

East Asia Forum Dialogue: Summary

The East Asia Forum Dialogue was held in Sydney, 26-27 March 2008 to discuss the 'Way Forward on Asian Economic and Political Security'. The Forum was addressed by the Prime Minister of Australia, the Hon Kevin Rudd. Around 70 distinguished participants from around the region and Australia took part. The conversation was private but a digest the discussion of the main themes on the program follows.

Asian Economic Developments –Managing Regional Vulnerabilities

- The economic transformation of Asia dominates world attention. But the emerging financial crisis in North America poses a proximate challenge to the dynamic of Asian economic growth. Notions of a 'decoupling' of Asia from the rest of the world are fundamentally spurious. The global economy is – and will remain – important for Asia and vice-versa. The issue is not whether what goes on in North America affects Asia but by how much, whether it checks Asia's growth significantly, and what might be done to ameliorate the effects of shocks from North America or other parts of the world.
- In the medium or longer term a key question is how Asia's growth is likely to change the shape of world output, world trade and the structure of global economic power. There are different projections of Asia's importance in world output and world trade. Those based on market exchange rate values of output suggest that it will be many decades before Asia (or East Asia) challenges the dominance of North America or Europe in world output or world trade. Those based on purchasing power parity values of output suggest that Asia will become the largest regional economy very much more quickly. The different assessments of the region's importance in the world economy may be useful for different purposes. At any point in time, the share of the current international market value of world output is the best measure of the global political reach of economic power. But projections based on purchasing power parity values of output capture changes in international market values of output over time, as

the currencies of rapidly growing economies appreciate in line with productivity. For example, if Japan's changing importance in the world economy had been projected on the basis of current exchange rate valued output in the 1960's its economic size and power would have been vastly underestimated in the 1970s or 1980s.

- This is not just a technical question. The different ways of calculating relative economic prospects affect judgment about what sort of economic and political adjustments the world has to make and how quickly. It is at the nub of questions about economic primacy if not political and security primacy.
- The scale and the importance of Asia for the rest of the world are undoubtedly on a rapid rise. One way of appreciating just how much and why the world has been caught by surprise by the change is to look at the scale of China's and India's impact on a whole range of commodity markets, the energy market and the environment and how their impact can be confidently expected to grow further and dramatically, even in a decade or so. In international markets, China is rapidly becoming the major trading partner for most other Asian economies, including Japan.
- The circumstances the East Asian economy faces now are very different from what they were like a decade ago. Now there are healthy balance of payments surpluses compared with the deficits of the late 1990s and the key risks arise from external (US) rather than internal problems.
- Despite the growing importance of Asian production networks, the lion's share of Asia's final goods exports continues to be exported outside the region (61.3% to the G3 alone). But diversification of export markets – rising shares to Eastern and Central Europe, the Middle East, India and Australia, for example – is likely limit the impact of an American recession on Asia.
- The main mechanism for dealing with shocks since the 1997 East Asian financial crisis has been self-insurance through the accumulation of foreign exchange reserves and policy gradualism (the so-called 'Asian consensus'). This strategy

will need to change going forward as the risks from global imbalances begin to crystallize.

- Excess savings in Asia will continue to exceed desired investment going forward. It is difficult to say how permanent this phenomenon will be. Savings and investment imbalances are in part explained by different demographic transitions in developed and Asian economies. But whatever case, high savings in Asia has placed downward pressure on the world real long-term interest rates with implications for the level liquidity in the global financial system.
- The burden of balance sheet adjustment in Asia is manifesting itself in volatile capital flows, asset price bubbles, and inflationary pressures. Vietnam and India present particular risks.
- Limited capital market development has made handling such volatility tricky and restricts the scope for intermediating savings into productive uses in the region itself.
- Monetary frameworks will be tested going forward and there will be a premium on the design of robust macroeconomic frameworks (and prudential machinery).
- The strength of the appetite for, and the will to implement, structural reform and to effect macro-economic and exchange rate regime change will be key – progress on the former front will reduce the burden on the latter.
- The immediate outlook for economic activity in the region continues promising. Policy trends (including the accumulation of foreign exchange reserves, inflation targeting, financial strength) have increased the resilience of the Asian economies to external shock.
- The American problem is likely to pare Asian growth back somewhat but not much in the shorter term so long as the policy response to the shock in Asia itself is sound.
- There is low probability of a major downturn in China over the next few years.

- But there are material medium term risks and a genuine question about the ability of regional policy makers to manage shocks and undertake real adjustment.

