement on contributions, borrowing limits, voting weights, and the establishment of the AMRO. The enhancement process should continue so that the CMIM may develop into a full-fledged Asian monetary fund. The core problems are conditionality and repayment; potential creditor countries are reluctant to lend reserves without assurance they will be paid back, and repayment can be confidently expected only when loans come packaged with conditions, but governments hesitate to demand conditions of their neighbors. Potential debtor countries do not wish to borrow if the borrowing is linked with an IMF program—which is the case when more than 20% of the borrowing limit is to be drawn—given the stigma associated with such programs. Also, funding is still relatively small.

Needed enhancements of the CMIM include: size of funding; development of surveillance capacity; eventual elimination of IMF linkage; and implementation of a flexible precautionary facility in addition to a crisis support facility. The AMRO's role and mandate should be clarified, matched with sufficient resources, and expanded to that of a full secretariat of the finance ministers' process. Because the credibility and authority of the AMRO's surveillance activity are key, it should become an institution with transparency, objectivity, and high standards of professionalism, and should be adequately financed. A flexible precautionary (non-crisis) facility should be established. The extent to which members are committed to respond to AMRO recommendations needs to be clarified, and conditionality also needs to be decided on. The relationship of the CMIM with the IMF will need to be redefined once formal linkage is ended.

The operations of the AMRO and CMIM may also be made more effective by creating a framework where ASEAN+3 finance ministers and central bank governors can work with each other, or at least by developing relationships with the existing central bank governors process in the region (EMEAP). Such moves would strengthen the regional framework for macroeconomic stability and consultation.

*Fiscal funding mechanism:* Asian leaders should also explore the possibility of establishing a fiscal funding mechanism to support fiscal stimulus measures of member countries, or infrastructure investment, when local financing conditions are constrained due to financial turbulence.

### **Asian financial stability dialogue**

Asian leaders should establish an AFSD, including finance ministries, central banks and financial regulatory agencies, to formulate regional views on appropriate principles, regulations, and practical mechanisms for the financial sector. Such a regional institution would establish useful links between international institutions such as the BIS and the FSB with national financial stability entities. Regional institutional developments that generate global public goods such as financial stability can contribute to the evolution of appropriate global financial architecture.

### **Financial market deepening and integration**

Asian leaders need to consider further measures to enhance the deepening and integration of Asian financial markets to facilitate the recycling of Asia's high savings to finance investment in the region. These measures include: establishing a regional mechanism for supporting infrastructure and other fiscal investments; further

expanding the Asian Bond Funds programs, perhaps including corporate bonds; continuing to develop and implement the Asian Bond Markets Initiative, including harmonizing of bond market regulations, infrastructure, and tax regimes; implementing the Credit Guarantee and Investment Facility; and creating an Asia-wide clearing system.

## **VII. The IMF and the World Bank: Reform of Operations and Governance**

### **Basic principles**

Three areas need to be addressed: increased representation of Asian and other emerging economy members, including quotas and chairs of the executive board; reform of lending conditionality; and reform of governance. An increased Asian voice commensurate with the rising importance of Asia in the world economy can change IMF governance in a positive way, and this is necessary to eliminate the IMF stigma in Asia. We support the efforts of the IMF Asia-Pacific Regional Advisory Group to propose reforms of the IMF, and Asian leaders should consider sponsoring a working group to propose additional reforms of the IMF and the World Bank to increase Asia's intellectual contribution to the debate on these issues. The IMF needs to improve its communication and cooperation with regional institutions to develop a more inclusive process. There needs to be a review of the international financial architecture on issues such as measures to manage volatile short-term capital flows, and how to balance adjustments between capital exporting and capital importing countries.

### **Asian representation and governance reform**

Adjustments of voting shares and the process of selection of organization heads need to be pursued. The process for selecting the chairs of the executive board also needs to be adjusted. Asian leaders should propose an immediate increase of IMF voting rights of 6 percentage points for emerging markets, and should set a concrete target of a quota share, such as 33% for Asia (compared with just over 20% now) by 2016. We support selecting an Asian as the managing director of the IMF in the near future.

The governance structures and objectives of the IMF and the World Bank need to be reviewed more thoroughly. The structures created in the 1940s—which include both political and corporate elements—should give way to a modern distinction between governance and management. The board of executive directors should act more like a corporate board and not be involved in day-to-day operations. However, there may be scope for greater inputs from ministers. Management should become more independent from the political process.

### **Operations—Lending and conditionality**

The introduction of enhanced and/or new instruments by the IMF is welcome, including the enhanced Flexible Credit Line and a new Precautionary Credit Line. The size of IMF funding needs to be reviewed, as well as its relationship to other institutions such as the CMIM. Also, the IMF capacity on the ground needs to be reviewed. In light of the experience of the 2007–2009 global financial crisis, the IMF also needs to review its recommendations regarding management of short-term capital flows and the needed policies of current-account deficit and surplus countries in adjusting current account imbalances.

**Fiscal support measures**

The IMF and the World Bank may want to “bail in” sovereign funds to support infrastructure investment and sovereign lending to crisis-hit countries. The World Bank needs to focus on providing global public goods, such as investments related to mitigating climate change and communicable diseases, contributing to achievement of the Millennium Development Goals, global food and energy security, and reducing poverty.