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From the Editor's desk

The formation of the G20 is a major achievement, perhaps even the most important achievement of international economic diplomacy in recent times. With its elevation to a leaders' summit five years ago, the G20 is now the premier forum for global economic governance. Most observers believe that this initiative made a decisive difference in preventing the global financial crisis from developing on a scale that threatened to have consequences as damaging as the Great Depression of the 1930s.

But what is the G20's role now that the global economy appears on the mend?

The G20 summit brought a fundamental change in the structure of global economic governance. The inclusion at the table of five Asian economies, in addition to Japan, recognised the shift in the structure of economic power that made the old order, dominated by the G7, obsolete.

The essays on the G20 in this issue of EAFQ are based on the book *The G20 Summit at Five: Time for Strategic Leadership*, the product of a major ANU–Brookings Institution project in the lead-up to the next G20 summit, to be held in Australia in November.

The challenge now is to create sustainable global growth based on real productivity gains and new long-term jobs in the value-added chains of the products and services of the future. Above all, G20 leaders have to ensure that key global economic institutions are robust and able to withstand unexpected shocks if and when they occur. Leaders can add value, for example, in addressing big questions about whether the global trade regime is headed in the right direction and how to shape the investment regime.

This issue of EAFQ also launches a new feature: four essays on major trends and developments in the region. This feature, Asian Review, will be a regular in the EAFQ alongside its coverage of a particular theme of importance about Asia's place in the world.

Peter Drysdale

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Time to embrace strategic leadership

KEMAL DERVIŞ AND PETER DRYSDALE

PICTURE: PABLO MARTINEZ MONSIVAIS / AP PHOTO / AAP

US President Barack Obama and Chinese President Xi Jinping before their bilateral meeting in St Petersburg in 2013: leaders can add value to the G20's proceedings by asking 'the big questions'.

THE leaders' level G20 was born at a time of crisis and panic. In early October 2008, when the United States issued the invitation to the G20 heads of state or government to assemble in Washington DC on 15 November, the world economy was facing the danger of a total collapse of the financial sector in the United States. Panic is contagious. A financial sector collapse in the largest economy and the financial centre of the world would have brought down with it the entire global economy.

The United States had to act to arrest the collapse, and did so by unprecedented intervention in its own banking and insurance sector. This was quickly followed by equally unprecedented fiscal and monetary expansion, and even intervention in the industrial sector. These actions contained the crisis but did not prevent a drift towards worldwide recession. It was clear that the financial sector virus was spreading, and that economic expectations had been shattered worldwide. There was a danger of steep global declines in investment and consumer demand, ensuing mass unemployment and beggar-thy-neighbour protectionist trade policies triggering the kind of vicious deflationary cycle that the world had gone through in the Great Depression of the 1930s. A floor had to be put under expectations, a sense of resolve had to be projected, fiscal expansion had to be encouraged wherever feasible, and protectionist reflexes had to be countered before it was too late.

This is how the leaders' level G20 was born. Previous resistance to including the large emerging countries at the head table—formerly monopolised by the G7—evaporated. China, India, Brazil and others were needed both psychologically and substantively for the response to the crisis be credible. The fact that there already was a finance ministers' level G20, born in the late 1990s after the Asian financial crisis, allowed the US to short-circuit the debate on who should be included.

It is not possible to measure exactly the impact of the first meeting in Washington or the second in London. We cannot be sure of what would have happened without them. Most observers agree, however, that the combination of decisive action by the US Federal Reserve and Treasury, the G20 commitment at the Washington meeting not to raise trade barriers, and then the signal at the April 2009 London meeting of broadly concerted fiscal expansion and a green light for tripling the 'firefighting' capacity of the IMF, did make a critical contribution to turning around expectations and arresting what was threatening to become a global economic free-fall.

Five years after those first two

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leaders' level meetings, the questions are whether and how these summits, which have become an informal institution, can really add continung value to global economic governance.

Firefighting an ongoing crisis no longer dominates the agenda. There has been a slow but steady global recovery, allowing for a gradual normalisation of monetary policy in the United States and reducing the near-panic relating to the Eurozone that prevailed in the past half-decade.

The year 2014 may witness instability, however, for non-economic reasons, such as the tensions mounting between the United States and Russia and unfolding events in Ukraine. The future will tell, but these events may cast a shadow on the G20's possible achievements.

The risk is that, absent an acute crisis, the G20 meetings could become purely ceremonial gatherings that continue to take place because of inertia. Alternatively, the absence of immediate crisis-like pressure could be an opportunity for the G20 to tackle the major structural medium- and long-term issues that continue to face the world economy. The challenge now is to create sustainable world growth based on real investment that stimulates total factor productivity gains and provides new, long-term jobs in the value-added chains of the products and services of the future. Laying the foundations for sustained growth through productivity-enhancing reforms is the right strategy. So too is enabling productive investment in infrastructure. It is also time to make sure that key economic institutions are robust and able to withstand unexpected shocks if and when they occur. Leaders can add value, for example, by asking big questions about whether the global trade regime is headed in the right direction, or how to shape the investment regime.

The challenge now is to create sustainable world growth based on real investment . . .

The composition of the G20 itself was an improvement on the G7/8. The inclusion of five more Asian economies (Australia, China, India, Indonesia and South Korea), three Latin American economies (Argentina, Brazil and Mexico), as well as Saudi Arabia and Turkey, was a major step forward. These additions, along with South Africa, delivered regional, cultural and institutional diversity to the high table. Since 2008 we have seen how this has led to a new style and discourse in summitry. Cultural and institutional diversity means that there will be differences of view across a broader range than in a like-minded group of largely Western countries. Agreement may be more difficult, debates more intense, and disagreements out in the open. In global negotiations, though, it is more important to be talking to those with whom reaching some kind of agreement is difficult rather than just with those among whom there is agreement to begin with.

These complexities elevate the importance of focus in the G20 agenda and effective communications. G20 leaders need to concentrate on strategic leadership. The proper division of labour is for meetings of finance ministers and central bankers to deal with the technical detail and for G20 leaders to provide strategic guidance on urgent global problems.

There has been some progress on ‘focus’ in the agenda. That will now be key to the centrality and effectiveness of the G20. There is also progress on ‘outreach’, at least in the sense of engaging stakeholder groups across the G20 community, such as business, organised labour, civil society, youth, think tanks and other segments of society. There has been less progress in institutionalising outreach to countries and organisations beyond the G20 community. Australia and Turkey, in their respective regions, have particular incentives to change that.

By far the biggest challenge for each G20 host is the total engagement that must go into providing leadership of the global economy through and beyond the host year. In 2014 the expectations are high that we will see a turning point from the ‘new normal’ to ‘strategically-directed’ G20 summits and hence a new phase in global governance. The task for Australia in 2014 will be to deliver and sustain an emerging sense of strategic direction. EAFQ

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This essay is digested from Kemal Derviş and Peter Drysdale (eds), The G20 Summit at Five: Time for Strategic Leadership, *Brookings Institution, Washington, 2014).*

Global targets offer hope of renewed growth

DAVID VINES

THE global recovery is strengthening but remains weak. A global growth target, pursued by the G20, could significantly strengthen this recovery process. But such a macroeconomic target needs to be supported by microeconomic reforms.

In advanced economies, demand is growing more rapidly than in the previous three years, but output remains below potential. And the growth of potential output itself is low, due to reduced investment, low profitability and low demand. In emerging-market economies, there is a slowdown in growth following a withdrawal of foreign capital and the associated external turbulence. The resultant tightening of financial conditions is reducing growth of demand in these economies too.

Macroeconomic policies are not sufficiently supportive. Advanced countries are undertaking fiscal austerity—particularly the US, the UK and Germany—and seeking to grow their demand by raising exports. Long-term interest rates are rising because of fears about the effects of the tapering of quantitative easing. In China, domestic demand is still not expanding rapidly enough, and in emerging markets such as India and Brazil policies are tightening because of external difficulties. The world faces a ‘new normal’ of low growth.

Many distinguished economists from emerging markets have called for international cooperation in setting macroeconomic policies. For example, Rakesh Mohan, the former deputy governor of the Reserve Bank of India, has complained that the tapering of quantitative easing has been carried out without sufficient regard for international spillovers and has called for the US Federal Reserve to ‘be aware’ of the interests of other countries. But in the words of the Australian Treasurer, Joe Hockey:

> There is no doubt that the Fed needs to be aware of these international implications in detail, and be mindful of them. …[And yet] ultimately, the Fed has to operate in a manner that is consistent with its domestic mandate.

Is cooperation possible and, if so, of what kind? Countries have a wider range of instruments than the purely macroeconomic. Those which cannot offer a different macroeconomic response may instead be able to adopt the global growth strategy that is presently being developed by the G20.

The possibility of a global growth strategy was put forward in a document titled *Macroeconomic and Reform Priorities*, prepared by International Monetary Fund (IMF) staff for the meeting of G20 finance ministers and central bank governors in February this year. That meeting identified a ‘global growth strategy’ as a cooperative process in which countries would be asked to contribute a set of particular policy changes which, taken together, might raise global growth by 2 per cent by 2018. This has effectively become a global growth target.

The document identifies a number of possible changes to macroeconomic policy and a broad range of additional reforms to supply-side policies which might be undertaken in G20 countries. The suggestions include promoting competition, particularly in the services sector, as well as reforms to training programs to address skill mismatches. Consideration is also being given to the taxation and social protection of low-income workers, along with the effects of labour-market institutions on job creation and participation, and policies to support technological catch-up. Success in these domestic reforms will enable countries to better support the development of global value chains.

Addressing obstacles to investment, notably in infrastructure, is another focus. Impediments include regulatory conditions and a lack of depth in financial markets. Progress in this context will depend on a satisfactory division of expenditure and of risk-sharing between the public and the private sectors.

These microeconomic reforms are likely to bring with them the ability to adopt more expansionary macroeconomic policies. Increased infrastructure investment will lead to significant increases in public expenditure, and the ability to create valuable infrastructure assets is likely to moderate fiscal austerity. Similarly, supply-side reforms in emerging market economies are likely to reduce national risk premiums and external difficulties, which would in turn enable other countries to implement more accommodating policies.

Countries have until June to consider what actual reform policies each might offer as part of a global growth strategy. These proposals will be peer-reviewed when finance and central bank deputies meet in Melbourne in June. A meeting of finance ministers and central bank governors in Cairns in September will set out the agreed strategy, which will form the basis of a Brisbane action plan to be approved at the G20 heads of government meeting in November.

WILL the proposed reforms actually be implemented?

It is clear that any reforms will be driven by domestic political agendas. There will always be those who stand to lose from reform. But the international climate can influence domestic political calculations. This was true throughout Asia in the 1990s in the early days of the Asia Pacific Economic Cooperation (APEC) process, when a sense of opportunities abroad fed into the ability to galvanise liberalisation at home. Back then, the prospect—and better still the reality—of liberalisation by others abroad, especially when they were important regional trading partners, was used by trade policy officials and politicians as they embarked on the contest with protectionists at home over liberalisation. This leverage was useful during the period, from the mid-1980s to the eve of the Asian financial crisis in 1997, when virtually all Western Pacific economies embarked on far-reaching unilateral liberalisation in the high tide of internationally oriented growth in East Asia. It became easier to liberalise in a climate in which many other countries were doing the same.

What is happening can be described as a similar process of 'concerted unilateral reform'. In effect, each country is able to be 'mindful' not only of the interests of other countries but also of the opportunities created by the actions of other countries. These opportunities will change the way in which each country can pursue its domestic mandate. The existence of a global growth strategy may well act as an inducement to national reform strategies. It does seem likely that such an approach will support a process of global cooperation and enable faster growth in the global economy.

