Growing Together Beats Falling Apart:
Making Asian Economic Integration Work for Asia, the United States, and the World

A report by the Asia Society Task Force on Asian Economic Integration and Global Trade

November 2010

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Foreword

To say that Asia is rising has become both a cliché and an understatement. It is a cliché because it is so often repeated. It is an understatement not only because Asia is rising as a region, but also because its rise is challenging many of the fundamental underpinnings of the world as we've known it for decades, even centuries.

While Asia's rise has lifted hundreds of millions of people out of poverty, it also has the potential to usher in a new era of international cooperation and collaboration. Asia's ascent, however, could alternately lead to a weakening of international norms, greater levels of economic nationalism, and a less secure world. The difference between these two possible outcomes will be determined by a series of decisions to be made by individual countries, regional groups, and multilateral organizations over the coming years.

To help develop ideas for how Asia-Pacific nations can work together to maximize the great potential of this incredibly dynamic region, Asia Society has produced a series of Task Force reports that present strategies for regional collaboration to address issues such as climate change, water and food security, and trouble spots including North Korea, Burma/Myanmar, and Afghanistan.

Because Asia's economic growth has been the central pillar of Asia's rise, fostering Asia's continued growth within the broader context of a balanced, fair, and integrated global economy will help lay a foundation for addressing many of the region's and the world's challenges and is in everyone's and every nation's interest. How to get there is the challenge.

As Asia's economies become increasingly integrated, as the Doha Round of global trade talks stalls, and as the specter of economic nationalism and protectionism looms, the Asia-Pacific community is reaching a point where far more active decisions will need to be made, with a wider set of stakeholders considered, to secure the region's economic future. In this process, either the countries of the region and the world will work together to make Asia's rise a win-win for the region and the world, or the forces of globalization that have helped make Asia's spectacular rise possible will ebb in a manner detrimental to all.

To help foster this type of optimally collaborative and mutually beneficial regional economic system, particularly in the aftermath of the 2008-2009 financial crisis, Asia Society established the Task Force on Asian Economic Integration and Global Rebalancing.

In consultations over the last year, the Task Force has developed a broad set of recommendations for how Asia's growing economic integration can continue to increase in a manner that avoids economic nationalism and protectionism and strengthens the global economic system as a whole. The Task Force has outlined how this growth, to be sustainable, must not come at the expense of the environment and must far better engage women, the poor, and other relatively disenfranchised groups.

It is not coincidental that the report was launched at the November 2010 G-20 Summit in Seoul, Korea. The G-20 has quickly become perhaps the leading forum for collectively considering the future of the global economy. It is our hope that the ideas contained in this document, and the specific suggestions for actions that might be taken by the G-20, can, if appropriate, be integrated into the G-20 agenda and beyond. Asia Society will certainly do its part to promote these ideas through outreach and public programs in many of our eleven centers across the Asia-Pacific region.

On behalf of Asia Society, we wish to thank Task Force Chairman Bill Rhodes for his leadership and insight, co-chairs Toyoo Gyohten and Harold (Terry) McGraw III, as well as all of the Task Force Members. We also have an enormous debt of gratitude to Project Director Zachary Karabell, the primary drafter of the report, Senior Advisor Kathleen Stephansen who provided invaluable intellectual support from the beginning of the process, and former Asia Society staff member Morgan Ramsey-Elliot who helped coordinate the many details that go into a project as complicated as this. Asia Society Trustees Betsy Cohen and P.C. Chatterjee were strong supporters of the Task Force project from the beginning, and we would not have been able to bring this initiative to fruition without them.

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Executive Summary

The world's center of gravity is shifting eastward. Asia's emergence as one of the pillars of the global economy has happened more quickly than many could have imagined even a short while ago. This spectacular economic and social progress has brought hundreds of millions of people out of poverty, catalyzed global economic growth, and spurred innovation. Regionally, many Asian economies are beginning a de facto integration process that is bringing the region together in new and meaningful ways.

Asia's rise is not an accident. It represents decades of intense work by Asians themselves combined with far-sighted global economic planning and the maintenance of open markets by the United States and its Western allies. Asia's rise also would not have been possible without the globalization of trade and capital and the information revolution, which have transformed the world over the past two decades.

In spite of this progress, however, it is not preordained that Asia will continue to grow in the future, or that this growth will lead to a better world for all. These universally desirable goals can only be realized if all nations, Asian and non-Asian alike, work together to achieve them.

At a time when many Asian economies are growing far faster than most developed world economies, and Asian populations and states are connecting to one another more than ever before, it is critical that a series of policies be developed, decisions made, and actions taken to ensure that Asia's increasing economic integration benefits not just Asia, but also the United States and the world as a whole.

Toward this end, the Asia Society Task Force on Asian Economic Integration and Global Trade makes the following recommendations:

1. Regional economic integration within Asia is vital but must not be at the expense of Asia's overall integration with the global economy.

To do this:

- Further efforts must be made to move forward with global, multilateral trade agreements. While bilateral agreements across the region are constructive, even more important are frameworks for global trade and commerce that treat Asia as a central factor.

- Regional trade agreements must be consistent with the rules of the international system and further global integration. Such arrangements must be designed as stepping stones toward broader multilateral agreements.

2. Although differences on trade and economic policy exist and must be addressed, economic nationalism and protectionism in all Asia-Pacific countries must be countered, and active measures should be taken to maintain and promote open markets based on principles of reciprocity and long-term sustainability.

To do this:

- All major players must remain committed to open markets and must find ways of communicating why those policies are ultimately beneficial to the majority of most populations worldwide.
- As the two most significant global trade powers, China and the United States must themselves fight against tendencies in their own countries to raise hidden barriers such as subsidies and to take inappropriate retaliatory action against the other country to placate domestic public opinion. Both must address the domestic dislocations that can accompany open markets.
- All nations must work to ensure that bilateral agreements do not proliferate at the expense of comprehensive global agreements.

3. The monetary and fiscal policies of Asia-Pacific countries must be better coordinated with other leading economies, ideally through the G-20 process.

To do this:

- With problems besetting the Doha Round of trade talks, the G-20, beginning with the November 2010 Korea Summit, must do more to coordinate economic and trade policies across borders and across continents in order to use the regional strength of Asia to catalyze global growth. If implemented, the principles laid out in the October 23, 2010 G-20 Finance Ministers' Communiqué would represent a major step in this direction.
- The many bilateral economic agreements between various Asian countries must be harmonized with and ultimately subsumed within a larger, global framework.
- Unnecessary barriers to cross-border capital flows and barriers to direct cross-border investment must be eliminated as Asian economies become stronger.
- The G-20 can play a stronger role in enhancing the skills of regulators in a globally interconnected environment, and should develop a regulatory framework for evolving financial markets.
- China's currency policy must evolve over time toward a more flexible, open system.

4. Climate change, environmental damage, and resource depletion must be taken into greater consideration by Asian nations and their global partners. The rise of Asia has global environmental impacts, and there must be assiduous efforts to address and mitigate environmental damage and greenhouse gas emissions.

To do this:

- Asian nations, in conjunction with the rest of the global community, must develop more effective mechanisms for addressing climate change. There is unlikely to be binding agreement on greenhouse gases in the near future, but many nations share an interest in both climate change and the rising costs of resources. These concerns can form common ground and allow for joint policies to mitigate both resource depletion and the environmental consequences of rapid industrialization.
- The private sector must have a central place in these discussions.
- In light of the lack of success in international climate negotiations, the G-20 should begin to develop common approaches to reducing greenhouse gas emissions.

5. Because economic growth depends on a secure geopolitical environment, rising Asian states must do more to address regional and global issues such as poverty, human rights, the full equality of women, and nuclear proliferation.

To do this:

- The robust growth of the region's economies must be sustained to help drive down poverty and generate domestic security.
- Asian states must play a stronger role in addressing regional and global issues.
- To facilitate this process, the United States must encourage Asian nations to take a more active role in the governance of the international system and help make this level of participation possible.
- Asian nations and their leaders must recognize that curbing nuclear proliferation, and fostering human rights and gender equality, can directly benefit their own growth and security, as well as that of the wider world.
- Asian states will need to accelerate the integration of women into the workforce for growth to be sustainable.
- Significant efforts must be made to strengthen the social safety net in places such as China to enhance quality of life and spur domestic consumption.

6. Innovation must be promoted as a long-term generator of growth. That requires more effective investments in education and research and development, increasing intellectual property protections, and promoting international cooperation to spur collective responses to shared challenges.