Energy and Environmental Security

- Dramatic increases in Asian energy requirements and emissions are predicted for the East Asian economies through to 2030 (and beyond). Technology is the key to limiting increased carbon emissions without compromising growth.
- Unlike the case of trade policy, it is in no country's self-interest to unilaterally adopt mitigating actions.
- Ameliorating emissions growth is a complex problem that will require commitment to international collective action in various theatres.
- The consensus as to whether the world and the region will succeed in achieving the required reductions in energy requirements and emissions is undeniably pessimistic, although not entirely without hope.
- The worst-case scenario of the Intergovernmental Panel on Climate Change (IPCC) seriously underestimates the extent of the problem for a number of reasons:
 - Chinese growth has been underestimated for decades and shows no signs of slowing in the near future.
 - Declining energy intensity in the late 1990s was a once-off, with energy growth now equaling, if not exceeding, GDP growth.
 - The 'platinum age' of growth is not confined to China, but extends as far as sub-Saharan Africa and will increase energy demand in years to come.
 - The importance of coal in three major economies – China, India and Indonesia – is rising, because it is the cheapest and most available energy source.
 - Rising oil prices may be expected to moderate oil use, but have had a limited impact thus far.

- The consequences for emissions depend on which energy fuels become the dominant substitutes, and how clean these are relative to oil.
- Voluntary action will not work, because the benefits from free-riding are still perceived to be too large. Developed countries must accept some convergence of per capita emissions across developed and developing countries, and also need to commit to investing in cleaner technologies across the globe. China is committed, but this is not yet translated into observable results. India is more resistant, with some justification given that it currently has per capita emissions only one fifth those of China.
- Dealing with climate change requires appropriate theatres for international collective action. A modest way forward might be to get a subset of key players to strike a bargain over time, rather than relying entirely on supranational initiatives.
- A failure to deal with climate change will be a major constraint on economic growth. A viable solution needs to break the link between emissions growth and economic growth.
- How can countries be induced to internalize the externality? The appropriate incentive structure needs to be clear about targets, instruments and punishment strategies. And the regime needs to be transparent and accountable.
- Could the international public good of a 'low emissions/ carbon capture' technology be provided readily? One perspective suggested that China could serve as a test bed for investigating the viability of R and D projects. Another perspective is reflected in the Japanese approach linking the adoption of energy efficient technology to the transfer of know-how and foreign loans. There is need for massive international public investment in emissions-reducing technologies across a broad spectrum to deal with the problem.
- There are different perspectives on the merits of a target/ instrument-based approach to climate change. An instrument-based approach has the benefit of minimizing the scope for corruption and brought finance ministries into the

debate more formally. Target-based approaches are more amendable to negotiating in multilateral forums and easier to communicate.

- The APEC Peer Review is an example of how a multilateral approach could complement the Kyoto protocol.
- The Asian growth trajectory certainly caught observers off-guard and the China-led rise in energy consumption will continue in the coming years. Coal is likely to remain the dominant source of energy. From one perspective that recommended investing in solutions to the coal problem, through geo-sequestration. The optimal mix of energy was unclear. Nuclear fuel – though attractive – remained beset by the safeguard issue.
- There was some optimism that generational change might relax the zero-sum nature of the collective action problem going forward. But the risks to the planet may be more pressing.

Dealing with Terrorism in Practice

- There have been no terrorist attacks in Indonesia since 2005, a success story which can be attributed to a number of factors.
- There has been careful development and use of the police force and law enforcement to ensure that the majority Muslim population does not feel alienated.
- The use of the term ‘war on terrorism’ is carefully avoided: instead the focus is on ‘dealing with crime’.
- There has been close cooperation with intelligence agencies within Indonesia, relying often on personal contacts based on trust.
- There has been close cooperation and support from developed countries, including Australia, Germany, Italy and the United States.
- The Australian Federal Police has provided indispensable training, expertise and technical assistance.

- Extensive interviews with terrorists suggest that radicalism is the fundamental cause of conversion to terrorism. Direct negotiation is a cheaper and better alternative to law-enforcement and military operations.
- There is need for international cooperation to expand 'counter-radicalization' and 'de-radicalization' programs.
- The AFP has changed strategy significantly, from being primarily about collecting evidence to 'proactive law enforcement and intervention'.
- Australia is a relative newcomer in the region to dealing with terrorism, given the much longer experience of Indonesia, the Philippines, Malaysia and India (often overlooked despite, its extensive experience).
- Different counter-terrorist agencies in each country have different approaches to regional cooperation, but there is positive experience and cooperation among agencies is working well despite the unfortunate circumstances in which it was initiated.

