

Asia Pacific Forum 2022

Global Fractures and the Asia Pacific Economy

1 – 2 December 2022

Introduction

This conference, titled ‘Global Fractures and the Asia Pacific Economy’, was hosted by the Japan Economic Foundation in collaboration with the Australia-Japan Research Centre at The Australia National University. Over two days, various speakers and panellists from across the region joined together to discuss the current challenges and potential solutions to the fragmented global economy.

COVID-19, Russia’s war in Ukraine, the US–China rivalry, and climate change are all upending global economic stability. In addition to these shocks, continued supply chain disruptions, rising protectionism and technology decoupling, are continuing to undermine the strength of the rules-based multilateral order. This conference saw experts from across the region analyse these trends and offer potential pathways to restoring the stability of the global economy.

Keynote Speech

Dr Craig Emerson delivered the keynote speech for this year’s conference. He highlighted that the world trading system is under the most pressure that it has experienced since the establishment of the General Agreement on Tariffs and Trade (GATT) in 1948. The purpose of the GATT was to encourage interdependence, so that nations could prosper together rather than at the expense of one another. Interdependence also reduces the incentive to attack another country. This system was working until the geostrategic rivalry between the United States and China emerged.

This geostrategic rivalry escalated during Donald Trump’s presidency. President Trump took the United States back to a mercantilist age — where it was believed that exports are good and imports are bad. He imposed tariffs because he believed that American manufacturing was being hollowed out due to unfair trading practices, rather than comparative advantage. The view that America needs to rebuild its manufacturing sector is still apparent and is keeping us in a world of US protectionism.

Given this environment, it will be impossible to achieve a trade agreement that China, the United States, and other WTO members will agree to. But plurilateral agreements offer a way forward. Plurilaterals will enable us to achieve something, rather than waiting for a great single undertaking. ASEAN, RCEP, APEC and CPTPP are all examples of regional plurilaterals, and there is room to make something bigger out of these arrangements. A free Trade area of Asia and the Pacific (FTAAP) can be achieved by building on existing agreements, and through offering non-binding, voluntary, non-preferential and non-discriminatory entry.

Climate change is another challenge confronting this region. Comparative advantage applies here too, and not every member of the Asia Pacific community will be equally adept at reducing emissions. Establishing bilateral and plurilateral agreements within APEC or East Asia to trade carbon credits will take the pressure of countries finding it difficult to reduce their emissions. These trade agreements will also facilitate the sharing of decarbonisation technologies, such as green hydrogen.

We are living in a bottom-up world now, where bilateral and plurilateral agreements are supplementing giant multilaterals. In pursuing so many plurilaterals, we must ensure that they contribute to the strength of the multilateral system.

Session 1: Geopolitics and the Global Economic System Post-Ukraine Conflict

There have been a number of shocks to the global economy in recent years. The US–China rivalry, COVID-19 pandemic, and Russia’s war in Ukraine have all threatened to undermine the multilateral, rules-based global economic system. These shocks have given rise to other concerning trends — supply chain disruptions, protectionism, and the bifurcation of the world order. The Covid-19 pandemic was a major shock to the global economy from which recovery has been and will continue to be uneven and disruptive.

On the regional macroeconomic front, the return of “King dollar” due to a series of steep interest hikes by the US Federal Reserve has weakened many regional currencies. As a result, many Asia-Pacific economies have suffered the impossible trinity principle (trilemma), in which the three policy objectives of fixed exchange rate, free flow of capital, and monetary sovereignty cannot be achieved simultaneously. This session focussed on these issues and their impact on the Asia-Pacific region.

US–China Rivalry

Growing great power strategic competition between the United States and China has strained the multilateral order. The United States, intent on maintaining its global and regional influence, is behaving increasingly competitively, focused more on confrontation with China than cooperation. This competition escalated during the Trump administration, which saw a bilateral trade war spread through the global economy. China has also become increasingly assertive and uncompromising on its national interests. In this context, tensions continue to escalate, as US policymaking is driven by the idea that maintaining regional influence means not bowing to China’s aggression. This trend has also made constructive communication difficult. However, the US–China summit meeting during the G20 is a positive sign that both leaders understand the importance of dialogue.