To do this:

- China must do more to deploy its vast resources toward internal domestic growth.
- Education systems throughout the region must focus on fostering innovation and development.
- Asian nations must develop an educational infrastructure that fosters entrepreneurship if they are to remain dynamic over the long term.
- The global intellectual property regime must be respected.
- New international collaborative efforts must be established to help address common challenges in energy, environmental protection, healthcare, and other areas.

7. Decision making on global economic issues must avoid rigid economic orthodoxy. Assumptions about the role of the state versus the market and about trade and currency, on which orthodox economics have relied, are increasingly less helpful in navigating the current economic climate and determining future policies.

To do this:

- Economic decision makers must be attentive to new ideas and theories and need to be flexible in their approach.
- Although the 2008-2009 global financial crisis underscored the threat of excessive deregulation, excessive state control of economic activity will prove equally dangerous in the long term and must also be avoided.
- The IMF must continue to review its past approaches and entertain new methods of maintaining growth and stability. In this light, the G-20 Finance Ministers' announcement of proposed shifts in IMF quota shares and Executive Board chairs would give Asian and other emerging markets and developing countries an appropriately greater role in IMF governance and decision-making.

Changes in Asian Economies

The global crisis of 2008-2009 has finally receded, but a different world is emerging in its wake. The economic landscape has changed, perhaps permanently. Many nations remain mired in recession or subpar growth. Old patterns have been interrupted, and new pathways have been created by the economic hurricane that swept the globe. No part of the world was left untouched, including Asia. But Asian economies were transformed by the crisis less because of harm suffered than because of how much the relative position of the region shifted. As the floodwaters retreat, the key nations of Asia have emerged as key drivers of global economic prosperity. In short, the world's center of economic gravity is shifting east.

China has received most of the attention, and for good reason. It has become the anchor of an emerging regional economic system, as well as a driver of global growth. Nonetheless, while China recently surpassed Japan to become the world's second largest economy, it remains (as Chinese leaders frequently state) less affluent on a per capita basis than the economic powerhouses of the twentieth century – the United States, Japan, and the core nations of the European Union. China is vital not only because it is wealthy, but also because its emergence is so rapid and dramatic. While Japan remains large and extremely important, its dynamism has faded in recent years. The economies of the United States and the countries of the European Union were hard hit by the near implosion of the financial system in the wake of the collapse of Lehman Brothers in September 2008. In key respects, however, the crisis simply revealed structural weaknesses that had been neglected for years: too much growth from financial engineering and a vastly over-leveraged housing market, and not enough from long-term investment and innovation.

Two structural realities must be recognized. Asia, anchored and powered largely but by no means exclusively by China, emerged from the crisis substantially stronger, flush with cash, and imbued with a degree of confidence that has long characterized the United States. At the same time, the United States and Europe, even with the global financial crisis, still account for more than 40% of global GDP. It is not premature to speak of the rise of Asia economically, but the decline of the Western economies remains very much an open question.

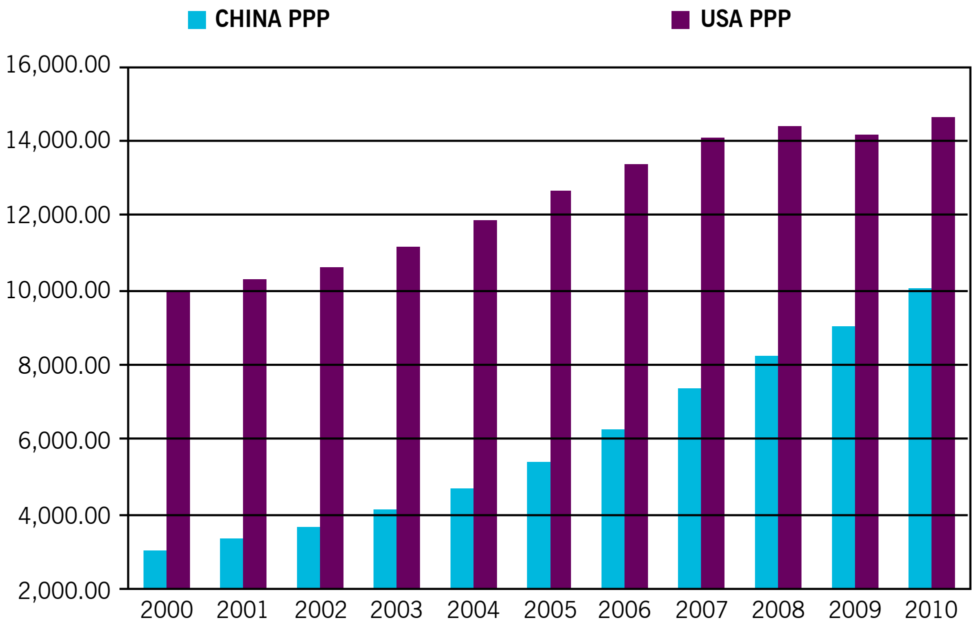
Nevertheless, any discussion of regional Asian economic integration must put China front and center. That China has been the engine of a rapidly changing Asian economic system is not a value judgment, merely a reflection of current economic reality no less unequivocal than the centrality of the United States to the economies of the Western Hemisphere in the 1970s. While China is frequently portrayed in the Western media as an export-dependent economy, one of its more profound effects on the Pacific Rim – not to mention Africa and Latin America – is as an importer. Japan, Taiwan, and Korea have seen their economies grow because of strong exports of high-end equipment and finished goods to the Chinese mainland. Singapore has thrived as a vital hub in the transportation and financial conduits linking the regional economies. As the Asian economies have expanded, Singapore, along with Hong Kong and Shanghai, has emerged as a banking center, with Tokyo receding from its former prominence. Singapore allows Western, Middle Eastern, Indian, and Asian businesses to finance projects, arrange logistics, and use its state-of-the-art port as a central point in increasingly complicated supply chains. And Vietnam, among others, has begun to compete with China as a source of labor for lower-end goods, including apparel, and is looking to supply China with inexpensive goods in the coming years.

The most dramatic – and frequently cited – indication of the shifting balance of the global economy is the size of China's foreign reserves, which are approximately $2.5 trillion. China's reserves stand in stark contrast to the budget deficits of Western nations, including, of course, the United States. Other countries, ranging from Vietnam and Thailand to Singapore and Korea, also have low levels of debt and favorable trade balances. Burned by the Asian financial crises of 1997-1998, these countries have proved to be more stable and, in the past several years, better managed financially than their Western peers. Even Japan, having reoriented its economy toward China, has been buffered.

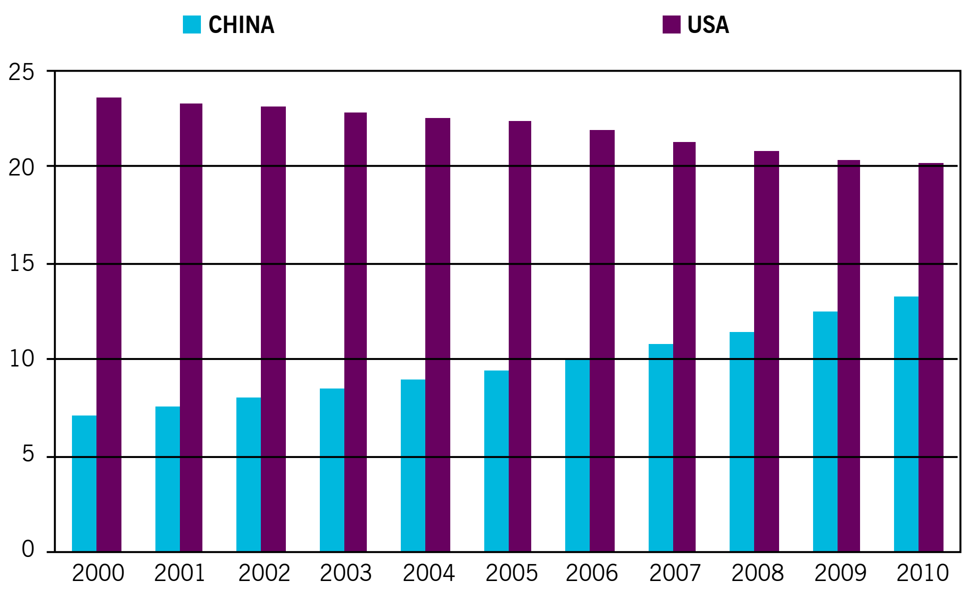
China's reserves are themselves a by-product of an export engine that has been used astutely by the Chinese government to reinvest in domestic infrastructure and development. China's utilization of foreign reserves is unique; few oil revenues of the Arab states in the 1970s were reinvested in the domestic economies, much to the detriment of those countries' long-term economic health. Over the past two decades, China has built a world-class urban and industrial infrastructure and a potent export economy, all with the long-term goal of shifting toward domestic demand and internal consumption. While it does not and cannot directly invest those foreign reserves in its domestic economy, it does use them as a foundation for aggressive state spending, bank recapitalization, and state-sponsored lending that has fueled a level and pace of industrialization that the world has never known before.