Beyond the War on Terror in Southeast and South Asia

- An unfortunate link exists between Indonesia's widespread poverty (and unemployment) and terrorist organizations, the latter offering a perceived way out of social exclusion and hardship and a vehicle for expressing anger at inequities in development and corruption among the powerful.
- Three key factors lie behind violence and extremism in the region, offering succour to 'angry young men' and excuses used to justify terrorism.
 - Structural (economic) inequality and limited socio-economic mobility;
 - Corruption by ruling elites (mostly 'secular');
 - The prevalence of poverty.
- These factors make a pressing case for a 'war on poverty' and continued economic development. There are two reasons for being optimistic about the future of terrorism in Indonesia: two major terrorist organizations have condemned further violence; the war on poverty is being taken extremely seriously by the Indonesian government.

- Although the battles with Al Qaeda-style terrorists had largely been played out, the process of nation-building in the region is far from complete and has spawned a gaggle of extreme and violent groups. These largely non-state actors are delineated along ethnic and socio-economic and ideological lines.
- Non-traditional threats (for example, SARS/tsunami/climate change) were becoming increasingly visible on the policy radar. The complex interconnectedness implied by these security challenges points to the scope for new regional security frameworks, and a new and different focus in security cooperation.
- Going forward, three challenges face Southeast Asia:
 - nation-building (enhancing political processes and institutions, ensuring political legitimacy, establishing sovereign authority and promoting domestic peace);
 - the need to build an ASEAN 'security community';
 - the need to respond to (and play a part in moderating) major power rivalry. To-date, the ASEAN role in moderating major power rivalry has been minimal and ignorance of the problem is potentially costly.
- South Asia (India, Pakistan, Bangladesh, Sri Lanka, Nepal and Bhutan), is 'neither peaceful internally nor coherent externally'.
- Inter-state conflict and rivalries are worse between Pakistan and Afghanistan than between India and Pakistan (a plus for the region itself, but not for the rest of the world), although serious in both cases.
- India-Nepal and Nepal-Bhutan also scored negatively, with the India-Bhutan and India-Sri Lanka relationships being the only two that are positive
- Threats in the region stem from two sources: non-state actors, including left-wing groups (such as the Nepalese Maoists in Nepal), right-wing groups (such as the Jama'atul Mujadeen) and ethno-centric groups (such as the Tamil Tigers), and non-traditional regional threats, including epidemic/pandemic problems (for

example, HIV-AIDS, SARS), natural disasters (for example, the tsunami and the Kashmiri earthquake) and ecological issues.

- India's failure to invest in a regional vision and the limited scope of its interaction with its immediate neighbours appears to be resulting in efforts to invent and define a new regional framework for itself. The sphere of non-traditional threats seems to be where it might engage constructively within and across the 'region'.

Security in Northeast Asia

- The underlying order (or set of relationships that have underpinned the institutions and responses to regional events in the Korean theatre are changing rapidly – ironically as a consequence of the very peace and prosperity that the existing order has helped establish.
- US primacy and ability to doubly reassure China and Japan about each other has facilitated stability and – to date – China and Japan have been content to accept sub-ordinate roles. This is unlikely to be sustainable in the medium-term.
- Increasingly, China is in a position to thwart US objectives and constrain US strategic options in East Asia by heightening the costs and risks to Washington of some military actions. This trend will require the US to accept China as an equal partner. This, in turn, places stress on America's ability to reassure Japan and gain Japanese support for its prime role.
- The rise of China is increasingly likely to bring about continent-wide interdependence. It is difficult to isolate sub-regions such as Northeast Asia, Southeast Asia or Asia in political security terms. This difficulty will become more pronounced as India enters the system.
- Although the notion of 'primacy' risks conflating economic and political power there seems little doubt that emergence of China has changed the structure of power in the global system.
- There is a risk that the rapid rise of a new power relative to established powers (and a slow-to exit incumbent hegemony) could engender instability. How can China's ascent be managed?

- Arguably it is best done through constructive engagement and encouragement of China to conform to established structures and market disciplines.
- The changing balance of power makes 'values-based' alignments in the region risky to irrelevant.
- Japan's increasing assertiveness in international affairs also changes the dynamic. And resolution of the North Korean issue would change the status quo in the peninsula, bringing short-term benefits, but longer term risks as it facilitates a change in the existing order.
- Sino-Japanese ties rely largely on economic engagement and interests in the commercial sphere transcending geo-political differences. Both countries are now embedded in global economic systems and political arrangements and their bilateral agreements are outdated.
- A tripartite security dialogue between the US, Japan and China may engender some degree of confidence, reassurance to balance the emerging order.
- The six-party framework also serves as a process that has potential to embed and legitimise the trilateral group and play an ongoing role at some level if it is successful.
- The theatre for regional security dealings is changing rapidly so that it is no longer easy to separate Northeast Asian from Southeast Asian and South Asia security affairs.