The reform process will be carried out within the structure of the G20 Mutual Assessment Process, or G20MAP, developed so that countries could continue the successful cooperation in macroeconomic policymaking that occurred at the G20 meeting in London in April 2009.

But the G20MAP has run out of steam. This is partly because its initial aim was to deal with global imbalances, in particular balance-of-payments disequilibria. A number of deficit countries—including the US—and surplus countries—including Germany and China—disagreed about how to resolve these questions. As discussed above, countries may not have the incentives necessary to change their macroeconomic policies in the global interest.

The new approach described here—combining microeconomic reforms with a macroeconomic strategy and doing this within the framework of a global growth target—offers new hope. It has given countries new incentives to cooperate in the setting of their policies, including their macroeconomic policies. This strategy is likely to revive the G20MAP and lead to higher global growth. EAFQ

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Strong case for coordinating global monetary policy

RAKESH MOHAN AND MUNEESH KAPUR

PICTURE: JACQUELYN MARTIN / AP PHOTO / AAP

Janet Yellen, chair of the US Federal Reserve Board: 'highly accommodative' monetary policies in the United States and elsewhere have encouraged capital outflows to emerging market economies.

SINCE the onset in 2008 of the North Atlantic financial crisis (NAFC), more often known as the global financial crisis, central banks in the US and the other major advanced economies have pursued highly accommodative monetary policy, including through unconventional policy actions. Policy rates have been near zero in these economies for almost five years, and both short-term and long-term interest rates have touched historic lows. These low interest rates encouraged the search for yield and, consequently, large amounts of capital flowed out of these reserve-currency economies to the still relatively fast-growing emerging-market economies (EMEs), complicating their macroeconomic management.

Capital flows to the EMEs are well known for their volatility over the past three decades. This volatility was again in evidence in May–August 2013, when the US Federal Reserve first hinted at tapering its unconventional monetary policy, and again in January 2014 after tapering began. However, stronger macroeconomic and financial policies and the buffers built by EMEs over the past decade have helped them to avoid a full-blown financial crisis. The tapering episode has nonetheless hurt their near-term growth prospects significantly, while also illustrating the potential underlying vulnerabilities in the international monetary system.

Developments since 2008 have put a spotlight on the impact that monetary policy in the reserve-currency countries has on the rest of the global economy.

Given these spillovers, there is a renewed debate on the merits of monetary policy coordination among the major central banks. The current stance of monetary policymakers in advanced economies is that there are no significant cross-border spillovers from their accommodative monetary policies, that they are indeterminate, or that they are in fact positive overall for EMEs. There is also a view that the mandates of monetary authorities are such that they can only take account of the domestic impacts of their policies: taking a cross-border global view would be beyond their mandates.

In contrast, the regulatory architecture of the banking sector has been characterised by international cooperation for a number of decades now—the Basel I, II and III standards are the well-known outcomes of this approach. The financial crisis provided an impetus to international economic and financial coordination, especially regulatory coordination and 'unprecedented and concerted' fiscal expansion. The G20 leaders' initiatives led to a significant strengthening of financial-sector regulations and regulatory architecture, including the establishment of the Financial Stability Board in April 2009.

The G20 initiatives also led to a noteworthy increase in International Monetary Fund (IMF) resources and lending capacity in 2009 and again in 2012, a critical step in restoring global financial stability. And, overall, there have been welcome G20-led initiatives to improve international economic and financial coordination since the onset of the financial crisis, playing a critical role in providing some stability to the global economy while avoiding a repeat of the 1930s Great Depression.

But as far as international monetary policy coordination is concerned, the traditional view of domestically oriented monetary policy is still seen as the optimal arrangement, although there are some calls for a reassessment.

It is not the case that there has been no coordination at all. In the aftermath of the NAFC, the activation of swap lines by the US Federal Reserve with central banks in major advanced economies and a few select emerging markets is an example of some coordination, but this effort appears to have been motivated by the likely adverse impact of liquidity in these advanced economies suddenly drying up on these economies themselves. Coordination does not appear to have been motivated by the likely impact of advanced economies' monetary policies on the EMEs.

If the prevailing view held by advanced-economy monetary policymakers does not change, EME authorities will have to manage these spillovers on their own. This would involve a combination of various policies to promote financial stability in their economies. Judicious capital account management to reduce the domestic impact of volatile capital flows would be a significant element in such policies. There is now near unanimity on the desirability of maintaining flexible exchange rates, but this is tempered by the desire to contain volatility in the face of significant disturbances in global financial markets. Thus capital-account management would need to be accompanied by appropriate foreign exchange intervention, while maintaining exchange-rate flexibility, and building up adequate precautionary foreign exchange reserves. Such macro-management would only be effective in the presence of prudent monetary and fiscal policies, and the continued development of domestic financial markets along with active financial regulation.

> Advanced economies' central banks need to explicitly acknowledge and appreciate the spillovers resulting from their unconventional monetary policies

But the possible effect of such uncoordinated policy action on the part of both advanced economies and EMEs could be potential fragmentation of global financial markets. EMEs might be forced to pursue more inward-looking policies, which will then have a negative impact on global demand and growth.

What is the alternative to such outcomes? Advanced economies' central banks need to explicitly acknowledge and appreciate the spillovers resulting from their unconventional monetary policies. Only then can an approach to international monetary coordination be devised. The IMF, in its role as the guardian of the international monetary system, could foster this understanding through its analytical work and then initiate discussions on possible forms of international coordination.

Central banks of the advanced economies have already set up standing mutual swap facilities. Similar arrangements could be explored by the reserve-currency central banks with other significant EMEs through the G20 process, with the IMF's assistance. Risk-mitigation measures would have to be found to protect the reserve-currency central banks from potential losses that could arise from extending such swap facilities to include currencies that are not freely convertible. EME central banks already have large holdings of reserve-currency sovereign debt securities: up to an point, ways could be found to use such securities as collateral for risk mitigation.

There is also a proliferating set of mutual swap arrangements between various EME central banks and with some reserve-currency central banks. Regional financing arrangements are also being developed to manage the consequences of volatile capital flows. This points to the need for greater international monetary coordination with the IMF in a synchronising role, rather than the alternative of increasing financial fragmentation on a global scale.

Increasing communication among monetary authorities, and the transparent availability of such liquidity facilities, could do much to actually curb volatility in global financial markets and hence in capital flows to EMEs, thus obviating the need for them to take defensive policy action. Although the comfort of the availability of such swap facilities from the reserve currency central banks runs the risk of encouraging an even greater volume of capital flows to EMEs in the boom period, the existence of such swap facilities is expected to be positive for the global economy.

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Grouping must shape a new world trade regime

MARI PANGESTU AND DAVID NELLOR

OVER the past decade global trade and investment discussions have moved far away from the formal global trade regime. The multilateral system has been mired in the Doha Development Round—defined by a single undertaking and a fixed agenda that is increasingly out-of-date. In the meantime, most countries have devoted their energies to regional trade and investment discussions.

The devolution of trade and investment discussions is prompted not only by frustration with the multilateral system but also by the needs of a dramatically changing trade structure. The existence of global value chains and a multipolar global economy changes the dynamics of trade and investment discussions. Moreover, a new set of concerns—ranging from food security to climate change—has emerged. These developments alone would pose significant challenges but, beyond that, there is a concern that even the more conservative assessments conclude that protectionism is on the rise.

The question is: what to do about it? The G20 needs to provide political leadership by defining and adopting a new global trade and investment regime that can respond to these challenges. The goal should be a free, fair and open trade and investment regime that boosts growth, drives development and inclusiveness, and promotes sustainability. The principles, organisations and processes within which trade and investment reform is motivated make up this global public good.

But instead of providing the requisite leadership, the G20 has been going in a different direction on trade. Repetitive references in G20 communiqués to completing the Doha round demonstrate that the G20 has no particular comparative advantage in negotiating specific trade measures. What is more, references to regional agreements and global value chains in the last two communiqués take the G20 in the wrong direction. They characterise the G20 as a forum for encouraging transparency and information exchange—all of which are welcome but can be addressed in other fora, such as the OECD.

THE proposal that the G20 deliver an improved global trade and investment regime fits well with its mandate and agenda. Since it assumed the mantle of leadership of the global economic and financial system in the midst of the global financial crisis, the G20 has focused on two areas: global growth and reform of global economic and financial architecture.

Trade and investment should be integral elements of both these priorities. Countries are encouraged to adopt unilateral measures in their trade and investment systems as part of their efforts in the comprehensive growth strategy. However, on the question of global economic and financial architecture, trade and investment have been kept to one side, especially in comparison to the focus on macroeconomic stability and the financial sector through the G20's major reform of the International Monetary Fund (IMF) and the development banks.

What might a new architecture of the global trading system look like? One approach is a 'multiple pathways' framework: that is, a framework that recognises that multilateral objectives can be achieved by adopting best global practice while using a variety of paths including regional, sectoral and plurilateral agreements.

ASEAN's Regional Comprehensive Economic Partnership (RCEP) was designed with this multilateral best-practice model in mind. RCEP spells out a set of principles to shape agreements under the partnership. They include open architecture norms, such as open accession, transparency, and best standards and practices.

The role and structure of a reformed World Trade Organization (WTO) in the 'multiple pathways' framework must be assessed. A WTO with a new mandate could play a constructive role in supporting best-practice regional and other agreements.

Against this background, the G20's medium-term goal should be to deliver the new architecture. Members could agree to observe a set of principles that ensure consistency with an overall multilateral vision. The principles would be adopted ultimately in a reformed WTO framework. These principles and the retooled WTO would be what the G20 could deliver in the medium term.

The immediate task is to get the G20 on the right track on trade and investment issues. To achieve this, the G20 must recognise that its strength—and therefore its focus—should be on establishing a new regime, rather than delivering specific policy measures within the existing one.

The Brisbane leaders' communiqué would set out the goal of strengthening the global trade regime. Leaders could announce the appointment of an eminent persons group (EPG) comprised of highly regarded people in international governance, trade and other areas. It would be tasked to make recommendations on the global trade regime, and specifically on the principles to be observed by G20 members and the design of the new, reformed WTO.

The EPG would be a 'peer group' from which G20 leaders would hear respected and independent reform advice reflecting a global perspective. To accomplish this goal, the G20 should appoint a working group of G20 officials—led by a G20 sherpa—tasked with preparing terms of reference for the EPG. The composition of the working group reflects the need to move trade discussions beyond a trade negotiation perspective to reflect the broader economic 'wins' of a stronger regime.

The G20 is effectively the guardian of the global economic and financial architecture. The world needs a far more robust trade and investment system and so it is incumbent on the G20 to deliver the essential global public good of a new trade and investment regime.

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G20: COUNTERING THE 'CORPORATE DODGE'

Taxing times should prompt move to revenue reform

KEN HENRY AND SHANE JOHNSON

ATTEMPTING to address the 'great corporate tax dodge' is high on the G20 leaders' agenda, having endorsed the OECD's Action Plan on Base Erosion and Profit Shifting (BEPS) at their St. Petersburg summit in September 2013. Leaders were prompted by global public anger over multinational companies' failure to pay their 'fair share', and their own concerns about weak tax collections. The real question is whether these issues can be resolved by simply patching up the current system or whether more fundamental reform is needed.

While governments have for decades tried to address aggressive corporate tax minimisation through cross-border mechanisms, the need to do so has become more pressing since the global financial and Eurozone crises. These events, and responses to them, have resulted in a serious deterioration in the fiscal positions of most advanced economies. This has led governments in many countries to impose strict fiscal austerity measures, including searching for 'elusive' revenue.

Leaders face the dual problems of needing to raise revenue and trying to stimulate investment and growth

Corporate tax has received particular attention because receipts have been slow to recover after the crisis. Cross-border minimisation might have something to do with this, but there are other reasons too. These include temporary factors—such as the use of accumulated prior year losses and relatively small capital gains tax takes—and possibly structural changes affecting the ongoing profitability of the financial sector.