One consequence of the financial crisis is that many Asian governments and business leaders began reconsidering their long-standing belief that their prosperity is inextricably linked to the United States. With an economy many times larger than China's, the U.S. is and will remain the world's largest economy for many years. For decades, the American consumer drove global growth and absorbed the world's exports. Now, with unemployment and underemployment high in the United States and with American consumers having lost their taste for debt, the domestic American economy is unlikely to support the same level of global growth in the coming years. While the U.S. maintains important political, economic, and military interests in the region, and while America will remain an immense and important market, it is no longer the alpha and omega of the global economic system.

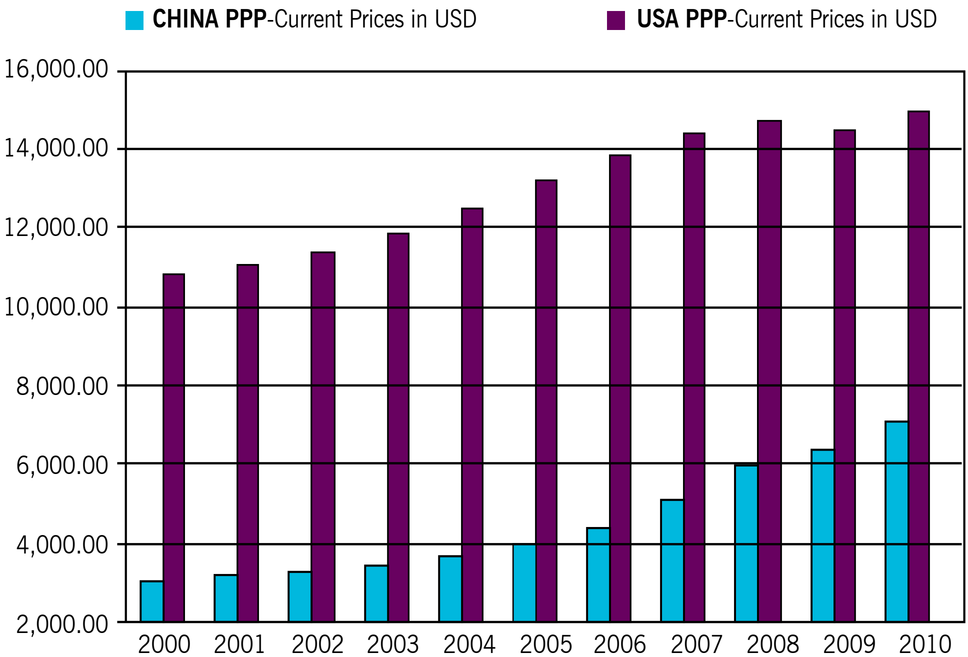
Current International Dollar Gross Domestic Product Based on Purchasing-Power-Parity (PPP) Valuation of Country GDP



China and U.S. GDP Based on Purchasing-Power-Parity (PPP) Share of World Total



China and U.S. GDP Current Prices (in USD)



Source: Data from World Economic Outlook Databases, International Monetary Fund, http://www.imf.org/external/ns/cs.aspx?id=28, accessed 8 October 2010.

Recognizing that shift, Asian nations have been engaged in more frequent and more serious discussions among themselves about trade pacts, economic cooperation, and regional bank funding. The most dramatic outcome to date is the Chiang Mai initiative, launched by more than a dozen Asian nations, which created an experimental currency swap fund worth as much as $120 billion. Though this will not fundamentally alter the current currency status quo, it is an example of the nations of the region beginning to think of their system as distinct and one that requires its own governing mechanisms.

There is a growing body of evidence suggesting that Asian governments and business leaders are interested in their own coalitions that do not directly involve the U.S. or Europe. Such coalitions have been vital in helping these nations navigate through the recent crisis, but they will not be sufficient for the level of integration that future prosperity demands.

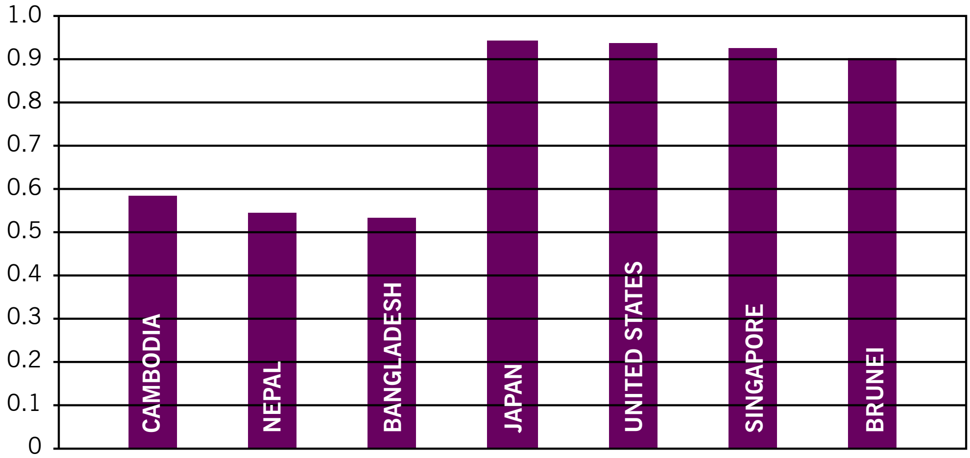
The move to regional economic and trade integration has gone hand-in-hand with Asia's more central position in global economic affairs. A number of free trade agreements have been established in recent years, with the active encouragement of governments from South Korea and Japan to Indonesia and Singapore. Taiwan and China have also made more strides in economic integration in the past two years than in the previous half-century. Although still a far cry from the economic integration of the European Union and the fifty states of the United States, the past ten years have witnessed a discernable push for strong inter-Asian trade. And it must be remembered that the European economic union did not evolve overnight but rather over the uncertain course of many decades. The states of Asia may not follow that path, but the initial steps echo that earlier precedent.

While most of this integration has involved the states of East and Southeast Asia – China, Japan, Korea, Taiwan, Singapore, Thailand, and Vietnam – India has also been involved. India is both part of and distinct from the Asian economic system, and it has purposely kept its markets and financial system insulated from the outside world. Nonetheless, sharing an immense border with China and recognizing the opportunities and challenges presented, it has been taking a more active role. This includes the Comprehensive Economic Cooperation Agreement with Singapore and free trade agreements negotiated with Korea and Japan. In a similar vein, Indonesia – resource rich and with a bustling, complicated system – has also been taking a more active regional role, though its government is largely consumed with the Herculean task of knitting together its own massive archipelago, as is the Philippines.

The web of overlapping and complicated regional discussions and pacts, ranging from the long-established ASEAN to more recent bilateral agreements, raises a potential issue. Regional integration within Asia is vital but must not be at the expense of Asia's integration with the global economy. The stalemate of the Doha Round of global trade talks under the auspices of the World Trade Organization has spurred these regional negotiations. But the risk is that as regional agreements proliferate, they will do so at the expense of worldwide agreements that have been key to the past decades of increased global affluence. As Asian states have become more confident in their ability to stimulate domestic growth and insulate themselves from the economic travails of the West, there has been an understandable tendency to see Asian economic integration as a fortress. But Asia is deeply integrated into the global system – and benefits from it. The attempt to create a closed, insulated system will harm regional prosperity and security.

At the same time, Asia's ascension demands that Asian states take greater responsibility for addressing the region's challenges, from currency policy and North Korea to the ethnic and religious tensions plaguing Central Asia, Pakistan, and Afghanistan. In addition, development across the region is far from even; the standard of living in Cambodia, Nepal, and Bangladesh is vastly different from that in Singapore, Brunei, and Japan. The gap encompasses such factors as access and quality of education, treatment of women, and levels of pollution.

Human Development Index



Source: United Nations Development Program, *Human Development Report*, 2007, http://hdrstats.undp.org/en/indicators/87.html, accessed 22 September 2010. The Human Development Index (HDI) is a composite index that combines measures of life expectancy, educational attainment, and income, expressed as a value between 0 and 1. For more information on the components of the HDI, see http://hdr.undp.org/en/statistics/indices/hdi/.