Growing economic fragmentation is dividing the world into US and China-led blocs. As these two big powers increasingly orient their trade practices around security concerns — exercising unilateral export controls strategically — regional countries are finding themselves in a Kindleberger trap. In this fragmented world, export-oriented economies, which tend to be key players in supply chains, risk losing 3 per cent of GDP to growing protectionism.

ASEAN countries are frustrated by the growing rivalry, and the expectation to align with one or the other. This non-alignment is evident in ASEAN’s trading relationship with both powers, wherein ASEAN has refused to apply any discriminatory policies on their suppliers. ASEAN countries lack trust and confidence in both the United States and China. In response to the growing tension, ASEAN countries are seeking to strengthen their unity, and are also looking towards Japan, as a trustworthy power, to play a greater role in the region. It is in the interest of ASEAN countries to continue trading with and receiving foreign direct investment from China, without being punished by the United States.

In the latest iteration of strategic competition, the United States has banned the export of semiconductor chips and the equipment used to produce them to China. This has seriously compromised the ability of South Korean semiconductor companies to operate in China, and they are now looking at relocating to ASEAN countries or India.

Russia–Ukraine

Russia's invasion of Ukraine further upended the rules-based international order. The invasion was driven by national self-interest, with little regard for accepted international norms. In responding to the invasion, the US, NATO and other powers have formed a solid coalition of resistance that has collectively isolated Russia from the rules-based international community, largely through sanctions. In response to the sanctions imposed upon it, Russia has cut off oil and gas supplies, which has triggered spiralling oil and gas prices, rampant inflation, and recession in numerous corners of the world.

While the Asia-Pacific region is less dependent on trade with Russia, and for this reason has suffered comparatively less from the conflict, the sanctions have had serious impacts on supply chains in the region. Many Asian and Pacific countries are export-oriented, and therefore are key players in global supply chains, and sanctions have inevitably compromised their export ability. However, the region's network of multilateral arrangements has served as a buffer against these sanctions, which further highlights the value of multilateral arrangements in binding the rules-based order together and carrying it through crisis.

Spiralling food, oil and gas prices led some countries to adopt export control policies to ensure domestic supply. Indonesia implemented a ban on palm oil exports, while India banned wheat exports. These policies distort free market price signalling and are damaging to the international trading system, as they choke supply at the expense of the region's greater prosperity.

Consequences

The trifecta of economic and geopolitical challenges — the pandemic, strategic competition and war in Europe — has given rise to several concerning trends. As trade and investment is increasingly used as an arena for great power competition, onshoring and friend-shoring policies have become commonplace. Using government subsidies to onshore production, or implementing export controls to shore up domestic supply of critical minerals are self-interested actions that undermine the principle of comparative advantage. This is a dangerous trend, as comparative advantage largely underpins the success of the international trading system.

These shocks have also led to security becoming a central factor in trade and investment relations. For example, Japan passed an economic security bill in May, 2022. The law calls for supply chains for key materials and parts, such as semiconductors, to be strengthened, and allows the government to oversee the installation of vital equipment and computer systems in core infrastructure, in order to guard against cyberattacks. Prioritising security when it comes to trade is inefficient, it undermines principles of comparative advantage and most favoured nation, and economic growth will suffer as a result. Such thinking is counterproductive, as economic growth provides governments with greater resources to undertake research and development to improve the competitiveness of a country. A competitive country is less vulnerable to attack from non-allied countries.

Interdependence, in a functional multilateral system, incentivises states to not behave antagonistically — it can provide security. But in the current environment, where major powers are exhibiting a lack of commitment to the rules of the multilateral order, interdependence is being weaponised. As interdependence is increasingly seen as a vulnerability and a source of risk, that the rules-based order can no longer mediate, the region will become fragmented. Uncertainty surrounding the efficacy of the rules-based order is exacerbated by the United States' refusal to appoint judges to the WTO appellate body. Without a dispute settlement mechanism, rules are less enforceable, and this has eroded confidence in the international trading system, consequently giving rise to protectionism.