This is just the beginning of the fiscal challenges G20 economies will face over coming decades—the fiscal challenges of the crisis itself will be dwarfed by those of ageing populations, climate change and changing community expectations over public services such as education and health care.

Leaders therefore face the dual problems of needing to raise revenue and trying to stimulate investment and growth.

Times have changed since corporate

PICTURE: SANG TAN / AP PHOTO / AAP

Protesters demonstrating against world financial institutions outside the Bank of England during the G20 London summit. Leaders have responded to global public anger over profit-shifting, but globalisation has left authorities struggling to find a coherent approach about whom and what they should be taxing.

tax arrangements were introduced in the early 1900s.

Globalisation has left tax authorities struggling to find a coherent approach about whom and what they should be taxing. Gone are the days of corporates residing in a single 'home' country. Today's multinational enterprises can access finance from almost anywhere in the world and commonly make use of integrated global supply chains.

The rise of e-commerce and the service economy has also expanded the boundaries of what is tradable and made it easier for firms to establish themselves in locations different from their consumers.

While companies are embracing globalisation, our tax systems have evolved with insufficient coordination and little sense of direction. Countries competing for mobile investment have undermined their tax systems. Tax concessions such as preferential capital allowance arrangements, patent boxes and income exemptions have eroded the tax base in some countries. Others have lowered statutory tax rates to attract mobile capital.

Combined with uncoordinated tax treaty arrangements, these measures have contributed to undermining domestic and international tax frameworks, distorted resource allocation—that has been their purpose, after all—and presented tax arbitrage opportunities for multinational companies.

Perhaps the best examples are the way companies can use their global footprint to shift value from their intellectual property to lower tax jurisdictions; use intra-company lending from subsidiaries in low tax jurisdictions to subsidiaries in high-tax ones; or use hybrid instruments that treat finance as debt in the country in which 'interest' is paid and equity where it is received.

These legal activities, and others in the same vein, are at the centre of the base erosion and profit-shifting (BEPS) problem.

Initial responses to the problem have been to name and shame offenders. Google, Starbucks and Apple have all found themselves in the headlines. Criticism that these companies were not living up to their 'social contract' or paying their 'fair share' have inflamed public concern. Perhaps such public shaming will induce companies to pay more tax voluntarily, at least temporarily, in order to avoid short-term reputational damage.

But naming and shaming does not address the underlying problems.

The OECD is attempting to do this with its BEPS Action Plan, which looks at the most aggressive forms of tax planning.

To date the main focus of the G20 and OECD has been on improving transparency and tax information sharing, and 'better align[ing] rights to tax with economic activity' (OECD [2013], Action Plan on Base Erosion and Profit Shifting, OECD Publishing).

Measures to improve transparency and tax information sharing are welcome. To be effective, reporting needs to take place under a set of consistent standards, otherwise there is a risk the information will be manipulated by the provider and misinterpreted by the recipient. The costs of complying and of administration must also not be overly burdensome. In particular, attention has to be paid to the capacity of tax administrators in developing countries.

It is clear the main corporate tax challenge lies with the allocation of taxing rights, but what is less clear is whether this can be addressed within existing corporate tax structures.

The fundamental problem is determining where a multinational's profitable economic activity actually takes place.

Even if these issues can be resolved—and a global agreement can be reached—the question is whether such measures will address the main concerns of the G20 leaders: namely, ensuring corporations both pay their fair share and provide a sustainable revenue source.

It is clear the main corporate tax challenge lies with the allocation of taxing rights, but what is less clear is whether this can be addressed within existing corporate tax structures

Unfortunately, the answer is likely to be no.

First, what is a 'fair share' of corporate tax? While companies may be required by law to pay tax, they cannot bear the tax burden. Instead, an increase in company tax will be borne by some combination of shareholders, other owners of capital, workers and consumers. Exactly how the tax is borne across these different groups will depend on a number of factors and will vary across countries. Whether the outcome is fair in any country, or among countries, is far from certain.

Second, the proposals are unlikely to provide a sustainable source of revenue. The BEPS Action Plan will not diminish the increasingly intense international competition for mobile capital. Pressure will remain for countries to cut their statutory corporate tax rates and to introduce additional targeted concessions. These pressures are likely to intensify over time.

This raises a bigger question. Can existing corporate tax systems survive in the long-term, and should they?

In addition to the BEPS issues, existing corporate tax systems are relatively inefficient, misallocating resources and lowering investment.

While these issues have been known for some time, they were a focus of the Mirrlees Review in the United Kingdom and the Australia's Future Tax System Review. Both reviews suggested fundamental reform to existing corporate tax systems was needed, with movement towards rent-based taxes identified as the most promising.

It is here, looking at the design and implementation issues of bringing corporate tax systems into the 21st century—including how they would operate in a global context—that the G20 and the OECD could provide valuable guidance and leadership.

But are we being too adventurous to ask why one would consider the corporate tax alone?

If G20 leaders are serious about improving the fiscal sustainability of their economies, as well as improving the prospects for economic growth, they should first agree on the need for fundamental reform of the overall tax and transfer system.

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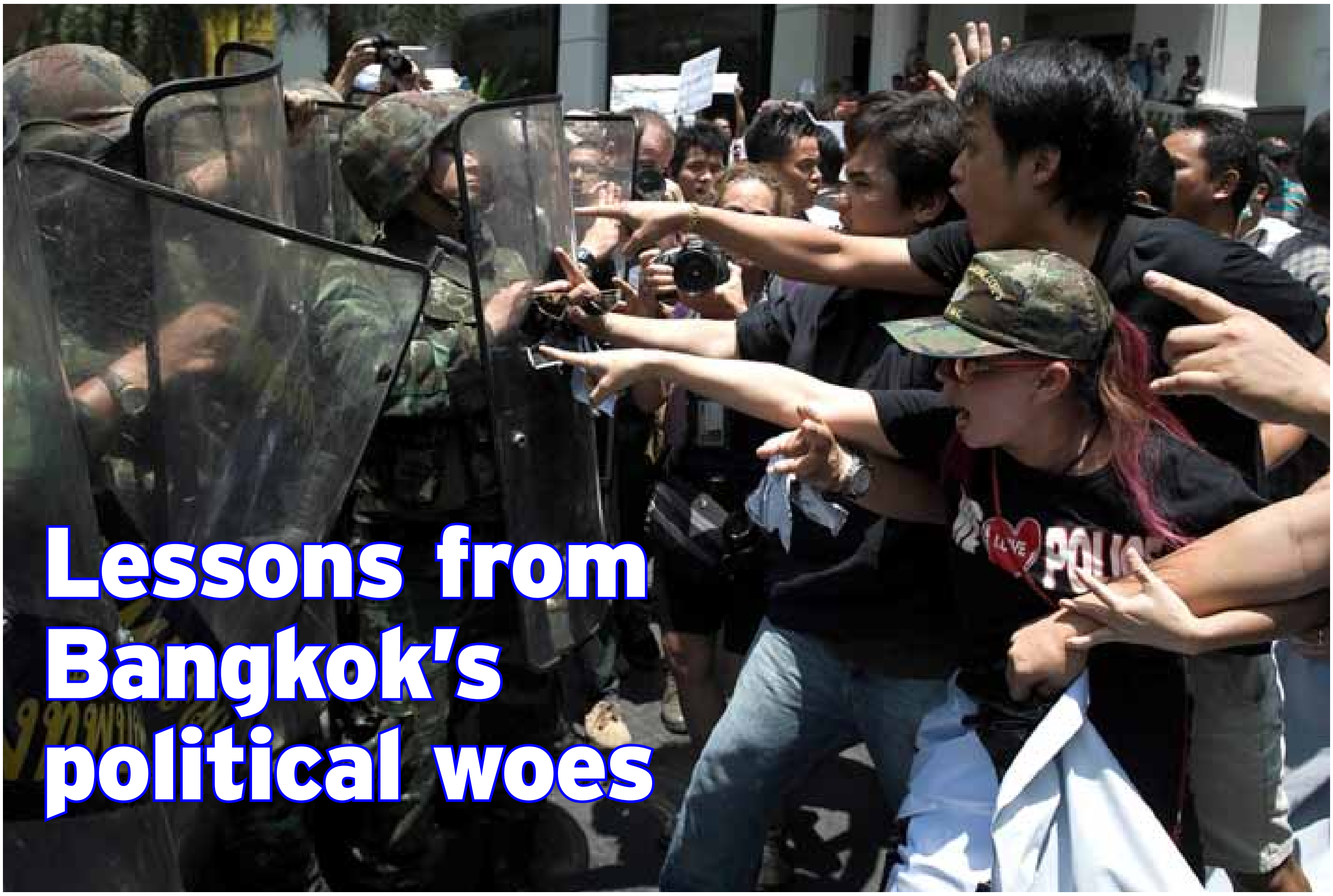
The views in this article are those of the authors and do not necessarily reflect those of the Australian Treasury.

PICTURE: NICOLAS ASFOURI / AFP PHOTO / AAP



Lessons from Bangkok's political woes

Protesters vent their anger in Bangkok on 25 May, after the junta placed all law-making authority in the hand of Thailand's army chief.

NICHOLAS FARRELLY

WITH the coup d'état of 22 May 2014, Thailand vaulted back to its familiar position as a cautionary tale. After much speculation, the anticipated takeover came with an announcement by General Prayuth Chan-ocha. Like his many predecessors as coup-maker-in-chief he took the microphone to confirm that the military was, once again, in charge. Nobody was surprised.

After almost a decade of episodic political distress the famous Thai smile hides stark divisions. Thailand has failed to build a stable consensus about how to distribute political and economic power. And powerful interests, including in the palace and the army, don't respect electoral mandates.

Since the second half of 2013 the opponents of former prime minister Yingluck Shinawatra ran an effective and demoralising campaign against her government. They barricaded parts of Bangkok, brandished whistles to indicate that Yingluck's 'time was up', and disrupted the smooth operation of official premises with ultimatums and sit-ins.

Through this chaotic period there were always worries that a coup—judicial, military or bureaucratic—would end Thailand's flirtation with representative democracy. And so it went.

This 2014 coup brings numbing anxiety about the prospect of civil war: a dramatic descent into the abyss that could pit northerner against southerner, rural against urban. Talk of a regional schism, once the preserve of online ranters, has gone mainstream. The kingdom—a unitary state fortified by the principle of unity above all else—is dangerously divided.

The royal family deserves some of the blame for this situation. During the twilight of King Bhumibol Adulyadej's astonishing and unprecedented 68-year reign, at a time when the institution needed to unite the people, it has taken sides in an unbecoming battle for political dominance. It has not weathered these storms unscathed. Thailand's most ardent democratic voices identify palace aides as their enemies.

Republican attitudes, which had been largely dormant since the 1980s, are re-emerging. And what was once a gentle, and private, rumble of dissent about the political role of the royals now takes on more extreme forms. With unhelpful external conditions, or bad luck, Thailand could topple from its perch among the most successful societies in Asia.

That prospect—one that would have seemed ludicrous merely a decade ago—now looms ominously for a country that has become comfortable with its positive international and regional standing. Across Southeast Asia there are worries that Thailand's internal strife could lead to problems in the wider neighbourhood. Among the members of ASEAN there is characteristic reluctance to show undue concern about what are, officially, the internal matters of a sovereign member state. But that stale prescription ignores the role that Thailand plays as an economic and logistics hub, to say nothing of its leadership in a region where democracy has shallow roots. Thailand, after the coup, is faced with the chance that it will no longer have the respect of its peers.