It is often argued that geopolitical tectonic plates are thrusting Asia up and pushing the West into relative decline. While there are signs that this may indeed be the future, Asia is not currently predominant and its future predominance is not a certainty. China's rise may seem certain now, but the future has a way of confounding expectations. While the relative decline of the United States may be inevitable as others become richer and more confident, the trajectory of the domestic American economy and its position globally remain unknown. Furthermore, the resilience of the U.S. should never be underestimated. In the 1970s, similar predictions of the eclipse of the United States proved premature. And while China continually assures the world that its rise will be peaceful, that too is far from certain. Any great power emergence, such as the rise of Bismarck's Germany in the late nineteenth and early twentieth centuries or the emergence of America in the mid-twentieth, is disruptive of old systems and can trigger violent crises. Some have argued that China's quest to secure natural resources in Zambia, Sudan, Venezuela, and Burma is part of the construction of a global empire. Others strongly disagree.

It is all too easy to envision a future path of Hobbesian conflict, but given the magnitude of the shift, we believe that the present is actually characterized more by an unusual lack of tension than by the existence of conflict. There have been no trade wars, let alone political instability and armed tension. Tension over currency has been rising but for the most part has not yet gone beyond strong words. Instead there has been an extraordinary degree of negotiation and dialogue, with all participants seeming to recognize that for now, no one can go it alone. The U.S.-China Strategic and Economic Dialogue has become more expansive, not less, and visits between Chinese officials and Americans at all levels of government have become a constant. The EU has taken the cue and established its own ongoing dialogue with China. Similar meetings regularly occur between China and its neighbors, as well as at the G-20 meetings that have become a cornerstone of the tentative global economic recovery.

At the moment, the U.S. is involved in negotiating the Asia-Pacific trade agreement, known as the Trans-Pacific Partnership (TPP) Agreement, with the objective of shaping a high-standard, broad-based regional pact. The TPP will build upon the United States' existing trade agreements with Australia, Chile, Singapore, and Peru and will forge new opportunities for U.S. exports of goods and services to Brunei, New Zealand, and Vietnam. The March and June meetings were followed by a third round in October of this year. The U.S. government is also trying to win Congressional support for a free-trade deal between the United States and South Korea.

Tension between Taiwan and China is at a historic low as economic ties have increased, and despite a recent uptick in tensions in the South and East China Seas, China's relations with Japan, Korea, and Southeast Asia have proven relatively stable in historical terms. For the win-win scenario to evolve, active collaboration must continue, even increase, as the global economy stabilizes, and efforts must be made to ensure that political differences do not impede economic relations.

For this reason, nationalist "go-it-alone" tendencies must be countered. These are notable in China and in the United States, many of whose citizens see the other as a threat to future growth and prosperity. Many Americans see China as a threat to domestic American job creation, and political debates sometimes encourage this belief. Many Chinese fear that America wants to limit China's growth, influence, and power. There is a widely shared view in China that the global financial crisis proves that closer relations with the United States and deeper interdependence with the American economy will bring harm to China in the end. However, China, the U.S., and states across the region and the world must recognize that the benefits of cooperation far outweigh the costs. China and the United States in particular have evolved into a powerful, complicated economic system. It is not without weaknesses, but it has become one of the more potent bilateral economic relationships in the world. Tending to the health of that relationship is vital not just for the two countries themselves but also for global economic stability.

Regional Economic Integration: What Does it Take?

Regional economic strength requires sufficient levels of economic integration. The formation of the European Union in 1992 and the creation of the eurozone ten years ago demonstrated that sovereign nations will give up some economic autonomy in exchange for greater regional prosperity. The recent travails of the eurozone have not altered that essential fact. Asia today, and East Asia especially, is becoming more integrated more quickly than anyone could have predicted, though there is no sign as yet of a willingness to go down the path of the euro. But when in 2000 the euro became the unified currency of more than a dozen member nations, it was the culmination of decades of stops and starts, including treaties and transnational European Union government institutions in Brussels.

While Asian economic integration is moving forward rapidly, it is not on the level of formal integration of the eurozone – nor is it clear that such integration would be the best path for the region. What is evident, however, is an eagerness to become more integrated and to create a potent regional economic system that can better withstand shocks from the West and elsewhere. The Chiang Mai initiative is one example of such an integration effort, and more such efforts are anticipated in the future.

Asian states have been better served by policies that increase, rather than restrict, the cross-border flow of goods and services. For now, given Asia's geographic scope and diversity and the fact that its various economies are at different stages of development, it would be unrealistic and unproductive to expect it to come together as a tight-knit union in a one-size-fits-all manner. Instead, as was noted at a recent Asia Development Bank meeting, an alliance of markets, preserving some differences by standardizing a range of practices, offers a more promising path. One possible direction is for subregional integration first. Northeast Asia – constituting Korea, Japan, and China, as well as Taiwan – is already highly integrated with regard to flows of goods, capital, and investment.

Trade is the anchor of integration, and various regional actors have been quite active in aligning their trade policies and removing obstacles. In the past few years, Southeast Asian economies have implemented the ASEAN free trade agreement. There have also been a series of individual agreements such as the ASEAN-China, ASEAN-Korea, ASEAN-Japan, and ASEAN-India free trade agreements. The United States and Korea have signed, but as of this writing, not yet ratified, a free trade agreement that would greatly benefit both countries. To add to the list of acronyms, there is also an ASEAN+3, which refers to the pivotal economies of China, Japan, and Korea and recognizes that regional integration pivots on how integrated these three become. Trade agreements that are inclusive will serve the region well as long as they are not laden with complex and discriminatory rules.

List of Asia-Pacific trade agreements between countries and between countries and trade blocs

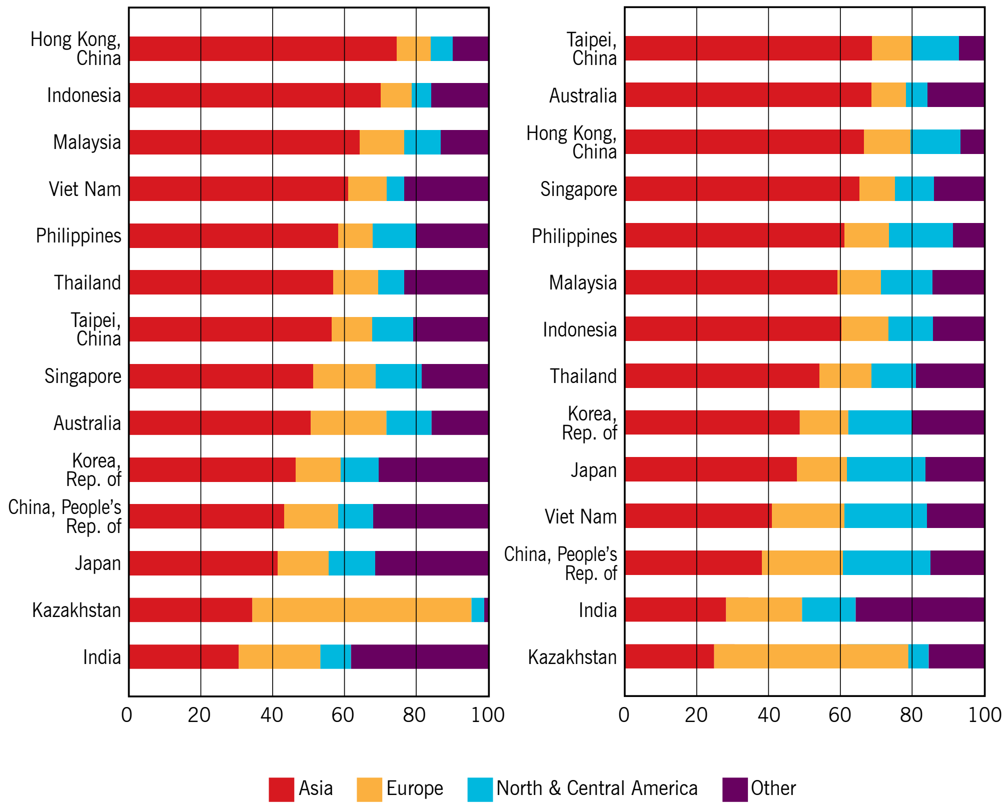
Australia New Zealand Papua New Guinea Singapore Thailand	**Japan** ASEAN Brunei Indonesia Malaysia Philippines Singapore Thailand Vietnam	**Republic of Korea** ASEAN India Singapore EU
China ASEAN Hong Kong Macao New Zealand Singapore	**New Zealand** Singapore Thailand	**Singapore** Sri Lanka
India ASEAN Korea	**Pakistan** Malaysia Sri Lanka	**United States** Singapore

Source: From the World Trade Organization Regional Trade Agreements Information System, http://rtais.wto.org/UI/PublicSearchByMember.aspx, accessed 22 September 2010.