Solutions

In the face of a struggling multilateral system and growing protectionism, there is room for plurilateral agreements and middle powers to positively shape economic outcomes and cooperation in the region. Like-minded small and middle powers should unite to sustain the rules-based, open free trade and investment regime. The United States' Indo-Pacific Framework needs to be inclusive, and middle powers have the capacity to shape the various pillars and agendas of the framework to achieve this.

Ensuring that trade continues in the current environment will help push countries towards greater levels of growth. Non-discriminatory and non-exclusive trade policies are needed amid this great power rivalry. As these key geopolitical shocks have reverberated across the region, the importance of multilateral diplomacy and processes has been reaffirmed.

Middle powers — who stand to benefit significantly from a functioning rules-based order — have the capacity to lead the resurrection of the WTO dispute settlement mechanism. For example, New Zealand, Australia, China and Singapore have all signed up to the Multi-Party Interim Arbitration arrangement, which can resolve trade disputes until the appellate judges are appointed. Japan is yet to sign up to this, but there is encouragement from the Japan Economic Foundation and other governmental camps to do so. Given that ASEAN does not want to choose between the United States and China, they can play a central role in bringing both powers to the table.

Session 2: Rules-based economic recovery

Current problems

The global economy is overshadowed by security issues and the normalisation of expansionary policy. The global economy has so far failed to come up with a coordinated, concerted effort towards a normalisation policy. At the same time, the COVID recovery is an opportunity to push for a greener global economy — and rules and norms in the WTO are vital to that. But the WTO is flailing, and there is no solution for settling disputes. A new mechanism to deal with dispute settlement is sorely needed, otherwise confidence in the organisation will be undermined. Increased use of discriminatory and restrictive trade policies is also eroding confidence in the organisation.

The current situation also stems from a failure to coordinate on monetary and fiscal policy. This was also not resolved at the G20 summit. The economic recovery from COVID needs to be balanced, and achieving this balance will require a restructuring of global debt. 60 per cent of developing countries are trapped in debt. Having a rules-based monetary policy to finance this economic recovery will be crucial.

Countries are facing inflationary pressures and declining rates of productivity growth, so their immediate focus is on the effects of the Ukraine conflict. The Ukraine conflict has made food and energy prices and higher interest rates, the primary concern. These problems are aggravated by trade, technology and currency wars, which prevents coupling, coalitions, and our ability to restore supply chain connectivity. We need mechanisms to monitor long term supply chain vulnerabilities, which largely stem from structural reliance on concentrated markets for the supply of critical goods. Numerous countries in the region are facing a food crisis due to supply chain disruptions.

The global economy is shifting inwards. For the last 40 years, the single most important driver of the international economy has been the incorporation of unemployed resources in China. Chinese products have facilitated growth in incomes at relatively stable prices, and adjustment issues have emanated from this. Chinese products easily supplanted competing products, disrupting jobs and communities. Rather

than finding consolation in cheaper goods and services, many of these communities have pushed for protectionism. Resources will generate maximum economic welfare if there are as few restraints on their allocation as possible. Growing restrictions on the movement of people, goods, services and investment through these protectionist policies are a constraint which is hindering international economic welfare.

In addition to the US-China rivalry, there are non-tariff barriers that are blocking regional trade. The Indian Ocean can play a larger role in connecting Pacific economies, and this will provide larger dimensions for economic governance. Shipping lanes need to be secure and insured so that they can facilitate trade. The United States' Indo-Pacific Economic Framework can contribute to the positive evolution of trade and investment.

Plurilateralism

Plurilateralism can help address current geo-economic problems while the multilateral order is unable to do so. Adopting voluntary, non-binding and non-discriminatory approaches to plurilateralism will encourage wider participation and collaboration. The region is home to 10 least developed countries that will soon graduate to the status of developing country, and they need to be brought into the fold.

Plurilateralism was used to set up the GATT, but this came with its challenges as it brings along many diverse interests. Plurilateralism still appears to be the best way forward, because the multilateral level is trapped trying to make decisions based on a single undertaking approach which is not feasible.