At this moment of mounting concern, leaders, intellectuals and analysts across the region are craning their necks to learn what they can from Thailand's woes. They hope that prompt recovery is possible but many will appreciate that it can take decades to fully redress the trauma that is being inflicted. Some countries in Southeast Asia have not yet managed to get past their histories of internal strife. Thailand is now exhibiting, in real-time, and for the 'internet generation', that its politics is a blood-sport, and one where all too tragically there are no real winners.

So what lessons should the other nine countries of ASEAN take from Thailand's experience? Should they be worried that their own systems are vulnerable to such rolling political tumult?

Crucially, Thailand demonstrates that there can be serious repercussions when democratic elections require a changing of the guard. The government of deposed former prime minister Thaksin Shinawatra, the older brother of former prime minister Yingluck, which held power from 2001 until the coup of 2006, represented an uncomfortable challenge to the old order of royal, military and bureaucratic authority.

PICTURE: NARONG SANGNAK / EPA / AAP

General Prayuth Chan-ocha: followed the path of his predecessors to become a coup-maker.

Thaksin's interpretation of Thai politics was brash, economically boastful and wildly popular. He also demonstrated the repugnant authoritarianism in which so many Thai strongmen indulge. The rule of law suffered as he steamrolled opponents too many to name. Yet nowadays many Thais remember the stability and prosperity of the Thaksin years as a benign golden age. In this context, powerful forces in Thailand, such as the army and the palace, couldn't accept the prestige that Thaksin accumulated, or the way he so profitably blurred the boundaries between business and politics.

Thaksin upset the self-appointed guardians of decency. He also threatened to comprehensively displace those he consistently defeated at the ballot box by interfering with specific career trajectories. The coup of 19 September 2006 was the response to his electoral success and the years since have witnessed the tough struggle to redefine Thai democracy.

But Thaksin's allies still win every election, most recently in February 2014. It is fair to judge that neither side is unblemished and that there is no simple way of delineating Thailand's 'good' and 'bad' elements. Even those who succeed electorally have a tentative relationship with democratic virtue.

This is a profound issue for democrats across Southeast Asia—the nature of elite interests means that those who win elections often hold fundamentally undemocratic perspectives. Nobody who knows him well would claim, with a straight face, that Thaksin is an exemplar of democratic instincts. Instead, he is the type of political operator who does well in a system where power and money are jealously sought and where one can beget the other. Across Southeast Asia the quest for power through electoral means, and through popular campaigns, gives elites new prizes to cherish and new battles to fight. Even though Thaksin has led political parties and a social movement that are emboldened by support from the masses, and partly by the rhetoric of social inclusion and economic redistribution, his primary focus remains the accumulation of power.

In the Thai instance the primacy of the monarchy, its guards in the military and the handfuls of dominant commercial enterprises that support the entire machine were challenged by Thaksin's alternative juggernaut. The

PICTURE: NICOLAS ASFOURI / AFP PHOTO / AAP

Protesters in Bangkok confront a police officer during demonstrations against the junta.

democratic constitution of 1997, the one under which Thaksin was elected in 2001 and 2005, gave hope that a compromise between popular interests and the elite would be possible. That proved chimerical, and since the coup of 2006 many Thais have wondered whether they will ever regain the optimism of democracy's yesteryears.

With the monarchy and military prepared to challenge legitimate electoral mandates, the anti-democratic instincts of these powerful groups have been highlighted and criticised, although in the Thai case there still is no all-out assault on privilege and its beneficiaries. Instead, apathetic acceptance reigns. It is unclear whether, in the fullness of time, those entrenched elite interests will survive the turbulence and unpredictability that has been unleashed by the stoush with Thaksin. For some people the struggle has existential consequences, with the cosmological and material layers dangerously entwined.

The Thai conundrum also has its own international dimension, especially at a time of ambitious integration across ASEAN. It has been determined that 2015 will be the year for the implementation of the ASEAN Economic Community. Thailand has been a strong supporter of these integrative efforts and is one of the societies best-prepared to deal with greater intra-regional mobility. The country, for instance, already absorbs around two million migrant workers from Myanmar. Its economy is flexible, nimble and globally connected. It could see a new economic boom once the ASEAN efforts bear fruit.

Thailand also benefits from the investment, construction and consumption frenzy in adjacent Myanmar. Many Thai firms are aggressively seeking opportunities across the border. As transport and communication links improve there will be countless ways for Thais to exploit what is described as Asia's 'next frontier'. But all of this potential progress could be undermined by the problems at home. Those problems could make Thailand a much more difficult neighbour.

Thailand's instability may even encourage the creation of enemies abroad.

The skirmishes with Cambodia in 2011 under Thailand's conservative Abhisit Vejjajiva government are one example. Thailand, after the coup, may also find its relations with Myanmar are strained as both nations flex their muscles along the border. But these are not the major problems. Thailand's current internal preoccupations ensure that it is vulnerable to intrigue. At one level, lax law enforcement has made it a hub for regional smuggling: in people, weapons and even fake documents. Its sophisticated 21st century economy is almost fully tied to global markets but it is also saturated by criminal activities. Regulation is politicised by partisan and sectoral priorities.

That is not a common formula for long-term success.

Yet, at another level, Thailand is subject to profound geopolitical shifts. Competition between China and the United States has a Thai nexus, with both countries claiming precedence and seeking to carve out new areas for dominance. In the long term there may not be room for everyone, no matter how adept Thai diplomats tend to be. For a neighbourhood that has recently been insulated from major power competition, invocations of ASEAN primacy may not be sufficient protection—especially when one of the primary players in Southeast Asia's regional politics is so preoccupied with internal affairs.

Is Thailand ASEAN's weak link?

With this question ringing loudly, it is the management of internal affairs themselves that should provide the greatest lesson, and warning, for the rest of Southeast Asia. Thailand's monarchy and its backers in the military are not prepared to accept Thaksin and his proxies' dominance of elections and the mandates that these give them to influence so many aspects of national life. In response they have precipitated a conflict that has already generated many years of instability and violence. Major problems that predate the 2006 anti-Thaksin coup, such as rampant inequality and the civil war in southern Thailand, have not been dealt with adequately. Instead, overwhelming attention has been devoted to brawling in Bangkok. The latest coup only reinforces that long-term pattern.

For ASEAN, a region that is peculiarly sensitive to interference in supposedly 'internal' affairs, there is very little that can be done. But the lessons that internal problems can blight a decade of potential progress should be all too apparent. In Thailand it is the defence of the monarchy that has become the over-riding concern. The primacy of this one institution has parallels across the region.

In Myanmar it could prove that in the future the military—its image diminished by the rise of civilian politicians—seeks to re-assert itself. The Philippines, a rambunctious place at the best of times, has struggled to get past the ways its elites have historically divided up the spoils. In Indonesia, jousting plutocratic factions could easily get into a battle without end. Then there are those systems where one party has held power for so long. In Singapore, Malaysia, Cambodia, Laos and Vietnam, decades-long rule is being tested from many directions.

They all face the prospect of internet-inspired mobilisations, even insurrections, and are looking at Thailand's quagmire with concern.

At the regional level, it is true that Southeast Asia has developed an impressive array of institutions to manage international conflicts. These are hardly perfect but the preeminence of ASEAN and its insistence on 'amity and cooperation' offers the peoples of the region some confidence that a major regional war is unlikely. But the mechanisms for the management of internal feuds are as basic as ever.

To protect against the most disastrous future outcomes, Southeast Asia would be wise to carefully heed Thailand's problems. These are problems born of a common inheritance of elite dominance in politics and the economy; hesitation about representative democracy; and the careless expectation that old systems will last forever. As time marches on, the constant calls for more pragmatic, cautious and patient adjudication of political and economic development will sound increasingly hollow. Many people want change. And still the idea that entrenched elites will surrender much power is wrong almost everywhere.

Since the retreat of colonialism, the entrenchment of powerful local elites has been the dominant Southeast Asian political characteristic. It just so happens that in Thailand a new elite, spearheaded by Thaksin, rose to challenge for supremacy. The old guard have decided that they can't go without a fight.

> General Prayuth's junta has already made its agenda clear with a rolling crackdown against dissidents, academics and independent media

This should not imply that Thailand will implode: we hope that the most pessimistic analyses are wrong and that the situation after the 2014 coup will offer new chances for compromise, even conciliation. Such a gentle end to Thailand's difficulties would save lives and resources, and further endorse a commendable Southeast Asian style of negotiated settlements.

There are those in Thailand, however, who are now unable to concede such an outcome. Instead they relish the brinksmanship, believing that their ultimate goal, the obliteration of their opponents, will be worth the hardship and recriminations. General Prayuth's junta has already made its agenda clear with a rolling crackdown against dissidents, academics and independent media. Things could get ugly.

Across Southeast Asia this is the prospect that needs to be watched most carefully. It would have obvious implications for Thailand and its regional standing, but that's not the main point in the long term. What would really matter are the reverberations from any extreme scenario in Thailand.

If Thailand ends badly then all of Southeast Asia will be faced with tough decisions about how political institutions, both national and regional, need to be rethought. EAFQ

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Cacophonous beginnings to a new Asian epoch

JEAN-PIERRE LEHMANN

ON 26 October 1909 a young Korean nationalist, Ahn Jung-Geun, assassinated Japanese statesman and four-time prime minister Itō Hirobumi on the platform of Harbin railway station. This triggered a number of developments in East Asia. Specifically, it gave Tokyo a pretext for the formal colonisation of Korea the following year and extended Japan's imperialist reach over the continent. Although Japan had already made its impact as a rising global power—notably in forging an alliance with Great Britain in 1902 and defeating Russia in war in 1905—beyond East Asia the Harbin incident was hardly noticed.

Just short of five years later, on 28 June 1914, a young Bosnian Serb nationalist, Gavrilo Princip, assassinated the Austrian Archduke Franz Ferdinand and his wife Sophie in the streets of Sarajevo. Within weeks virtually the entire planet was at war.

What happened in Harbin had purely local consequences. What happened in Sarajevo went global. The period from the end of the Napoleonic wars until the end of the Cold War (1815–1991) encompasses the 'European centuries' in the sense that the global narrative of that epoch was written in Europe. Although Europe declined after World War II and the United States emerged as the dominant global power, it was what happened in Europe that mattered: in America, perhaps only the 1962 Cuban missile crisis came close to being a globally significant event on the same scale as the World Wars.

THE narrative of this century will be written in Asia. It is in that sense that this is the Asian century, not in the sense that Asia has inherited the mantle of global power from the United States. Though the Ukrainian situation appears to resurrect European ghosts, it will not significantly alter the march of history to Asia. The 21st century is the Asian century.

Differences between the two parts of the Eurasian continent are considerable. Europe has fairly precise borders, it is geographically compact, and is the location of one civilisation. Asia, in contrast, is a term coined by the Greek historian Herodotus (c. 484–425 BCE) to refer to everything lying east of Anatolia. 'Asia' was originally a Western concept articulated to differentiate between 'us' and 'them'. In reality, Asia is composed of several civilisations, including the Arabic, Persian, Indian and Chinese civilisations.

PICTURE: WU HONG / EPA / AAP

A student celebrates Chinese Youth Day, 4 May, in Qingdao city. The rising generations will have the opportunity to write Asian narratives and create a greater Asian cultural and intellectual space.

This is not to say that there have been no exchanges between Europe and Asia. On the contrary, throughout history there has been a great deal of trans-Asian interaction, whether through empires—for example, the expansion eastwards of Arab power, influence and trade from the 7th to the 15th centuries, or the Mongol empire in the 13th and 14th centuries—or through trade along the Silk Road and the Spice Route. Indeed, recent research indicates that the Silk Road may have been an even better conduit of ideas than of goods.