This process of economic integration has accelerated in the past two years, but of course predates the financial crisis. With each wave of development, ties between Asian economies have deepened and generated more trade and investment. Bilateral trade numbers present only one aspect of the regional story. For instance, while trade between Japan and China continues to increase rapidly, non-Japanese Asian export share to China tripled in eleven years, jumping from 4.8% in 1998 to 15.4% in 2009. The emergence of Vietnam is a result of the rise of intra-Asian economic activity. This dynamic reflects both the dispersion of the manufacturing production chain across Asia and growing domestic demand for imports. A typical electronics supply chain might include plastics or rubber from Malaysia, chip sets from Korea or Taiwan, transshipment through Singapore and Hong Kong, and final assembly in China, for sale in all of those countries as well as substantial exports to the United States and Europe.

Figure 4.2b **Origin of Merchandise Imports**, 2009 (present)

Figure 4.2b **Origin of Merchandise Imports**, 2009 (present)



Source: ADB, *Key Indicators for Asia and the Pacific*, 2010, http://www.adb.org/Documents/Books/Key_Indicators/2010/pdf/Globalization.pdf, accessed 29 September 2010.

In the recent Financial Times editorial, "Thriving China Is Ever More Open for Business," China's Minister of Commerce, Chen Deming, cited General Motors, Siemens, and Volkswagen as examples of "companies driving growth abroad through their Chinese operations."[1] In other words, their activities reinforce regional trade as countries neighboring China benefit from increased demand for intermediate goods, while jobs are created in advanced economies by buying capital goods and services.

A crucial ingredient for regional economic integration is the diversification of the major countries of the region. Many of the economies remain dependent on exports for their economic growth – a strategy that worked to great effect as long as consumer purchases continued to increase in the more affluent Western world. But with consumption leveling

[1] Chen Deming, *Financial Times*, 25 July 2010, http://www.ft.com/cms/s/2/18dae5d2-981c-11df-b218-00144feab49a.html?ftcamp=rss, accessed 10 August 2010.

off in the United States, Asian states need a more multifaceted mix of exports and domestic consumption, and exports to the Western developed economies may become more of a zero-sum game. We already witnessed some of that after the financial crisis, when trade between the United States and China dipped and then grew rapidly again after mid-2009 to reach pre-crisis levels by 2010, but only at the expense of other exporters such as Vietnam and Korea. Even here, of course, the picture is more complicated: As China becomes more affluent, with hundreds of millions entering the middle class, China itself is becoming an attractive export market for regional economies that may be able to produce goods more cheaply. That is an opening and an opportunity for multiple actors, ranging from Cambodian textile factories to equipment and steel from Japan and South Korea, to basic manufactured goods from Vietnam and finance from Singapore.

Finally, the oft-stated maxim “China over-saves while the U.S. over-consumes” misses a key element: While China’s official savings rate hovers in the mid-40% range, some of that savings is driven by the absence of health care and other social benefits provided by government or business. With the market reforms begun by Deng Xiao Ping, much of the “iron rice bowl” social safety net in China was disassembled. Only now is the Chinese government addressing the absence of such safety nets and the negative effect that is having on domestic consumption in other areas of the economy. Of course, there is also the substantial issue of corporate over-saving and underinvestment in China, a problem that also besets the U.S. economy. Companies in both countries are flush with cash but wary of spending it. On the U.S. side of the equation, while American consumption represents about 70% of the U.S. economy, nearly half of that is for health care expenditures. Once health care is accounted for in both systems, the contrast is not nearly so great.

Still, regional leaders are convinced that their economies need to augment the strength of internal consumer markets in order to ensure long-term prosperity. Stronger domestic consumption requires greater economic diversification. Here again, the Chinese government has been aggressively focusing on internal markets and on cities away from the export-oriented coastal provinces. The results have been impressive: Retail sales growth remains in the double digits, close to 20% year-on-year through the spring and summer of 2010, despite some reports of brief slowdowns in auto and home appliance sales. Consumers in smaller cities and rural areas have been particularly active, perhaps because they are playing catch-up to the more affluent, developed economies of the coastal regions of China. The central government in Beijing has also resumed its focus on building up a domestic banking system that focuses on retail investors and not just companies, real estate, and infrastructure. That will then enable individuals to be ever more active participants in the nation’s economic life. Smaller regional economies such as Malaysia and Thailand may have similar aspirations for robust, self-sustaining domestic markets, but will never have internal scale sufficient to meet national growth needs. This explains Thailand’s continued dependence on tourism revenues and Vietnam’s attempts to become a significant regional low-cost producer.

The pull of China is also impacting Taiwan. The de facto economic integration of

China and Taiwan is yet another unique hybrid, even as the future political context remains uncertain. And the two regional behemoths after China – South Korea and Japan – have both shifted their attention more to the region and relatively less to the United States and Europe than in previous decades. While trade and capital flows between those two and the West remain substantial, the rise of China has opened up a dynamic market that has aggressively bought goods, offered lower cost production, and altered supply chains. Recent international tensions notwithstanding, companies such as Komatsu and Tokyo Electron of Japan or Samsung and Hynix of Korea, as well as the respective auto companies of the two countries, such as Toyota and Hyundai, have all benefitted immensely. Increased trade and investment have also been a boon for financial service companies, ranging from Western and regional banks in Hong Kong and Singapore to Chinese banks that have invested globally – from Africa to Latin America to Indonesia.

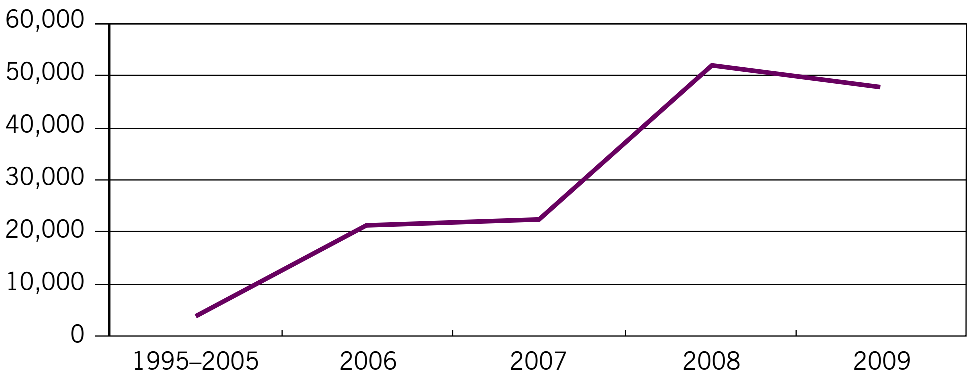
As part of these transformations, trade and investment between regional players has also increased, for example between Japan and Korea, Korea and India, and Thailand and its neighbors. While the amounts do not approach the hundreds of billions of dollars annually between the U.S. and China or between Japan and China, collectively they add up and account for an increasingly large percentage of activity. Trade between India and Korea alone is approaching $20 billion a year. While the older patterns between these countries and the West are showing signs of strain, the newer trade patterns and flows are expanding quickly and are welcomed, though not without tension. Relations between various actors, such as Vietnam and China or Korea and Japan, have their own complicated history of conflict. As China takes a more prominent role in regional security, and as the United States plays a less dominant role in the region's politics, these old tensions have the potential to become more acute.

Finally, more regional integration requires more regional cross-border investment. There must be greater comfort with cross-border capital flows. Many nations in the region have bitter memories of the harm such flows can do, stemming from the crisis of the late 1990s, but these nations are far stronger now and greater flows will only enhance the region's growth. There is also resistance to some types of foreign investment. At present, the United States and China, as well as Japan and Korea, have policies in place that make it difficult for foreign businesses to conduct operations in certain industries. The United States has been especially concerned about direct Chinese investment in "sensitive industries" in the domestic American economy, particularly in the energy and technology sectors. China places its own restrictions on what foreign investors can purchase. Just as the Chinese oil company CNOOC was thwarted in its bid to purchase the American oil company UNOCAL, UNOCAL would not have been allowed to buy CNOOC, and Coca-Cola was not permitted to buy the Huiyuan Juice Group. But if the Chinese currency does indeed appreciate, that will make direct investment in the United States even more attractive – provided that America permits it.

Private investment will be committed only if businesses believe that there is sufficient future export demand or domestic consumption demand to make it worthwhile. For now, governments have been a primary source of investment in business and infrastructure, along with Western companies that have poured trillions into the region over the past decade. In July alone, the Chinese National Development and Reform Commission initiated new "priority projects" in western China worth RMB 692.2 billion (about $102 billion). These investments should help the local economy, and should be viewed as a new fiscal stimulus. They are also entirely consistent with China's long-term policy of using state-sponsored industrial projects to jumpstart economic development.