American Challenges and Responsibilities

- Under whatever Presidency, the US will continue to be pre-occupied elsewhere.
- China-US-Japan relations will define Asian geo-politics for the foreseeable future.
- Mutual reassurance between the three parties will be the key.
- The risks of instability are material and shifts by the US in/out of its China relationship can happen quickly.
- Problems with limited US engagement in the region stem from a lack of a well-articulated post-cold war choice and dated cold-war perspectives.
- The lack of balance in Sino-Japanese relations complicates the task for the US.

- There are financial constraints that might encourage a US ‘withdrawal’ from the Pacific and the simultaneous degeneration of the Sino-Japanese would have dangerous ramifications.

China’s Economic Impact

- There are three questions about China’s future economic impact:
 - will China have a post-Olympic recession;
 - what are the main challenges for future growth;
 - what are the policy strategies to deal with these challenges?
- There is low probability of a recession after the Olympics because investment remains high, with heavy domestic investment in infrastructure in transport, industrial upgrading and high levels of FDI likely to continue in coming decades.
- Among the key challenges facing the Chinese economy is overheating because of the very high levels of investment (over 25 per cent annual growth since 2003). External imbalances, driving rapid reserve accumulation are putting pressure on the currency. Income disparities, both urban-rural and regional continue to grow. Resource and environmental pressure is extreme.
- Ageing of the population will become a serious problem post 2030.
- There is a large unfinished reform agenda, including in the banking sector, equity markets, fiscal system (county-level governments are on brink of bankruptcy), with badly performing SOEs in competitive sectors.
- The policy response to these challenges are tied into Hu Jintao’s ‘Scientific Approach to Development’, which builds on two key platforms: one is that development is the absolute truth (Deng Xiaoping), the other is that development and growth needs to be balanced and sustainable (Hu Jintao). The basic instruments for achieving this are market-oriented reform and ongoing integration into global markets.
- Six policy responses follow from the key challenges, namely, more support to rural development, economic re-structuring (including reducing export reliance

- and increasing consumption), enhancing the capacity to innovate, policies to address regional inequality, strengthening social development for a harmonious society and deepening institutional reform and opening up.
- There are four conditions that will favour future prosperity: institutionalization of the leadership ensuring political stability; a leadership that is well-informed, pragmatic, responsive and market-oriented; a political system that is representative but cannot sensibly be exactly the same as that in America or elsewhere; a strongly motivated population and continued openness to FDI, bringing capital, management, technology and markets to China.

Regional Cooperation Architecture

- Economic architecture in Asia is sometimes criticized as too weak or under-institutionalized, but arguably Asia has the regional economic architecture that the nature of the region requires
- Asian regionalism needs to be inclusive, trans-regional and global in orientation and encompass the dynamics of evolving economic and political power.
- Asian regional architecture aims to promote peace and stability and to strengthen the global system because the global system has been the key to the region's central development objectives.
- There is a variety of different arrangements (ASEAN, ASEAN +3, ASEAN+6, APEC, ARF) and all of the broader arrangements incorporate ASEAN as a central element.
- The evolving architecture was initially directed at: keeping the US positively and actively engaged, securing a greater role for Japan and luring China in and facilitating its peaceful rise in the region. The last objective has become steadily more important. These were political objectives built on the economic development priority in the region.
- The 1997 financial crisis caused not only a financial, but also an identity crisis (and political crisis of confidence) for ASEAN. The verities of trans-Pacific

engagement were challenged and ASEAN+3 emerged as a defensive, hedging strategy in East Asia.

- ASEAN remains the 'fulcrum of power-plays in the region' but there are differences of perspective on how permanently this will remain so because of questions about the strength of ASEAN coherence and the priority of the play of the bigger powers in the region..
- ASEAN has now set an ambitious goal to turn one third of ASEAN's current 560 million people (growing to over 700 million) into a middle class in 10 years. By 2015 it aims to have established an ASEAN community built on three pillars – economy, political-security and socio-cultural.
- The ASEAN Charter intends to make compliance a major issue, although whether carrots or sticks will be used to achieve compliance remains to be seen. The ASEAN Community is a work in progress.
- East Asian trade arrangements are still a mish-mash of regional and bilateral arrangements that lack consistency. From China's perspective, ASEAN +1 was very difficult to negotiate and the broader ASEAN+3 FTA proposal was canned for being unrealistic. An ASEAN+6 FTA of any substance is likely to be even more difficult to negotiate, although a feasibility study underway. And the Asia Pacific FTA proposal that America has put on the table is equally unrealistic. Essentially, more players make life more challenging, but inclusiveness is important because of the benefits of involving all the key players.
- Progress towards FTAs, including with ASEAN, has been slow. But deep economic integration has occurred without FTAs and the main barriers to further integration are domestic structural policies that cannot be readily dealt with by the negotiation of traditional FTAs.
- Commitment to global arrangements (like the WTO) and national policy reforms continue to be much more important to regional integration. This explains the elevation of the structural reform agenda in APEC.