The rise of European imperialism in the 19th century which extended, with the single exception of Japan, to the entire continent of Asia, brought these intra-Asian exchanges to an end. Though Siam (renamed Thailand in 1948) escaped actually being colonised, squeezed as it was between British Burma and French Indochina, it had little room for sovereign manoeuvre. Similarly, though China was not colonised, it was subjected to Western (and later Japanese) imperialist indirect rule.

Notwithstanding claims to the contrary, Japan's imperialism in East Asia did not create any form of pan-Asian space. The expansion of American power in Asia during the latter half of the 20th century retarded the resurgence of intra-Asian exchanges.

In the past two decades things have changed quite considerably. While Asia at the dawn of the 19th century had a share of over 60 per cent of global GDP, by 1950 this had fallen to less than 20 per cent, with a third accounted for by Japan. But by the late 20th century it was clear that Asia was back. East Asian economies in particular have witnessed the world's highest and most sustained growth rates. Cross-border intra-Asian trade and investment has soared and constitutes a key driver of the global economy.

WHILE much of Central and Western Asia remains in a state of economic, political, geopolitical, social and ideological turmoil, greater ties are developing with East and South Asia, especially due to the fact that large Asian economies are now major importers of Middle Eastern oil. Whereas the two big Eurasian nations, Turkey and Russia, have throughout the two previous centuries focused their visions primarily on Europe, this is changing as both Moscow and Ankara seek to develop closer ties with Beijing, Delhi and other Asian capitals. The membership of the Shanghai Cooperation Organisation, founded in 2001, includes China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan. Afghanistan, India, Iran, Mongolia and Pakistan have observer status, while Belarus, Sri Lanka and Turkey are listed as dialogue partners.

The rise of Asian power can also be seen by the fact that when the G8 (now G7 again) expanded to the G20, the majority of the new members were Asian—China, India, Indonesia, Korea and Saudi Arabia, along with the Eurasian power Turkey, and Australia, which economically is now in the East Asian orbit.

Yet this does not translate into Asian unity. The continent is defined by numerous fault-lines and powder kegs. There are territorial and other disputes of various degrees of seriousness between numerous Asian states, extending from west to east: Pakistan versus India; India and China; Bangladesh and Burma; China and the Philippines and Vietnam; Japan and China and Korea; and, of course, the two Koreas, just to name a few. A number of these are either current or potential future nuclear powers.

Another potential source of conflict is water security. Half of the world's population depends on water flowing from the Tibetan plateau. Indeed the entire 'WEEF' range of issues—water, energy, environment and food—will punctuate the Asian century narrative.

In the face of all these challenges, what is likely to be a critical problem is that Asians do not know each other. Commercial and geopolitical relations may have been revived, but cultural and intellectual ties remain weak. Western soft power still tends to dominate in numerous important respects. For example, while Asian young elites flock in great numbers to American (and Australian, Canadian and European) universities, intra-Asian university exchanges are comparatively few. The same applies to the media. Often Asians depend on Western media for news about other Asian societies, as they have very few correspondents of their own in other Asian countries. Al Jazeera is a rare exception.

The same applies to scholarship. Whereas Asian studies institutes proliferate throughout the West, they are relatively few in most Asian universities (with the notable exception of institutes in Hong Kong and Singapore). Internationally published books and articles on Asian societies will in all probability have been written either by locals (that is to say, Indonesian authors writing on Indonesia) or by Westerners, rarely by other Asians.

THE mythological Tower of Babel is believed to have been situated in Asia—according to recent research most likely in North Syria. The two European centuries were extremely brutal and bloody. It remains to be seen what the narrative of the Asian century will be. Its initial stages are, like the Tower of Babel, cacophonous. The world urgently needs a greater Asian cultural and intellectual space in which Asians can create knowledge, confidence and trust by sharing perspectives on the world and each other. EAFQ

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Where will the Chinese economy land?

PICTURE: AAP

Shoppers at a market in Jiujiang city, in China's Jiangxi province. The upward trend in consumption should continue as rapid wage growth lifts household income.

YIPING HUANG

IN MID-April, China's National Bureau of Statistics reported real GDP growth during the first quarter at 7.4 per cent, marginally below the official target of 7.5 per cent for 2014. During a recent lecture with 35 branch managers of a leading joint-stock bank, I conducted a small survey by asking for their assessment of the reliability of the first-quarter GDP data. All of them believed that it was significantly overstated. In fact, most businessmen and economists estimate the actual GDP growth to be between 1 and 2 percentage points below the official figure during the first quarter.

Perhaps this explains the high degree of anxiety among officials when economic data weakened visibly in February and March. As a result, the government took steps, often described as mini-stimulus or targeted easing, to stabilise economic growth. These include increases in financing and investment in areas such as high-speed rail, urban housing, new power plants, and so on.

But doesn't this reaction raise a question about how serious the government was when it argued in favour of tolerating slower growth and accelerating economic reform?

Although the government lowered the growth target to 7.5 per cent—from 8 per cent previously—it is still quite reluctant to let growth slip below its new target.

Although the official GDP growth figure for 2014 will likely be around 7.5 per cent, all of the economic momentum points downward. Export growth will probably be very modest, because the US economic recovery has been weaker than expected and the

Chinese export sector is undergoing major restructuring due to a rapidly rising cost base. The upward trend in consumption should continue as rapid wage growth lifts household income, but public consumption may remain soft as a result of the government's anti-corruption drive.

Fixed asset investment is still the main area in which the government acts to stabilise growth. But weakening market conditions in the property sector mean the outlook is not encouraging. Manufacturing investment should be relatively stable given the outlook for exports and consumption. The central government may increase infrastructure investment if the economy weakens again, but there is little room for local government action in this area because of a decline in revenue from land sales and the tightening in financing conditions for local government investment vehicles (LGIVs). Recently, the central government started an experiment allowing ten provincial governments to issue local government bonds.

In addition, a recent International Monetary Fund (IMF) study estimates that if the comprehensive reform program approved in November is rigorously implemented, it could reduce Chinese GDP growth by 0.2 of a percentage point in 2014 but boost growth by more than 2 percentage points in 2020. While it is probable that the short-run negative impact will be greater and the medium-run impact more modest, the overall point stands: short-term pain will result in long-term gain.

. . . as officials and economists worry about the impact of the growth slowdown on employment, labour supply is actually drying up, with wages continuing to rise rapidly

While there are downside risks for economic growth, the government is being overly cautious. Officials often warn against three potential problems of growth below 7.5 per cent: increased unemployment, financial instability and a loss of investor confidence. But these arguments are not well-supported by facts. The greatest fiction in policy discussion today is the need for 12 million new urban jobs every year. This is exactly the same number that was given 16 years ago when the government first proposed the need to maintain an 8 per cent growth rate. At that time, the labour force was rising by 8 million a year. Now it is falling by 3 million a year. But as officials and economists worry about the impact of the growth slowdown on employment, labour supply is actually drying up, with wages continuing to rise rapidly.

The potential impact of a growth slowdown on financial instability is more difficult to assess, given the gigantic size of the shadow banking sector, massive LGIVs liabilities and growing non-performing loans in the banking sector. However, all these activities are linked to the state, one way or the other. This is why, if China suffers from major financial instability problems in the near term, it will be because of reduced liquidity rather than a loss of capital. Financial stability is tied to the fact that everybody relies on the central government's fiscal capacity. The problem with China's financial system is therefore one of flows, not stocks.

The impact on investor confidence is even harder to figure. At the end of last year, most investors actually favoured a lower growth target because that would send a stronger message about the government's determination to push ahead with reform. Look at how the domestic A-share market has performed and it is obvious that investor confidence has been weak for quite some time.

Recently, the government accelerated its pace of implementing wide-ranging economic reforms. It looks like the government should be able to push ahead with reforms more quickly in areas of reducing administrative controls, liberalising the financial system and reforming factor prices, but more slowly in areas of land reform and restructuring of the state-owned enterprises. These reforms should eventually lift China's GDP growth potential by improving resource allocation and supporting productivity gain. However, in the near term, growth will likely weaken further before it picks up. EAFQ

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How the young think about their insular life

NORITOSHI FURUICHI

THE youth of Japan appear to face a bleak future—a catastrophic budget deficit, ageing population and collapsing social security system. Despite this, according to data released last year, Japan's youth are astonishingly positive in their outlook. In the government-run Public Opinion Survey Concerning People's Lifestyles, levels of youth life satisfaction reached 78.4 per cent—the highest they had been since 1967 and higher than during Japan's booming 'bubble economy' period.

What's more, an NHK survey on youth attitudes reveals that more than 90 per cent of high school students are 'happy' and the majority of junior high school students are 'very happy'. This information might seem hard to process given that the situation of Japan's youth appears to be worsening.

From 2000, the mass media has been widely declaiming about the 'dissatisfaction' and 'unhappiness' of Japan's 'unfortunate youth'. Landing a stable job has become increasingly difficult and it is no longer rare to hear of people handing in over 100 resumés in their search for work. The phrase 'black companies' (sweatshops) has come into the mainstream to describe companies—and there are many—that break the Labour Standards Law. These companies often exploit desperate youths who are forced to work long hours with zero job security.

Last September, a Ministry of Health, Labor and Welfare investigation found that 4189

PICTURE: KEN LEE

A kiss in the midst of the passers-by on *seijin no hi*, the day of the traditional coming-of-age celebration, in Tokyo's Shibuya district. Young Japanese may be aware that they face tough times in the future, but surveys show they are happy about their present circumstances.

businesses, out of the 5111 investigated, had broken labour laws. A ministry official stated that 'even though it was not just targeting [businesses abusing] young people, many young employees [were] found toiling under duress'. Consequently, from 2015, the labour ministry will be asking companies to provide worker turnover data to graduates in order to shed light on prospective labour conditions—and prevent abusive work practices.

Japan's social problems are snowballing.

It is hard to think of Japan as being a very 'happy' or 'content' nation when looking at its budget deficit (the largest among developed countries); the decades-long clean-up process for the Fukushima nuclear disaster, now underway; increasingly xenophobic rhetoric; and an ageing population threatening to topple the social welfare system. In addition, Japan provides low levels of social security to its working generation.

So why, in spite of this, are young people's levels of life satisfaction and happiness so high?

In 2011, I published the book *The Happy Youth of a Desperate Country* and tried to tackle this question.

Japan is a wealthy and peaceful nation, with low levels of crime, high levels of education, and well-established lifestyle infrastructure. There are many things Japan has to thank the older generation for. In that sense, Japan is blessed with unprecedented wealth.

Japan has become a more comfortable place for young people to live in. Continued deflation since the 1990s has encouraged higher-quality products at competitive prices—without having to spend too much, it is now possible to have a reasonably enjoyable everyday life. 'Fast fashion' has helped, with labels such as Uniqlo, H&M and ZARA providing affordable fashion 'fast'. And now just by owning a smartphone one can spend hours killing time.

'Family welfare' is also an important factor in youth happiness. In Japan, as in Italy, the percentage of unmarried people still living with their parents is extremely high. Both young men and women often live with their parents until they are married. In 2012, 48.9 per cent of unmarried people between the ages of 20 and 35 were living with their parents, as were 16.1 per cent of unmarrieds aged between 35 and 44. Even if a young person isn't earning a wage, with support from their parents they don't think of themselves as poor. Many parents of today's youth also have assets, such as property—something many young Japanese will never buy themselves.

'Enjoy today, tomorrow is coming' encapsulates the mentality that increasingly absorbs Japan's youth

'Enjoy today, tomorrow is coming' encapsulates the mentality that increasingly absorbs Japan's youth. This 'consummatory' mindset is where, rather than striving towards long-term goals, the focus is on having fun in the 'here and now'. The modern youth of Japan cannot relate to the feelings of their parents or those who experienced the period of rapidly rising living standards and economic growth during the 1980s. The mantra 'I am poor now but the future will be filled with riches' is no longer relevant. Japan has become an incredibly wealthy country—the third-largest economy in the world—so its youth are treasuring the here and now, with little incentive to look towards a brighter future.