One positive is that foreign direct investment (FDI) in China remains strong, coming from all major actors including the United States, Japan, Taiwan, and Korea. Total investment is on pace for more than $100 billion in 2010, up from 2009 but still below its pre-crisis peak of nearly $150 billion in 2008. Chinese outward investment has been picking up in regions ranging from Latin America to Central Asia to Africa. While it is difficult to precisely quantify the amounts, China has been investing on average $50 billion a year for the past three years. Most of that has gone toward purchases of mining interests, energy resources, and agriculture, but China has also been increasing the pace of its outward investment in industrial businesses in the United States and throughout the world. The Chinese have recognized that local production often reduces costs and eliminates some of the hidden costs and tensions inherent in cross-border exports. But China still maintains strict controls over inward and outward investment, as do other regional actors to varying degrees. Further liberalization of those restrictions would help accelerate both growth and integration. Such liberalization might include loosening restrictions on the ability of foreign companies to own subsidiaries outright, and reducing the number of sectors and industries (such as energy and communications) where such investments must clear high national-security hurdles.

Trends in China's outward FDI flows (2005-2009) –in millions USD



Source: Data from UCTAD, *World Investment Report 2010*, http://www.unctad.org/sections/dite_dir/docs/wir10_fs_cn_en.pdf, accessed 22 September 2010.

China's Currency and its Discontents

The Chinese currency is one of the most significant factors in the emerging Asian economic system and in the global economy as a whole. The currency does not float freely and is not convertible, but China is nonetheless deeply interlinked via trade and foreign investment in the global economic system. This is an unusual and, in most ways, unprecedented situation. Beijing views its currency policy as a bulwark that has insulated China from the financial tsunamis that swept East Asia in the late 1990s and the world in 2008. Many others across the Asia-Pacific region and around the world see it as giving China unfair advantages and creating untenable global imbalances.

China's recent decision to resume the "crawling" currency peg has the potential, if followed through, to facilitate the longer-run shift in the economy. The Chinese government has been focused on stimulating domestic demand, and both moderate inflation and a gradually rising currency meet that need. The midsummer moves of 2010 are a start, but with an appreciation of barely 2% as of this writing, it is largely symbolic and has failed to temper vigorous and growing opposition in the United States, especially in Congress. If tensions over currency levels increase and, as Brazilian Finance Minister Guido Mantega and financier George Soros have warned, a "currency war" ensues, all nations and the global system will be harmed.

Currency has been among the most sensitive and controversial topics in ongoing discussions between China and the United States and between China and the European Union. A fair number of Western officials are convinced that China has kept its currency deliberately undervalued; Chinese officials point to its more balanced global trade profile as proof that the currency is more fairly valued than not. In March of 2010, in fact, China reported a trade deficit, even as it ran large surpluses with Europe and the United States.

Nevertheless, in order to build up a strong domestic market, the Chinese central government needs to increase domestic purchasing power and continue its reforms of the banking sector to allow for the growth of consumer credit and loans. Since 2005, the government has followed a policy of allowing a gradual appreciation of the currency. Between then and just before the financial crisis, the yuan gained nearly 21% against the dollar, which dampened some of the criticism of China in the United States. That policy of appreciation, however, was shelved during the financial crisis from the fall of 2008 through the summer of 2010.

We believe that a more robust yuan is in everyone's interest. Regionally, an appreciating Chinese currency should help raise the purchasing power of importers, and thus benefit exporters such as Vietnam and India. More importantly, it will help monetary authorities in Asian countries deal more effectively with rising inflationary pressures without jeopardizing competitiveness through the appreciation of their currencies against the yuan. And in terms of smooth international relations, Chinese flexibility on the currency assures its trading partners that China understands that its prosperity hinges on greater integration with both Asia and the world at large.

Perhaps most important, currency appreciation has direct and beneficial effects on the domestic Chinese economy that are a necessary precondition to the next stages of regional and global economic integration. For example, some appreciation could offset asset bubbles, including in the urban real estate markets of China's fast-growing cities. Gradual appreciation should hasten the expansion of the country's social safety net by allowing larger transfers from State-Owned Enterprises (SOEs) into the private sector. The oversized role that SOEs still occupy in China remains an impediment. As noted above, the greatest obstacle to reducing the high savings rate in China is the absence of adequate social safety nets. But the shift of capital out of the SOEs will be successful only if it is accompanied by policies that promote higher private sector participation in domestic industries, expand the share of household income, increase income available for consumption, and develop consumer finance in the Chinese financial system.

To be fair, SOEs have also been central to the massive growth of China in the past two decades. Some – including Petrochina and China Mobile – are managed with a high level of competence. But SOEs can and do inhibit competition and create prohibitively high barriers to entry for both domestic and foreign entities. These advantages allow some SOEs (especially in the resource, financial, and telecom sectors) to build up substantial corporate savings. However, these savings often do not flow to the private sector (though they do get invested in the Shanghai Stock Exchange, where many SOEs hold substantial portfolios of other SOEs' stocks). Apart from tax payments, few SOE earnings are channeled to the government's budget. Even so, the central government tries to keep budget deficits low by keeping social spending and subsidies well below levels in advanced economies.

The net result of limited government spending on what used to be known as "the iron rice bowl" is that household precautionary savings (insurance against serious illness and extended unemployment) are higher than they otherwise would be. An underdeveloped financial sector further supports the household savings rate. The Chinese financial service sector provides relatively little financing to households; less than 20% of domestic credit to the nonfinancial sector went to households in China, compared with more than 50% in the U.S. The underleveraged household sector consumes less than it could, while well-connected companies find credit cheap and readily available. Some of the loans that have been extended in the past two years are likely to default or be refinanced (as much as 25% of loans to SOEs are deteriorating), but even pessimistic estimates of the level of non-performing loans in China suggest that there is more than enough liquidity in the system to absorb the bad loans. That said, the Beijing government takes the risk seriously, and beginning in the spring of 2010, reserve requirements for banks have increased and the government has instituted a variety of measures meant to curb future loan growth. In recent years, Chinese banks have become some of the largest in the world, and how these are governed and run will have consequences not just for China but for the region and the world as a whole.

The policy of keeping the yuan cheap reduces the purchasing power of Chinese consumers, which in turn reduces spending on foreign goods and services. That also encourages foreign companies such as GM, Yum Brands, Nike, Avon, Intel, Samsung, Komatsu, and Siemens to set up factories and supply chains within China catered to the domestic Chinese market – though the sheer size of that burgeoning market is also an inceptive irrespective of currency. In toto, these policies lead to an unusually large current account surplus. Over the past couple of decades, the rapid but uneven development of the Chinese economy has led to a sizeable accumulation of national savings ($2.5 trillion in reserves at last count) and the investment of these savings in safe and liquid U.S. financial assets. Many believe that these surpluses – and on the flip side the deficits in the United States – contributed to the financial crisis of 2008.

Foreign Exchange Reserves and Gold (in millions USD, 2009)

China	2422000	**Singapore**	187800
Japan	1024000	**Germany**	181300
Russia	439000	**Algeria**	149300
Saudi Arabia	410300	**Thailand**	138400
Taiwan	353000	**Switzerland**	135100
India	274700	**France**	133100
S. Korea	270000	**Italy**	132800
Hong Kong	255800	**U.S.**	130800
Brazil	238500		

Source: CIA, *World Factbook*, https://www.cia.gov/library/publications/the-world-factbook/rankorder/2188rank.html, accessed 30 September 2010.

It is impossible to determine who is right in the currency valuation debate, but it is clear that both the Chinese currency policy and the large U.S. deficits contributed to the crisis. If the Chinese government supports a policy of gradual appreciation of currency in order to accomplish its core goal of nurturing a potent and sustainable domestic consumer economy, such a policy will benefit the Asian economies that depend on access to the Chinese market for their growth. It should also benefit a United States that has an interest in both selling more to China and having more direct Chinese investment in the United States – provided that the domestic climate in the U.S. does not treat such investment as a foreign threat in the way it did Japanese investment in the late 1980s.

The Dangerous Lure of "Doing it Alone"

The increased confidence of many Asian nations is a vital ingredient in the current success of their systems. It is also a risk to the win-win scenario. In the past year especially, many voices have begun to speak of a decoupling between emerging markets and advanced economies, and have speculated that China and Asia are reaching a point where they can "go it alone." One of the best-selling books in China in 2009, titled *China Is Not Happy*, assailed the policy of closer economic ties with the United States and argued for a relentless focus on China alone. The message bears an uncanny – and telling – resemblance to a 1989 bestseller in Japan, *The Japan That Can Say No*. While this is not to suggest that China will follow a similar path of spectacular rise and sudden decline, the Japanese legacy of keeping foreign businesses and investors at bay was one reason for Japan's inability to continue its trajectory upward. While China has welcomed the investments – both FDI and more indirect – of hundreds of billions of dollars by American, European, and Asian companies, it also creates barriers, and its recent stimulus had more than a small share of "buy China" provisions that gave local companies substantial advantages over foreign companies. Other regional players have talked of creating economic pacts that purposely exclude the West in the belief that Western economies have become liabilities to their future growth. This approach is in no one's interest.