- While there is competition among Asian regional groupings is highlighted there is also economic and political complementarity among them, with APEC and EAS being trans-regional in character.
- Can the regional arrangements that are in place now fill the gap on political-security dialogue and reduce the risk of instability around the changing balance of political power?
- The East Asian Summit (EAS), with the involvement of China, India, Japan, Southeast Asia and Australasia has potential to provide ballast in the re-alignment of Asian economic and political power.
- From one perspective, the EAS, premised on a mutual security understanding and with its heads of government meetings, might serve as a forum for regional political and security dialogue.
- However, the US is not a member of EAS and it is unlikely that the US would be to accept membership.
- APEC, which includes America, also meets at heads of government level, and has steadily widened the scope of its dialogue to include human security issues, is a natural forum for high level, if informal political and security dialogue. However, India is not a member, the membership is broad and Taiwan's membership is a complication.
- Another suggestion is to build high level political security dialogues around the Six-Party talks process in Northeast Asia. At one level this will be important but at another it would be inadequate and not inclusive of Southeast Asian and Australasian interests.
- ARF also serves an important confidence-building function but is not readily directed to filling this gap.
- There is a range of options that would allow the difficulties to be handled and that deserve further in-depth exploration:
 - one suggestion was to back-to-back EAS and APEC;

- another was to establish the conditions for India's membership of APEC;
 - a start could be made through informal meetings around APEC when Asia Pacific heads of government get together.
- Asia still does not have a caucus in which the priority is how to deal collectively with the rest of the world's responses to Asia. That is a major weakness in the value of regional arrangements for managing the big trade, financial, environmental and political issues of the day. EAS might be energized for that purpose

Concluding Issues

- The transformation of human economic life that began in Britain in the late eighteenth century has now reached its apogee in the industrialization of the populous countries of Asia.
- This is associated with a shifting of the tectonic plates of global economic power and ultimately strategic weight. We are moving towards a position in which 4 large powers, the third, the EU increasingly integrated and culturally attractive over time, and the fourth, India, much larger than the next.
- Regional and global stability over the next quarter century will depend increasingly on these entities being able to live with the major objectives and approaches of each other.
- How important ASEAN is in this world will depend on the post-Soeharto leadership of Indonesia developing a clear view of ASEAN's international role and other ASEAN members accepting this vision.
- Sustained rapid economic growth has also been driving a sea-change in the character and dynamics of national politics. Almost everywhere across Northeast and Southeast Asia – in varying degrees – national politics is more less heavily centralized, more diverse and more pluralistic.
- Today, issues of socio-economic equity and the environment command more attention than in the past. Typically, governments can no longer act as decisively

as in past decades and are more likely to be balancing a broader set of policy objectives than previously.

- Pressures for political change are also present in China but it will not likely quickly to cave into popular pressures for democratization. Leninist political systems are more durable than other authoritarian frameworks and a key question for how China relates to the rest of the world relates to how its political system evolves.
- The architecture for regional cooperation will, necessarily, feature both bilateral and multilateral elements. All countries will pursue their most sensitive priorities bilaterally, but, equally, all will also have an interest in a more effective multilateral framework.
- The ASEAN-centredness of most existing regional frameworks has happened significantly by default. It happens simply because ASEAN exists as the most effective regional body, and the United States, China and Japan have been unable, to date, to develop a satisfactory framework to enable them to resolve difficult issues collectively. This seems likely to change sooner or later.
- Japan needs a more active and more effective international strategy. Many of Japan's friends in the region now routinely discount Japan influence. This is not in Japan's interests, or the interests of the rest of the region.
- The biggest stumbling bloc here is the inability of the United States, China and Japan to come together in a mutually satisfactory way. In essence, there are two broad options for achieving this. One is that a framework be developed that includes only the principal players, that is, the United States, China and Japan. Another is that a satisfactory framework that includes most East Asian states, plus North America. This could, perhaps, be achieved through APEC. It could be achieved through a broadening of the East Asian Summit. Or, on another level, it could be achieved through broadening the Six-Party Talks process.