Incremental developments in plurilateralism are the way forward. Smaller countries are predisposed to paper rules, while larger economies attempt to impose their view on others, but even they are constrained by other big countries and the costs of monitoring and enforcing. Rules for different policy domains have to be consistent. Disagreements in one area will influence agreement in other areas. Through plurilateralism, we can aim for consensus and compromise. Having the ability to draw on a wide range of plurilateral alternatives is more secure than a retreat towards autarky.

There have been productive plurilateral initiatives within the multilateral system, and this suggests that it is a good way forward on trade liberalisation and rule making. But pursuing plurilateralism as the solution should only be done if it is firmly rooted within the multilateral process, and appeals to the multilateral principles of openness. If we go down the route of friend-shoring, and trading only with trusted partners, we will be on a pathway to a poorer world. Breaking up production networks and supply chains will increase costs significantly. Openness is key, and because of this we need to be wary of the Indo-Pacific Economic Framework's efforts to exclude China. Forming an Asia Pacific community will mean avoiding exclusivity and ensuring that the members of various regional plurilaterals make their groupings multilateral in character.

Although plurilateralism offers some solutions, if pursued too excessively it will overcrowd the region with rules and groupings. Harmonising regional trade agreements can address this.

APEC

APEC has a peer review mechanism embedded in it. Against the backdrop of the WTO crisis, adopting a peer review mechanism could help further openness and reform. If we are to achieve an Asia Pacific Economic Community by 2040, we need to think about how we can link the Asia Pacific and Indo-Pacific, and explore possibilities for linking CPTPP and RCEP.

Views towards APEC are mixed. Some believe its role has declined due to a lack of vision and lack of momentum, which has meant that political support for an integrated Asia Pacific has declined. The United States is hosting APEC next year, which leaves room for hope that they will retract and rethink. APEC should be leveraged as an avenue to resolve the security of supply chains, and as a place to integrate the region and integrate digital trades.

Session 3: Implication of Climate Change and Energy

The world is currently undergoing a monumental transition to clean energy. Net zero emissions need to be reached by around 2050 in order to mitigate the threats posed by climate change, but reaching this target will require greater financial support and international cooperation. This session identified a number of key avenues to support the global energy transition, including greater public-private sector collaboration, green financing, and financial support for developing economies.

Public–Private Partnership

This discussion revealed that there is extensive scope for public-private sector collaboration in tackling climate change. The private sector is a crucial source of innovation and can leverage this to improve energy efficiency. The private sector can also help incorporate artificial intelligence (AI), which can be used to pre-plan agricultural inputs using weather data, for example. Supporting and expanding the accessibility of technology along supply chains more broadly will elevate efforts to develop clean energy.

The private sector is also well positioned to shape consumer preferences and behaviour. Businesses should take the lead in adopting more sustainable consumer goods, and guide consumer preferences through marketing. Sector specific approaches should be adopted — the agricultural sector can use data to reduce water requirements, the construction sector can improve solar panel uptake, and the hospitality sector should exclusively use biodegradable products and reduce its food waste. Companies can reduce emissions from within their own supply chains by implementing nature-based solutions such as reforestation and agroforestry, rather than evading their obligations through carbon credits. In the past few years, a number of companies have been fined for ‘greenwashing’, and this is a positive sign that the private sector can be held accountable to its climate commitments. Accountable action — for businesses, governments and consumers — will be an important driver of the energy transition.

A number of barriers need to be overcome to support greater public-private collaboration. Standard environmental, social and governance (ESG) principles for responsible investment should be employed. Governments can also use taxes and incentives to direct the private sector and consumers towards climate conscious economic activities, and encourage small and medium-sized enterprises to engage in sustainable practices. Businesses need to become active stakeholders in helping the world adapt to clean energy, but doing so will require coherent and consistent government policies.

Financial and concessional loans can complement private investment. Non-financial cooperation — promoting trade, harmonising standards, carbon trading and technology sharing — can support private sector initiatives. A simultaneous top-down, bottom-up approach, where strong government policy works alongside engagement with enterprises, businesses and the media, will be crucial. Governments should provide the ‘catalyst’ funding that is needed to mobilise private capital. For example, green banks are blended financial vehicles that take some government money to launch, and then leverage private sector money to fund different projects. There are some domestic banks which already do this, but can they operate on a global scale?