Up to a point, the desire to solve problems regionally is an unalloyed positive development. The risk, however, is that too much confidence will lead to a false sense of autonomy. The lack of a domestic market of sufficient scale in China is an impediment to translating "go-it-alone" sentiment into policy. Export-dependent economies such as Vietnam know that they cannot go it alone, though they do imagine a future where Asia does not need the United States. The stagnation of domestic markets in Japan has also changed Japanese politics and demanded policies that encourage regional integration.

Chinese authorities seem to have realized that despite all the talk, delinking the yuan from the dollar and becoming less entwined with the United States is premature. Japanese authorities, having confronted the United States over the continued presence of troops on Okinawa, have also found that there are limits to the "go-it-alone" strategy, as its conflicts with China in September 2010 underscored. Though sometimes controversial and not always welcome, the United States has played a critical role in promoting peace, security, stability, and prosperity in Asia and the Pacific for the past seventy years, and its continued role remains central to the region's future.

At the same time, the Asian region is growing and becoming more confident, and America's role must evolve accordingly. The markets that the United States and Europe provide are part of the equation, but so too are non-Asian companies that are vital to the growth of many Asian economies. These companies provide both capital and innovation, and while China and other Asian nations will likely generate their own capital and innovation in time, for now non-Asian companies are part of a symbiotic system. Western companies provide vital inputs that facilitate the growth of the domestic Chinese market, and the United States and U.S. Treasuries remain a safe haven for Chinese capital. The United States security arrangements with various countries in the Pacific Rim also allow various countries to focus more on economic growth and trade and less on pressing issues of security and regional competition – though already countries such as Japan, Korea, Australia, and China are strategizing and arming for a future where the U.S. presence is more modest.

Number of harmful measures by country and type

	China	Japan	Philippines	S. Korea	U.S.	Vietnam
Bailout/state aid measure	0	3	0	2	3	0
Competitive devaluation	0	0	0	0	0	1
Consumption subsidy	0	1	0	0	0	0
Export subsidy	0	0	0	0	1	1
Export taxes or restriction	2	0	0	0	0	1
Import ban	1	0	0	0	1	0
Import subsidy	0	0	0	0	0	0
Intellectual property protection	1	0	0	0	0	0
Investment measure	2	0	0	0	0	0
Local content requirement	2	0	0	0	2	0
Migration measure	0	0	0	1	1	0
Non tariff barrier (not otherwise specified)	1	2	0	0	1	0
Other service sector measure	0	0	0	0	1	0
Public procurement	4	1	0	0	1	0
Quota (including tariff rate quotas)	1	0	0	0	0	0
Sanitary and phytosanitary measure	0	0	0	0	1	0
Sub-national government measure	0	1	0	0	0	0
Tariff measure	3	0	0	3	1	5
Trade defense measure (AD, CVD, safeguard)	14	6	1	1	3	0
Total	**31**	**14**	**1**	**7**	**16**	**8**

Source: From Global Trade Alert, http://www.globaltradealert.org/site-statistics, accessed 30 September 2010.

It is our view, however, that decoupling is more a fantasy than a reality. While the future may evolve in that direction, for now the Asian and American systems, anchored by the intimate bonds between the United States, China, Japan, and other nations, are interdependent. While some believe that the relationship is imbalanced and dysfunctional, others point to the relative stability of the global economy and to the U.S.-China dyad as a vital element in the global economy. This is not to deny that there is a shift in the global economic pull toward Asia. But Asia still requires foreign demand from the United States and the European Union; China still imports considerable high-end technology and industrial goods and needs the regular infusion of foreign capital and investment, even though domestic demand is strengthening.

For this reason, Asian economic integration, such as it is, must develop as a win-win for Asia, the United States, and the world. Since the near-implosion of the global financial system in the fall of 2008 there have been dozens of official meetings and summits, bilateral and multilateral. These have undoubtedly brought the various actors closer together, but the bewildering array of caucuses may come at a price, and there is a risk that the forest gets lost for the trees. The most appropriate current global framework to monitor, maintain, and advance regional economic integration and a prosperous, stable, and growing global system is the G-20 framework.

Until now, most of the energies of the G-20 have understandably focused on the aftermath of the financial crisis and worldwide banking regulations. Now and in the future, the attention of the G-20 should turn ever more toward growth. Specifically, it should focus on the emergence of Asia as a global economic engine and on how to smooth and rationalize relations between the Asian economies and the United States. The U.S.-China relationship remains the single most important element, but it cannot and should not be handled in isolation. Relations between the northern tier of East Asia – Korea, Japan, China, and Taiwan – form one potential axis of a regional system, and relations between the southern tier of Thailand, Malaysia, Singapore, and Vietnam possibly yet another. Indonesia – rich in raw materials and with its own burgeoning domestic market – and India, which is now embarking on a massive wave of infrastructure improvements, add yet another dynamic to the mix.

Monetary and fiscal policies of all of these sovereign nations must be better coordinated. While these discussions take place in bilateral meetings and at the G-20 summits, there must be a greater appreciation that interest rate and fiscal decisions in the United States have profound implications beyond American borders. Similarly, Chinese authorities need to recognize that their currency decisions have ripple effects far beyond their borders and ultimately shape the global economic climate. For reasons of self-interest alone, these decisions need to be considered and negotiated not simply as an aspect of national policy, but as elements that can strengthen or weaken the global economy. And of course, trade policy must be coordinated as well.

Stepping Up to the Plate/Into the *Dohyō*

With the economic rise and greater integration of Asian economies comes a new set of responsibilities. But while Asian governments have been willing to take a greater role in the governance of the global economy, many have been much less willing to address a host of security and social issues that their economic rise – and the maintenance of security and stability in the world – demand.

To ensure Asia's continued growth, regional security issues must be addressed. For the past sixty years, those issues have been managed within the context of a strong U.S. presence in Asia. But tension over primacy in the South China Sea has not disappeared. Japan and China, for example, have been quietly but substantially increasing their defense spending. The continued impasse over the nuclear ambitions of North Korea has not made the situation any simpler. The economic integration between Taiwan and China has reached a point where armed conflict between the two countries seems remote, but both continue to plan for that contingency.

For regional economic integration to continue, these security issues must be dealt with more explicitly and comprehensively. China must tread carefully or risk creating a security backlash in the region that undermines further economic integration.

In addition, regional actors have been slow to take action on regional issues such as the terrible human rights conditions in Burma and North Korea, nuclear arms proliferation in North Korea and potentially Iran, and the consequences of Asia's shrinking water supply[2] and threatened food security.[3] While the outcome of the simmering problems will acutely impact all regional players, there is little indication that Asian states are prepared to act either individually or collectively to resolve them. China has certainly been focused on North Korea, but for now appears to have taken a "don't rock the boat" approach, hoping against nearly all evidence that the regime will evolve into a more responsible state. For all of these problems, far greater results-driven regional collaboration will be critical.

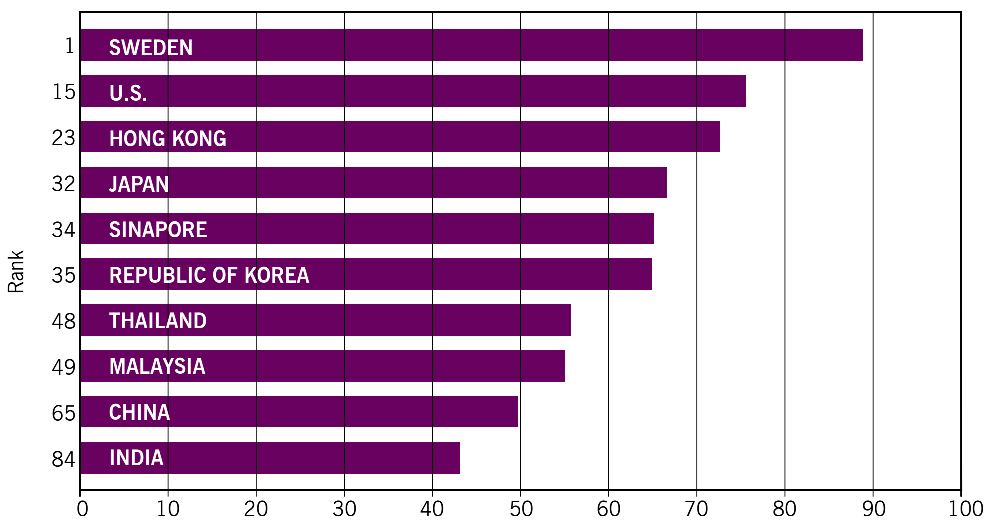
[2] See Asia Society Task Force, "Asia's Next Challenge: Securing the Region's Water Future" http://asiasociety.org/policy-politics/environment/water-and-food-security/asias-next-challenge-securing-regions-water-futu.
[3] See Asia Society Task Force, "Never an Empty Bowl," http://asiasociety.org/policy-politics/environment/water-and-food-security/never-empty-bowl.

