8 October 2010

Dear Dr Rhee, Dr Siregar, and Dr de Brouwer

_Seoul 2010: Opportunity for Asia and the G20_

As you will know, over the past two years, together with the late Dr Hadi Soesastro of the Indonesian Centre for Strategic and International Studies (CSIS), we have been coordinating a roundtable on Asia and the G20. We appreciate the encouragement you and your predecessors have provided in undertaking this work. On the eve of your final preparations for the G20 Summit in Seoul in November, we are pleased to offer for your consideration this note on the thinking that has emerged from the roundtable, concluding with its latest meeting on 4 October in Seoul. A list of experts, officials and others who have been consulted in the course of this work is attached for your background.

_Most important outcome: strong commitment to recovery strategies_

The most important outcome of the G20 in November will be the reassurance of strong commitment from G20 leaders to macro-economic recovery strategies and to the structural changes needed for balanced growth and sustained development in the long term. As the most dynamic in the global economy, Asian economies have an especially important role in setting out the course ahead for re-balanced and sustainable growth.

There are deep worries about the political pressures, latent but powerful, on governments in many of the world’s major economies favoring policies, such as too early a fiscal contraction, that would throw the G20’s cooperative strategies off course. A risk is that elections and political transitions scheduled in a number of key countries by 2012 may lead to resort to ill-considered protectionist restrictions or subsidies that limit market openness and set back the recovery. The Summit can serve to keep these pressures at bay in order to sustain recovery and growth in the years ahead.

_Recovery is still fragile and growth unbalanced_

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

Averting worldwide depression in 2008 was made possible by the major economies working together to re-start their economies and refraining from systematic resort to protectionism or competitive devaluations. Their action created the confidence needed to stimulate demand sufficiently to avoid a depression, through setting fiscal and monetary policy appropriate to national economic conditions.

In 2010, leaders can agree to continue the coordination of policies, informed by the work they commissioned from the IMF. The IMF's Mutual Adjustment Process scenarios set out two vastly different prospects for employment and living standards in the next 5 years:

- either weak recovery, and a second wave of recession, with poor coordination of macro-economic policy settings;
- or a sustained recovery from the global financial crisis with rising employment, if G20 governments adopt an approach that is coordinated around re-balancing growth.

The market awaits strategies for sustained and balanced growth

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

Correcting imbalances: Asia should take the initiative

Correcting imbalances will require continued macro-economic policy adjustment and fiscal and structural reform in both countries with current account deficits and those with current account surpluses. In countries with current account surpluses, of which there are in several in Asia, the priority should be on substantial restructuring, which strong capacity for growth both allows and recommends for national development. While current account surpluses are falling in key Asian economies, it will be important to avoid their growing again. Asian members of the G20, drawing on their own past experience and success, can help to set ambitions for structural reform and change that are crucial to achieving more balanced and sustainable global growth.

The restructuring experience of Korea, Australia, Japan (in the 1980s) and the ASEAN economies (in the 1990s), together with the agenda for structural change and rebalancing that is being set out in China today, offer examples and lessons for rebalancing strategy globally.

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

**Structural reform**

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

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

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

**Exchange rate flexibility**

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

... *rather than exchange rate re-alignment*

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

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

*International monetary arrangements and IMF governance*

Effective coordination to underpin future stability of the international monetary system could be undermined by asymmetrical adjustment between deficit and surplus countries. While current account deficit countries cannot sustain their deficits and are forced to run down their reserves or depreciate their currencies, surplus countries can find it politically convenient to maintain nominal values of exchange rates and run up foreign exchange reserves. Cooperative action to avoid this is highly desirable – and it will depend on surplus countries having more say in, and having confidence in, international monetary arrangements. IMF governance reform is essential to building this confidence. On the question of making financial market regulation more effective and robust, Asia could make a positive contribution to strengthening global financial system governance by establishing a functioning Asian Financial Stability Dialogue (AFSD) that draws in the whole region and complements the work of the Financial Stability Board (FSB). This would add to the work of building confidence globally in financial market regulation.

*Concluding the Doha round is central to recovery and development*

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

The Doha Round has dragged on for far too long. At Seoul, leaders can agree on a balance of interests and direct negotiators to complete the Doha Round as soon as possible and no later than the end of 2011. Another statement of nothing more than good intentions will not be helpful. The time has come to give Trade Ministers permission to conclude the Round to lock in the gains already available. They can then address the issue of WTO reform: its negotiating modalities and the problem of bilateral and regional arrangements not being subject to effective discipline so that they serve core global trade objectives at a critical time for global trade openness. Bringing the WTO up to date and re-positioning it so that it can deal with all dimensions of contemporary international commerce is central to the G20’s development agenda.

*Asia’s global responsibilities*

The G20 provides the opportunity for Asian economies to address all these and other problems that need global solutions. Asian economies need to decide how best to take up these issues through the
G20, especially by putting forward options which support and complement the interests of other regions. Conscious that the G20 process will work most effectively if there are clear priorities given to the discussion of major issues, it will be helpful to flag and position issues of importance to the region for future meetings and give fuller consideration to issues of global priority through regional meetings.

Regional cooperation should support the G20 priorities
An early opportunity to establish productive interaction between the global and regional processes might be at the Yokohama APEC leaders meeting immediately after the Seoul summit. APEC leaders can link the pursuit of their five-part growth strategy to G20 priorities, with early emphasis on rebalancing growth. Careful thought needs to be given to how Asian members of the G20 can best link their participation in trans-Pacific and East Asian regional arrangements to their individual responsibilities in the G20 and to the representation of broader regional interests. How regional structures should develop or be re-organised to serve these purposes is an important issue for further consideration.

Please accept our good wishes for the success of your deliberations.

Yours sincerely

(Soogil Young)  
(Peter Drysdale)