So high levels of life satisfaction may not automatically have a positive meaning.

When a person doesn't have hopes and dreams for the future, they may say they are 'happy now' or 'I am satisfied with my current life'. Note that the elderly have high levels of happiness and life satisfaction too. According to sociologist Masachi Osawa, the elderly cannot imagine a 'bright future that is much happier than now' as they are approaching the end of their lives, and to say that they are unhappy would be to deny the happiness and meaning experienced over the course of their lives—so their satisfaction levels increase with age.

This is evident in the results of the government's life satisfaction survey. If life satisfaction is looked at across the years, it is notable that levels of happiness among the older population are not only higher but also increase with age—in spite of tougher times economically.

In a recession people are less likely to blame themselves if their wage does not increase—they can blame the poor economic conditions. In boom times it is impossible to blame society. As a result one is left with the stark reality that 'in spite of the boom, I am being left behind'—and, with disappointment, life satisfaction falls.

Interestingly, surveys of poorer societies in developing countries find that there are times when happiness levels are much higher than among successful people in developed countries. This may be attributed to one's perceived status within a 'reference group', a phrase coined by social scientist Herbert Hyman to describe the importance of self-appraisal compared to the group—satisfaction will be higher when there are high and stable levels of group equality.

Perhaps with these factors combined it is possible to understand why life satisfaction and happiness is increasing among young Japanese. Even though Japanese society has been in a state of despair, it is not illogical for its youth to be satisfied that the burden is being shared.

The government's lifestyles survey, which aims at those above 20 years of age, shows that the number of people 'worried about the future' has been increasing. During the bubble economy, youth who replied that they had 'worries' sat at 40 per cent, while in 2009 this increased to 67.3 per cent. So when thinking about the future itself Japanese youth are worried, but it appears they are happy about the present at the same time as resigned about the future.

The results of the NHK youth attitudes survey on high school students also showed a doubling over the past 30 years in the number of students stating they are 'very happy'.

The consummatory mentality among Japan's youth may also help explain such a high increase in youth happiness. For example, out of 16 different 'interests' in the NHK survey, the majority—55 per cent—chose 'hanging out with friends'. Only 17 per cent answered that they were interested in 'keeping up with wider Japanese and world affairs'. Answers to do with the wider world or society rated lowly while things that were immediate, tangible and 'close' or self-centred, such as music, marks and exams, rated highly.

PICTURE: TORU YAMANAKA / AFP PHOTO / AAP

Ready to take on the world: college students at a ceremony in Tokyo to mark the start of the annual hunt for jobs. A recent survey into the attitudes of school students showed that the number who considered themselves to be 'very happy' had doubled in the past three decades.

Those replying that they are most interested in 'hanging out with friends' continues to increase. According to the cabinet's Eighth Youth World Consciousness Survey, 38.8 per cent in 1970 chose this answer. But in 1980 this had increased to 58.8 per cent and in 1990 to 64.1 per cent. From 1998 it has sat at around 74 per cent. Love for one's hometown and the number of youth refusing to leave their home region is also increasing. Even internationally these numbers are high.

More recently Japanese youth have been described as *uchimuki* ('inward looking' or 'insular'), but it would be wrong to say that they do not value things around and close to them, like their friends. Rather, when measuring happiness and life satisfaction, the basis has shifted from society and politics, 'public and wider things', to 'friends' and 'hometown'—things that are in one's immediate world. However, the *uchimuki* phenomenon is not necessarily due to lack of interest in leaving Japan or one's immediate world but may also reflect high levels of present contentment—a consequence of the wider well-off socio-economic situation of Japan.

The wealth that has supported the happy youth of Japan will slowly and surely fade.

Young people will soon be unable to rely on the welfare provided by their families. Within a few decades the many parents who are still supporting their children will require nursing care. Under the burden of fees for aged care, parents' accumulated savings will be strained and in many cases disappear entirely.

Today's young people too will age. The elderly in Japan currently have many siblings and many are married, so care is often carried out by families

PICTURE: LYN DURHAM / AAP

Roaming and riding in Tokyo: Japan has become a much more comfortable place for young people to live. Continued deflation since the 1990s has encouraged higher-quality products at competitive prices, so that without having to spend too much the young can have a reasonably enjoyable everyday life.

and relatives. But the youth of Japan currently have few siblings, and many never marry. The number of 'lonely old people' will increase.

It is unclear how sustainable Japan's social security system is. The current system was established during the post-war period, and is clearly structured to rely heavily on young people. However, the working population needed to support the system is declining—and government and business have put off addressing the low birth rate issue for quite some time.

A crucial impediment to addressing these issues is that youth are underrepresented in positions of power. Japan's decision-makers—who are generally older—tend to be concerned more with issues affecting older voters: the voting rate of those aged 65–69 is almost double that of those in their 20s.

A population that doesn't have a replacement rate of 2.1 births per woman cannot sustain its population. Japan's rate is 1.4. The Japanese government has finally revealed plans to implement policies to address the low birth rate and provide greater childcare, but its success is far from certain, and by the time the children are raised and can work 20 years will have passed.

Japan will not lose all its wealth straight away. The problems it faces will really start to hit home in the next few decades. But, because Japan is so rich, people don't really notice the gravity of these issues. Even if they do, the mindset is still that 'the present is more important—the future is so far' and the hard solutions are put off. This is the typical pattern that civilisations follow before they collapse.

The future of Japan's youth is not only their problem—it is the problem of every Japanese citizen. Society, as a whole, will have to take on the problems that Japan's young people are confronting today. EAFQ

Noritoshi Furuichi is a Japanese sociologist and PhD candidate at the University of Tokyo. He has published the best-selling book Zetsubō no Kuni no Kōfuku na Wakamono-tachi (The Happy Youth of a Desperate Country).

Sigourney Irvine translated this article, based on extracts from Noritoshi Furuichi's book.

Scope for an ambitious development agenda

HOMI KHARAS

ON THE surface, aligning the G20's development goals with the United Nations-led post-2015 agenda would seem to be relatively simple. The G20 has called for economic growth that is 'inclusive and resilient' as well as strong, sustainable and balanced. Similarly, the post-2015 development agenda is aimed at finding a set of development goals that would be inclusive, transformative and sustainable. Both offer a new commitment to multilateralism in the course of enabling all individuals to grow to their full potential while avoiding environmental threats.

But while the G20's objectives and the post-2015 agenda overlap to a considerable degree, the two processes are quite different. The G20 is still fundamentally an exclusive club, in spite of it recognising that it has a broader set of responsibilities towards non-members, especially low-income countries, because of its weight in the global economy. Its work on development is guided by the Seoul Development Consensus and Multi-Year Action Plan, programs that focus more on economic growth than the social poverty-reduction programs of the Millennium Development Goals (MDGs). The G20 has also given voice on the development agenda to some of the largest middle-income countries in the world that have not found the MDGs to be relevant for themselves or their cooperation with others.

By contrast, the post-2015 agenda is an inclusive process in which all countries participate and negotiate priorities that apply universally. The starting point is the UN's Millennium Declaration and the associated MDGs and targets that were set to reduce global poverty, but all indications are that the post-2015 agenda will be far more expansive. Low-income countries are important voices in the post-2015 dialogue.

It is important that the two processes generate an aligned agenda. The G20 must recognise the need to address social and environmental issues that could undermine growth if left unattended. The post-2015 agenda must give more prominence to growth and prosperity than is found in the MDGs. The rich countries of the G20 must accept their own responsibilities, and the post-2015 agenda must find ways to develop an agenda that is exciting to middle-income countries.

> Structural reforms in G20 countries are needed to move to a decarbonised growth pattern to make consumption and production sustainable

It is already clear that the post-2015 agenda is more ambitious than the MDGs with an emphasis on growth and economic transformation. At the same time, the global development narrative is shifting away from something that rich countries do for poor countries to a narrative that emphasises the interconnectedness of economies and the spillovers from one country to another. Getting one's own house in order and acting collectively in the common interest are becoming more important to global sustainable development than merely increasing aid.

The G20 has, until now, focused on the structural reforms of its members to strengthen growth, reduce imbalances and build resilience to counter the impact of the global financial crisis. To align with the post-2015 agenda it must now do the same with the looming global sustainability crisis. Structural reforms in G20 countries are needed to move to a decarbonised growth pattern to make consumption and production sustainable. G20 members must build global norms and institutions to create appropriate incentives and help weaker economies to make the transition to these new growth paths.

The difficulty faced by the G20 is that even though its members are among the largest and most important economies in the world, they have no authority to dictate measures: the G20 is not a decision-making forum but rather a discussion forum that gently steers national and international institutions and provides political impetus to selected processes. It can only lead by example. It has had trouble articulating a development agenda that generates tangible results. And it has faced considerable criticism for producing more declaratory statements than actual achievements on the development agenda.

The challenge then is to produce more deliverables that are worthy of leaders' attention and discussion. The post-2015 agenda is promising in this regard. It proposes the collective action and structural reforms in rich and middle-income countries that are necessary to achieve global food security, universal energy access and sustainability, fiscal health, and stronger and more predictable international trade and financial flows, among other things.

The G20 could, and should, lead the way in tracking its members' contributions against the post-2015 agenda and in framing collective action on issues like profit-shifting by multinational enterprises, while supporting stronger institutions and better governance and transparency in all economies. The post-2015 agenda provides some clues as to where the focus of the new global partnership should be, including trade, finance, aid, climate, tax evasion and illicit financial flows, and access to technology. Without strong G20 leadership to spur collective action these issues may not receive proper attention, and could stall the shift to a new development narrative.

Australian chairmanship of the G20 in 2014 offers a timely opportunity to reframe the development agenda along these lines. Australia has clearly linked its national self-interest to Asia's successful development. Its own experience shows how well-regulated markets can drive strong economic growth and its chosen focus themes of faster growth, more jobs and strengthened infrastructure investments resonate across all countries.

PICTURE: NOAH SEELAM / AFP PHOTO / AAP

A homeless family enjoys a meal provided by a food program in Hyderabad. Achieving global food security is an important element in the G20's ambitious post-2015 agenda but strong leadership will be needed to ensure that the new development narrative does not stall.

The G20's development agenda has wrestled with two problems: how to raise the profile of development interventions so as to make them a priority for leaders, and how to focus the agenda so actionable items can be pursued. Alignment with the post-2015 agenda promises to help on both fronts by anchoring the group's core activities to an agenda shared by the rest of the world.

Going forward, G20 leaders should throw their weight behind the completion of an ambitious agreement on the post-2015 agenda and agree to measure their performance against the targets established by the United Nations. To achieve this, G20 leaders should ensure that each member designs and implements a structural reform agenda that will lead to sustainable development in their own countries. It will also be important to build a program of global cooperation and collective action which enables other countries also to pursue sustainable development. EAFQ

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Financial stability in need of a narrative

COLIN BRADFORD

THE global financial crisis of 2008 revealed failures and fissures in national and global financial systems. A big and as yet untold—even unfinished—story is what actions the major economies have taken, both at the national and international level, to address weaknesses in overseeing, supervising and regulating financial institutions and markets.

The belief that financial markets were self-regulating has been shaken and indeed shattered by the crisis. Now there is a resurgent effort by policymakers to reassert public responsibility for economic outcomes that protect and promote the public interest in financial stability, growth and price stability. The G20 leaders' summits and meetings of finance ministers and central bank governors over the past five years have been at the forefront of this effort.

For a long time, price stability has been the predominant goal of central banks, and in many countries their only goal. Inflation-targeting grew in favour in many countries where central banks became exclusively focused on price stability as their mandate.