Green Financing

Global investment in energy will need to increase from US\$2 trillion a year to US\$4-5 trillion in order to realise the transition to clean energy. Energy supply security, particularly in light of the Ukraine conflict, is a growing concern and driver of policy and investment. Sustained financial support for clean energy will see changes begin to happen under the pressure of the market, not just government intervention.

Harmonising standards will be key to green financing. This includes ESG standards and green globe certification requirements. Inconsistent ESG standards means that firms go forum shopping for ESG bonds — trying to find a rating agency that will give them a high score — and this distorts the market.

Global capital rules can also be leveraged to promote inclusive and sustainable development. In 2020, around US\$18 trillion sat in negative yielding bonds worldwide. Incorporating sustainability metrics in global capital rules like Basel iii can help channel this money by incentivising banks to hold more green debt and issue more green bonds. Reshaping global capital rules is a potential area for international cooperation that will also deliver significant benefits to developing economies.

Developing economies face acute challenges when it comes to financing their energy transition. Vietnam, for example, has set ambitious SDG commitments and has pledged to achieve net zero emissions by 2050. But it needs an additional US\$368 billion to support these efforts. Developing economies cannot undergo the energy transition alone — international cooperation and support is sorely needed. This is where green financing can play a greater role in supporting developing economies through their energy transition.

US-China barriers

Deteriorating US-China relations pose a significant threat to international energy cooperation, because the clean energy transition is dependent on technology exports from China. Greater US-China engagement is needed in technology to ensure that bilateral tensions do not harm other states' ability to reduce emissions. The tension between the United States and China has ripple effects — states are disincentivised from cooperating with one country in case it affects their relationship with another country. When two great powers are refusing to work together to address the climate crisis, it provides small and middle power countries an excuse to shirk their responsibilities too.

Encouraging greater US-China climate collaboration, will be crucial to the global energy transition. The recent meeting between US President Joe Biden and Chinese President Xi Jinping during the G20, where the two leaders agreed to pursue international climate negotiations, is a positive sign that climate cooperation can be siloed from the other issues in the bilateral relationship.

Collaboration

Asia Pacific countries account for one third of global green-house gas emissions and 60 per cent of the world's coal supply. These economies should explore avenues to strengthen cooperation in energy transition. Key areas for collaboration include hydrogen, road transport, steel and agriculture.

CPTPP and EVFTA already include strong commitments regarding the transition to renewable and green energy. To support these, APEC and ASEAN members should have individual action plans to implement their agenda. APEC's 2040 vision requires greater collaboration, dialogue, and the development of a green taxonomy. The United States' Indo-Pacific Economic Framework includes a clean economy pillar,

but international collaboration is required to implement this. There is scope for APEC to appoint a leader who can support the clean energy initiative and ensure that developing economies receive the support needed to undergo the green transition.

The circular economy offers a new way of thinking about growth. It focusses not only on economic growth, but green growth, and views the economy as circular rather than linear. ASEAN adopted this idea of a 'circular economy' and is committed to making the green transition on the principles of inclusion and resilience. Implementing the circular economy will require cooperation and multi-stakeholder collaboration.

Conclusion

The topics discussed across the three panels highlight the challenges we face in the context of a struggling multilateral order. COVID-19, Russia's invasion of Ukraine, and the US-China rivalry have upended the global order. There is growing impetus to develop alternative avenues to support open trade and international cooperation that help to restore a robust multilateral order. Much of the discussion during this conference emphasised the role that plurilateralism can play in this effort. Nurturing plurilaterals will help prevent rising protectionism, friend-shoring and discriminatory trade policies. Great power strategic competition between the US and China is a key challenge to restoring the multilateral order, and middle power countries should look for areas where they can engage both powers. Climate change is one of these areas. Given the severe existential threat posed by the climate crisis, US-China cooperation in this area is not only essential, but may provide an initial step to greater collaboration.