Unlocking Human Potential

Empowering Asia's talented populations will be key to securing the region's long-term growth. To this end, innovation must be promoted as a long-term generator of growth by making more effective investments in education and in research and development, increasing intellectual property protections, and finding areas where greater international cooperation can spur collective responses to major transnational challenges.

A series of pressing social issues that have accompanied the rapid emergence of the region must be addressed. The flowering of an affluent and confident middle class in India and China has been a great boon but has also cast into even sharper relief the reality of intractable poverty that still characterizes life for hundreds of millions of people in both countries and many other parts of Asia. The same is true for Vietnam and the massive archipelago states of Indonesia and the Philippines. It is estimated that two-thirds of the world's poor live in Asia. While the Chinese government is intently focused on rural poverty and moving the rural poor into new urban areas, social divisions remain pronounced, and as communist ideology fades, questions of social justice and fairness have been aired loudly and critically. India presents some of the largest extremes between rich and poor in the world. Throughout the region – and not unrelated – is the evolving role of women as well, and the degree of economic prosperity of these societies is closely tied to the degree to which women are an integral part of the workforce.

Women's Economic Opportunity Index

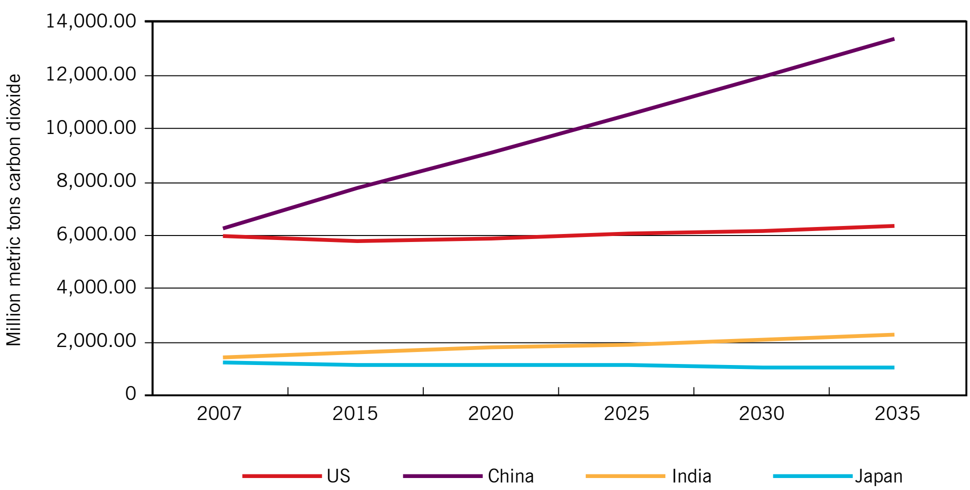


Source: Economist Intelligence Unit, *Women's Economic Opportunity*, June 2010, http://graphics.eiu.com/upload/WEO_report_June_2010.pdf, accessed 6 October 2010. The Women's Economic Opportunity Index builds off work done by the United Nations Development Programme and World Economic Forum's Global Gender Gap Index. Focusing only on the formal sector, it includes 26 indicators, ranging from measures of access to property rights to financial access and women's employment.

As Asian countries become richer, and as more of the world's commerce and capital flows through Asia, the inadequacy of many legal structures in parts of the region will become more of an issue. The long-standing issue of intellectual property rights in China and some other parts of Asia is one glaring example. Many foreign companies have resigned themselves to having their intellectual property stolen and copied in China, and have focused instead on research, development, and innovation to maintain a competitive advantage. Chinese courts have been ineffective in supporting intellectual property claims, but over time, domestic Chinese companies and entrepreneurs will need their own protections in order to justify their investment of time and money in building new enterprises. At a meeting of the World Economic Forum in Tianjin in September, Chinese Premier Wen Jiabao explicitly addressed concerns over intellectual property rights and promised action. If followed through, this would be an important step. Disregard for intellectual property protections undermines progress that will help the Asia-Pacific region and the world.

As the region undergoes a new wave of industrialization, the environmental impact is substantial and dangerous. This problem is most acute in China and India. Dependent on coal for electricity and quickly becoming an automobile culture, China has become a leading source of greenhouse gases.[4]

Predicted carbon dioxide emissions by country



Source: US Department of Energy, Energy Information Administration, *International Energy Outlook 2010*, http://www.eia.doe.gov/oiaf/ieo/pdf/ieorefcase.pdf, p. 141, accessed 22 September 2010.

[4] See "A Roadmap for U.S.-China Collaboration on Carbon Capture and Sequestration," http://asiasociety.org/policy-politics/environment/climate-change-and-energy/roadmap-us-china-collaboration-carbon-capture-. See also "A Roadmap for US-China Cooperation on Energy and Climate Change," http://asiasociety.org/policy-politics/environment/climate-change-and-energy/roadmap-us-china-cooperation-energy-and-climat..

While the government is loath to interrupt the growth trajectory in order to preserve the global climate, the costs of its current policies domestically are becoming untenable. Health issues from year-round pollution and the depletion of groundwater are not "externalities" that the Chinese government can ignore. Neighboring countries, and Korea and Japan especially, have taken the lead in adopting more sustainable, less carbon-intensive growth policies, and China has become the world's largest investor (to the tune of hundreds of billions of dollars over the coming decade) in urban transportation, low-emission technologies, and alternative energy. Nonetheless, much more needs to be done. Water issues are becoming acute, as urbanization and rising food consumption strains the water table in China and water infrastructure in India and parts of Southeast Asia. In a region with some of the lowest per capita water resources in the world, this problem is magnified by rapid growth, especially of cities. The spending on innovative solutions is imperative, but it must be recognized that these will not bear fruit for some years, and the situation may deteriorate before solutions are found.

Regional actors must pay greater attention to various social, environmental, and security issues. The economic rise of the region has magnified the environmental problems of rapid industrialization, and the shifting global balance of economic power means that the role that the United States has played in maintaining regional security is shifting. These issues could spiral dangerously unless the states of the region act collectively to address them.

In short, as Asian economic integration and affluence increases, the major actors will have to attend to a host of issues that have until now been left unattended or have been seen as the responsibility of the United States. Failure to act on these may not just impede future growth, but could even reverse it. These challenges are real, and can only be addressed by the concerted efforts of a more collaborative Asia-Pacific region and world.

Asia's increasing economic integration has the potential to benefit Asia, the United States, and the world. Only a concerted effort by all concerned, however, will make it so.

Biographies of Task Force Members

Ajay Banga is president and CEO of MasterCard Worldwide, and is a member of the board of directors. Previously, at Citigroup, he held several leadership positions, including chairman and CEO of the International Global Consumer Group, CEO of the Asia Pacific Region, and president of North America Retail Banking. He spent thirteen years with Nestle India in a variety of sales and marketing roles, and two years at Pepsico. Mr. Banga is a director on the board of Kraft Foods. He has a BA from Delhi University and an MBA from the Indian Institute of Management, Ahmedabad.

Ronnie C. Chan is Chairman of the Hang Lung Group and Hang Lung Properties Limited. He is a Vice Chairman of the Asia Society and Chairman of its Hong Kong Center, a Vice-President of The Real Estate Developers Association of Hong Kong, and an advisor to the China Development Research Foundation of the State Council of the People's Republic of China. Mr. Chan also serves on the governing or advisory bodies of several think-tanks and universities, including the Hong Kong University of Science and Technology, the University of Southern California, USA, where he received his MBA, and the Tsinghua University.

Howard Chao is the partner in charge of O'Melveny & Myers LLP's Asia Practice, and resided in Asia for many years while establishing the firm's offices in China. During his 30 years with O'Melveny, Howard has been engaged in a broad variety of transactional matters. He is a recognized authority on China and has extensive experience advising clients on China matters. He has advised clients from many sectors on their investments and operations in Asia. He is the recipient of *Chambers and Partners*' prestigious award for Outstanding Contributions to the Legal Profession (2009).

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