But the crisis has shown that the division of labour between central banks and finance ministries—the former tasked with financial goals and the latter preoccupied with the real economy of employment, income and output—is increasingly untenable. Although the principle of the independence of central banks from executive authorities has been

The Governor of the People's Bank of China, Zhou Xiaochuan, in discussion with International Monetary Fund chief Christine Lagarde. Meetings of G20 finance ministers and central bank governors have been at the forefront of promoting support for financial stability, growth and price stability.

PICTURE: JIM WATSON / AFP PHOTO / AAP

honoured in most countries, central banks are custodians of the public interest and have been increasingly responsive to having a more balanced basket of goals.

Monetary policy has been at centre stage as the primary instrument for economic recovery and growth since 2010, after fiscal deficits had exhausted fiscal policy space. Inflationary pressures have receded from attention as financial stability as a public priority came to the fore for central banks, and for other regulatory authorities as well as for parliaments.

Financial stability is a more complex goal than price stability. It involves detecting the downside systemic risks that stem from macroeconomic imbalances, overextended private financial institutions and markets, weak regulatory structures, and the failure of safeguard and gate-keeping mechanisms to manage market volatility and exogenous shocks. In most countries, central banks have significant roles in this process—indeed, sometimes the most important role.

To be sure that systemic risk assessment is effective, all four of these elements of financial stability need to be monitored, analysed and reviewed for possible dangers and for action that might be needed to contain nascent threats. The capacity of national institutions to carry out an integrated assessment of internal systemic risk, as well as the capacity of international institutions to assess global systemic risk, may not be up to scratch, given the analytical complexity of these elements. The institutional arrangements that govern these four fields are different in every country and are fragmented in some, adding to the challenge.

But national governments and international institutions have made

Haruhiko Kuroda, head of the Bank of Japan, one of the central banks which has pursued a policy focused on quantitive easing.

progress to address these challenges. Since the crucial London G20 Summit in April 2009, G20 governments have acted to strengthen their capacity to oversee, supervise and regulate their financial markets and institutions. They have led the international efforts of the IMF, the OECD and the Financial Stability Board (FSB) to catalyse and harmonise national financial reforms and to initiate and support global financial regulation and coordination. The first phase of this

. . . strengthening national capacity to oversee, monitor and regulate financial markets and institutions is essential to protecting the public from financial shocks

effort is now nearly done. Australia is pushing for completion of this first phase of financial reforms for the November G20 Summit in Brisbane.

As complex as this landscape may be, several things are clear. First, enlarging the mandate of central banks to extend their horizons to growth and financial stability is in the broad public interest. Secondly, strengthening national capacity to oversee, monitor and regulate financial markets and institutions is essential to protecting the public from financial shocks. Thirdly, systemic diversity among the major economies in the G20 brings to the fore a richer variety of institutional and policy experiences on which policy-makers can draw in their reform efforts to cope with new realities.

Finally, recent efforts by the major economies to address financial vulnerabilities and risks in their economies and in the global economy through the G20 and the international institutions (especially the IMF, the OECD and the FSB) mean that there is a broad range of policy tools available, especially compared with the pre-crisis situation, which was characterised by an undue faith in the self-regulatory nature of financial markets.

What is lacking still, despite these positive developments, is a narrative for the public that conveys the nature of these efforts over the last five years and connects the public to their stake in this evolving story. The G20 Brisbane Summit in November provides an opportunity to weave this narrative and tell this story, connecting G20 leaders to their publics in new and promising ways. EAFQ

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Accelerating investment in economic infrastructure

ANDREW ELEK

THE world has a huge demand for economic infrastructure, including better transport and communications among economies. The world economy is performing well below its potential and, in 2011, Indonesia alerted APEC and G20 leaders to the significant potential benefits of meeting this demand. In the short term, new investment would help to further boost demand, while current low rates of interest provide an excellent opportunity to invest in economic infrastructure that would raise long-term productivity and integrate economies.

For these reasons, the governments participating in both APEC and the G20 have agreed to accelerate investment in economic infrastructure. But it will not be easy to go beyond declarations of good intentions and studies to significant new investment.

Finance is not the immediate constraint. Economies with a sound enabling environment for investment can mobilise financing for well-prepared projects which are expected to earn an adequate rate of return. Unfortunately, there are not nearly enough such projects.

All governments need to improve their policy environments and their capacity to prepare commercially viable projects. Involvement and collaboration in organisations like APEC and the G20 can help them to develop the necessary human capital and institutional capacity, while overcoming the policy and administrative obstacles to accelerating investment.

But policy development alone will not be enough.

Governments also need to commit to implementing some well-

Construction workers move stainless steel at a building site in Beijing. APEC leaders can agree this year on steps to promote infrastructure investments.
PICTURE: PETER PARKS / AFP PHOTO / AAP

conceived infrastructure initiatives backed by a shared determination to solve the inevitable problems that will be encountered. The lessons of experience are the most effective means of drawing attention to the policy changes and institutional improvements needed to expedite investment in subsequent projects.

Some useful examples are already being set in the Asia Pacific. As part of their determination to create an ASEAN Economic Community, Southeast Asian governments are investing in the necessary transport, communications and energy networks, with support from the ASEAN Infrastructure Fund.

Asia Pacific leaders also adopted the APEC Framework on Connectivity last year. Officials are drawing a blueprint to upgrade physical, institutional and people-to-people connectivity. When they meet later this year, APEC leaders can agree on some early steps to translate that blueprint into a pipeline of infrastructure investments, backed by a substantial investment to create the skills and institutional capacity to finance and manage them.

APEC is not, and should not become, a financing or implementing agency—the resources needed to plan and then implement projects to improve connectivity will need to be provided by individual governments and by attracting investment from the private sector. It will take time to mobilise resources on a large scale, but the Asian Infrastructure Investment Bank (AIIB) makes it possible to take some important early steps in 2014.

China is expected to launch the AIIB when it hosts the APEC leaders' summit in November. The bank is open to shareholding by any government or private investor; more than ten governments have already agreed, in principle, to be foundation shareholders. The AIIB is to focus on narrowing gaps in the region's economic infrastructure, so support for investments to connect Asia Pacific economies fits neatly into its mandate.

To initiate a productive partnership with APEC, the AIIB could commit a very small part of its expected capital base to finance the preparation of an APEC master plan on connectivity during 2015, together with a feasibility study to demonstrate how Asia Pacific governments can work together on a significant initiative to improve connectivity—for example a coordinated, region-wide effort to upgrade the capacity and performance of ports and airports.

The potential gains from practical cooperation to improve trade logistics are far greater than any possible APEC-wide deal on trade liberalisation. Work to upgrade transport facilities can set the example for implementing the many other components of a long-term plan for better physical, institutional and people-to-people connectivity among all Asia Pacific economies.

The G20 can learn from APEC to accelerate investment in economic infrastructure.

G20 leaders have already commissioned policy-oriented research to ensure that financing does not become a constraint once the pace of investment in economic infrastructure accelerates. Looking for ways to mobilise more private savings to finance infrastructure will alert policymakers to some significant new issues.

The best way to attract investment is to reduce the perceived risk of investing in infrastructure in various economies. The most effective way governments can do that is to establish sound and transparent policymaking, and to construct an institutional framework which is based on sound principles and creates a business-friendly environment.

The share of private financing of investment in infrastructure will need to increase, but public-sector investment will remain essential to attract finance from global capital markets. It is essential to clarify when public investment in infrastructure is justified and to assess objectively the capacity of governments to borrow for productive investment.

IT IS not efficient to expect many individual or institutional private investors to acquire the expertise needed to estimate the potential benefits and risks of specific infrastructure projects. Multilateral development banks were created to reduce the transaction costs, but these banks are not making an adequate contribution to commercial financing of investment.

The new AIIB provides an incentive to consider expanding the financing capacity of existing development banks. At their 2014 meeting, G20 leaders can ask the World Bank and other multilateral development banks to prepare strategy papers they can review in 2015. These strategies should set out how international financial institutions intend to attract more private-sector finance for infrastructure and how they could increase their own commercial lending to meet a much larger share of the finance needed to narrow gaps in economic infrastructure. EAFQ

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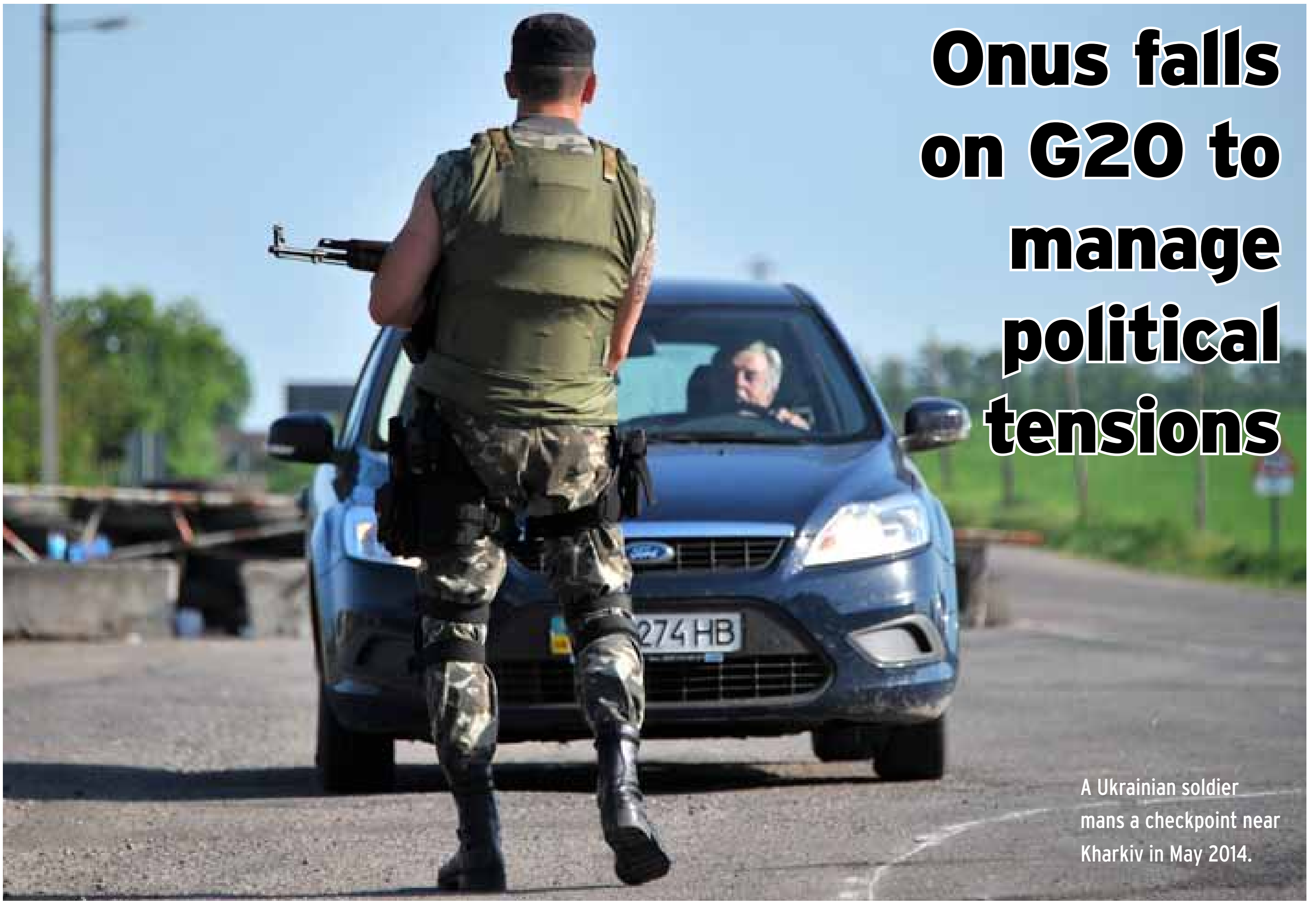
PICTURE: GENYA SAVILOV / AFP PHOTO / AAP



Onus falls on G20 to manage political tensions

A Ukrainian soldier mans a checkpoint near Kharkiv in May 2014.

BRUCE JONES

FIVE years have passed since the peak of the global financial crisis and the elevation of the G20 from a meeting of finance ministers to a meeting of leaders. The organisation has helped states to make substantial progress towards financial recovery, although there is still more work to be done on preventing the next financial crisis.

The geopolitical situation has begun to change, and not for the better.

Crises of a different type—geopolitical and security crises—could begin to affect the functions of the G20. While this does not mean that the G20 could or should take on foreign policy challenges, it does mean that the G20 needs to operate in more creative ways to deal with a changing geopolitical landscape.

Discussions of foreign policy and security have entered the G20 spectrum before—in 2012 the Mexican presidency held a foreign ministers' meeting, and in 2013 the crisis in Syria forced foreign policy on to the agenda of Russia's summit. But neither of these summits was able to move the needle on tough geopolitical and security issues. The Australian government has to confront the prospect that the Russia–West crisis over Ukraine is not likely to have subsided by the time of the Brisbane summit, and other crises—from the East China Sea to Egypt to Syria to North Korea—could also force themselves into the frame in November.

There is no question that a phase of mounting geopolitical tensions has begun. The Middle East is undergoing the violent process of revolution and counter-revolution that will likely last another half decade—possibly longer. Geopolitical strains are rising in Asia, where tensions between major economies could undermine the ability of some G20 members to cooperate within international fora. There are also tensions in a series of policy domains where governance mechanisms are comparatively weak, including cybersecurity, the broader domain of internet governance, maritime security, and energy security. And finally, the recent events in Ukraine highlight that geopolitical tensions in Europe and between the West and Russia are very real.

At the very least this suggests the need for an active agenda for managing geopolitical tensions. Is that a job for the G20? If the answer is no that begs the question: who else? The UN Security Council does not have all the players in it, and is a tool far better suited to operational crisis management than it is to processes that lower geopolitical tensions. And the G8 is too narrow. There is an argument to be made that the G20 may not be the place to go to ameliorate geopolitical tensions but, for now, it's the only answer we have: where else can emerged and emerging powers come together to discuss pressing issues?

Still, the G20 must not give up its core agenda of economic recovery. On the contrary, the core agenda of the Australian G20 must surely be continued focus on sustained economic growth. However, the Australian G20 can concentrate its efforts on the financial issues, while at the same time innovating on foreign and security policy questions to contribute to a lowering of geopolitical tensions or the management of geopolitical crises.

There are two options within the G20 to do this: establish a foreign ministers' track, or explore more innovative, less formal options. Specifically, for Brisbane, the Australian government should ask the leaders to bring with them a senior national security official. It should be left to individual leaders to decide who to bring with them—their foreign minister, their national security adviser or their diplomatic adviser. The decision should be theirs, and perhaps influenced by the agenda.

AUSTRALIA should also host an informal side event for these officials, chaired by either Australia's national security adviser or the foreign minister. And at the time of inviting, the meeting should have no planned outcome—no statement, no communiqué; it should be an informal session.

But the Australian government should communicate to the G20 members, through informal channels, that it intends this informal session to be available in the case of a major crisis brewing which demands G20 leaders' attention the way the Syria crisis did.

While the Australian government would inevitably face some pushback, it has deep enough relationships with all the critical players to weather criticism or concern should some G20 members be uncomfortable with this approach. There will be no advances in the management of geopolitical tensions without innovation and some risk-taking, and the history of effective multilateralism tells us that middle powers with close ties to the top powers are best placed to play this role.

It is past time for the G20 to innovate in the domains of foreign policy and security, and find creative ways to contribute on the geopolitical side of things. The G20 may not be the perfect vehicle for that function but, for now, it is the only one available. And if the G20 does not ramp up efforts to forge the tools necessary to manage rising geopolitical tensions, it will find that the underlying relationships allowing the G20 to perform as it has—criticisms aside—on the financial and economic issues will begin to erode, putting the core functions of the G20 themselves in jeopardy. It is not too late to manage rising geopolitical tensions and maintain a degree of stability in great power relations; the G20 has an important role to play. EAFQ

A supporter at a pro-Ukraine demonstration in London in May 2014. The G20 is the only international forum where 'emerged and emerging powers come together to discuss pressing issues'.

PICTURE: GUY CORBISHLEY / NEWZULU / AAP

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Climate change the hot topic at Brisbane summit

PICTURE: RAFAL GUZ / EPA / AAP

United Nations Framework Convention on Climate Change Secretary Christiana Figueres, left, COP19 president Marcin Korolec and COP spokesman Eric Hall at the 2103 Warsaw COP19/CMP9 conference. The conference broke up without the 194 countries present reaching an agreement.

ROSS GARNAUT

THE time is right to place climate change at centre stage of the 2014 G20 leaders' group meeting in Australia. The G20 has a record of leadership on the international climate change agenda. With the world working toward a critical meeting of the United Nations Framework Convention on Climate Change (UNFCCC) in Paris in December 2015, a firm position articulated by G20 leaders in Brisbane in November would be in time to influence the Lima UNFCCC meeting in December 2014.

The G20 is ideally suited as the main forum for overcoming the 'free rider' problem of collective action on climate change. It contains all of the world's main greenhouse gas emitters and all the countries that are most important to effective global effort on climate change, as well as those that have been most active in the UNFCCC. While the G20 contains the most influential developed and developing countries, it can stand outside the entrenched and stereotypical divisions that have become barriers to effective action within the UNFCCC, with its huge and unwieldy membership and traditions of symbolic posturing.

Climate change is not a new issue for the G20, nor is influence on formal decisions of the UNFCCC something new. At the 2009 Copenhagen climate convention, the G20 played an important role in establishing the objective of holding the contribution of human-induced climate change to 2 degrees Celsius. It formulated a strong position on removing fossil fuel subsidies, an important position that has seen some domestic reform worldwide, and one which should be reiterated. The G20 meeting in Russia in 2013 agreed to reduce hydrofluorocarbon emissions, under the Montreal Protocol, as a contribution to climate change mitigation. The G20 in Australia could agree to initiate negotiations at the next meeting of the Montreal Protocol's Conference of the Parties.

The chances of the G20 playing an important role in accelerating momentum on international climate change action at this time have been improved by shifts in domestic policy in the United States and China. Over the five-year life of the G20, the governments of the world's two largest economies and greenhouse gas emitters, have introduced major domestic programs to implement emissions-reduction targets that embody major changes in established trajectories. The pivotal importance of the Paris UNFCCC meeting in December 2015 makes the Lima meeting crucial to any prospects of the G20 being helpful to a strong outcome.

It must be said that there are also less happy portents for success. The new Australian government, the host of this year's G20 heads of government meeting, is seeking to repeal legislation on domestic carbon pricing linked to international markets, although it has confirmed the previous government's target of a 5 per cent unconditional reduction by 2020. It committed itself during the 2013 election campaign to strengthen the Australian target up to a reduction of 25 per cent depending on what other countries were doing.

Overall, though, the G20 is well positioned to lead the development of a new style of collective action on climate change.

A system of international collective action can emerge in one of three ways: through the exercise of power by strong interests, through binding agreement, or through shared acceptance, by individual citizens or states, of constraints on decisions and behaviour. All three approaches have been important in early attempts to find a basis for effective global climate change mitigation. But as it became clear at the Copenhagen meeting that there would be no legally binding agreement on climate change mitigation for the foreseeable future, we are now seeing the gradual emergence of an international system built mainly on the third approach of shared norms. Norms are largely being shaped by emerging implicit agreements on what constitutes reasonable efforts by individual states, and by the recognition that free riding may incur costs in relations with other states, including market access.

The new approach carries some important features over from the early international discussions. Scientific cooperation remains centrally important to the collective effort. The objective of keeping atmospheric temperature increases to 2 degrees above preindustrial levels, mechanisms to measure and verify emissions, and instruments for international trade in entitlements have been developed or strengthened.

I call this new approach concerted unilateral mitigation, with a 'pledge and review' system of targets determined by domestic political factors and external review by other countries. To ensure its effectiveness one major gap in the international regime needs to be filled. We require some framework to guide assessments of whether the level of mitigation undertaken in each country amounts to a fair share of an international effort to achieve the agreed global outcome. This would need to include guidance on adjusting targets for 2020, setting appropriate targets for 2030, and also setting long-term targets for low levels of global emissions in 2050.

It would be useful and probably necessary for heads of governments that are committed to strong global mitigation outcomes to appoint an independent expert group to develop a framework of this type to allocate the global effort among countries. Members would be appointed for their international standing in appropriate fields and would not represent individual countries or groups of countries. Their guidance would extend to indicative allocation of emissions reduction targets across countries, in the form of parameters for nationally appropriate mitigation action for developing countries. Within the context of concerted unilateral mitigation, each country would be free to accept or reject the guidance provided by such a framework. The framework would become a focus of international review of each country's effort and would evolve in response to discussion and experience.

It would be more efficient, environmentally and economically, to have global free trade in natural gas. But the protection that export restrictions provide for domestic users has strong support . . .

The G20 is well-placed to establish an expert group to develop this guidance. It could also play an important role in the pledge and review process, building on previous G20 mechanisms of peer reporting through expert groups. Alternatively, it could delegate the review and its interaction with the expert groups' guidance on targets to a body established by the Major Economies Forum.

In some areas, the grouping's role is less clear. For example, it is not obvious that the G20 will be able to do much to reduce US trade restrictions on natural gas. These restrictions are sometimes supported on the grounds that they are accelerating reductions in greenhouse gas emissions. They are certainly having this effect in the United States. But by elevating natural gas prices in East Asia—and in Australia and other countries that are supplying gas to East Asia—they are inhibiting emissions reductions outside the US. It would be more efficient, environmentally and economically, to have global free trade in natural gas. But the protection that export restrictions provide for domestic users has strong support, and despite the hopes of free traders, the G20 may be unable to do much to remove trade barriers in this area.

PICTURE: JACEK TURCZYK / EPA / AAP

Environmentalists march on the venue of the Warsaw conference in November 2013. The time is right for the G20 to give a strong lead on climate policy.

To take another example, there is only a weak case for G20 intervention to increase investment in the commercialisation of low-emissions technologies. While private firms are bound to underinvest in the research, development and commercialisation of new energy technologies, most countries are now finding their own reasons for investing in innovation in low-emissions technologies, so that it seems that voluntary domestic commitments would be able to manage the free rider problem. It would, however, be productive for the G20 to establish a process for reporting on national efforts to show each country that other nations are making substantial contributions to generate international spillovers from investing in innovation in low-emissions technologies. The G20 could also usefully draw attention to the opportunities for choice of infrastructure investments to reduce the costs of the commercialisation of new low-emissions technologies.

There is one other important role for the G20: increasing pressure for free trade in goods and services that are important inputs into activities that reduce greenhouse emissions, including such raw materials as uranium and natural gas, as well as in biofuel alternatives to fossil fuels and capital goods that generate renewable energy. This would fit the G20's established interest in securing open trade on a global basis. There has been considerable discussion and some action within APEC, the WTO, and the Trans-Pacific Partnership of the importance of free trade in goods and services that are important to the global mitigation effort. The G20 heads of government meeting could focus attention on the environmental and the economic advantages of establishing free trade in important inputs, adding momentum to discussions in other forums.

Now is the right time for the G20 to become the centre of a strong international effort. The climate change issue is important enough to the economic and political life of the international community, the prospects and costs of failure of international collective action large enough, and the possibility of successful intervention high enough to make the increase in momentum in global climate change negotiations an important feature of the Brisbane summit.

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Australian National University

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