Asia In The World Economy Roundtable 2018

Post-Event Report

29th – 30th November 2018

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National University of Singapore

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mastercard. Center for Inclusive Growth

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INTRODUCTION

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The theme of this year's roundtable is growth and inclusion and Asia. While growth and inequality are long standing questions in economics, they are increasingly pressing topics in a time of trade wars and disruption of the rules-based order. The days of a unipolar hegemonic system global system are over. The rise in inequality following an era of globalization has led to populist and nationalist political movements, and now to trade wars and economic conflict.

This is ironic, as openness to global trade and finance has lifted hundreds of millions out of poverty, especially in Asia. If social justice were a genuine motive for populism, these movements would consider the power of globalization, properly managed, to reduce worldwide inequality. Instead we have disruption and protectionism.

At the same time, the global order led by the US and West Europe is waning. Asia is growing in influence. Notably, the 'global financial crisis' was largely a trans-Atlantic event. China remained an engine for growth and supported the global economy in the post-crisis period.

This leads us to reconsider old questions about global order, such as whether a single great power is needed for leadership in trade and in world order generally. And what is the role of those countries who are not great powers in maintaining the world system?

A new Asian perspective on the world is needed – one that is not predicated on Western leadership. This requires a new mindset. For now, the default mentality in both Asia and the West is to look for Western initiatives to address global problems. It is time for this to change. This does not mean wholesale change to the global system, but it does mean change.

Session 1: The Asian Economic Outlook: Macroeconomic Policies and Finance

The *global economy* is growing at around 3.6 per cent per year, and Asia contributes more than half of this. Yet there are substantial risks around the region. Japan continues with slow growth, with a tightening labour market, modest wage growth and a modest return to inflation. China is slowing down substantially with mounting domestic debt. The government has to keep pumping money into the economy – otherwise it will grind to a halt. Global interest rates are beginning to rise. ASEAN and India, though, continue to grow strongly.

While global inequality has fallen, income inequality *within* Asian countries has increased and in some is high by global standards. Recent work by the International Monetary Fund has highlighted that high inequality harms growth, and other research has pointed to the links between low levels of social spending and high precautionary household savings. We can expect this to be a topic of increasing debate in Asia.

The outlook for *Japan* is very important to the rest of Asia precisely because many of the conditions Japan has faced since the 1980s (the bubble and post-bubble economy) are emerging in other parts of Asia.

Japan's population is already ageing and declining. This is often offered as an explanation for economic stagnation. But it may be overstated. In Japan, the impact of ageing is partially offset by increased participation, with female participation in the labour force up 200,000 in the last five years.

The more important causes of stagnation may lie elsewhere. In the 1950s and 60s, Japan saw annual GDP growth of around 8 per cent, with annual total factor productivity (TFP) growth of 7 per cent. By comparison, the 1990s and 2000s saw annual TFP growth of 0 to 1 per cent. This shift may in part be explained by the rise of 'zombie companies', with damaged balance sheets and inflexible labour arrangements. These companies are protected by bank credit but no longer capable of driving innovation across the economy. This is a legacy of the credit bubble that burst in the early 1990s, and serves as both a warning to the region and a possible focus for future policies to address stagnation. Most prominently, China's credit bubble today is similar to Japan's in the 1980s. China should learn from Japan's policy mistakes – not repeat them by sheltering zombie SOEs through state banks and other subsidies.

More generally, 'creative destruction' has not been happening in Japan. Restoring it is the key to future TFP growth. That requires more supply-side reforms than Abenomics has delivered so far. The elderly can be productive, especially with new technologies, but an ageing population can equally block policy reforms.

Then consider the current state of the Japanese labour market. Tight conditions are not leading to higher wages. This may be due to a labour market split between privileged, tightly controlled regular workers and a looser market for casual employment. The high-wage regular employment market is soft and companies are slowly shedding these workers, while the market for lower-wage casual workers is tight. This is driving a compositional shift in the national labour market which is a drag on growth in average wages. As a result, recently introduced measures to open Japan up to low-wage, low-skilled foreign workers may have the adverse effect of holding down average wages and softening growth, rather than providing the expected boost.

The Japanese story on exchange rates also provides lessons for the region. In the mid-1980s there was strong domestic pushback to yen appreciation following the Plaza Accord. Within Japan this is often blamed for causing stagnation in the 1990s. This has been offered as a reason for China to resist RMB appreciation today. But yen appreciation was reversed by the Louvre Accord a few years later. This fueled the credit bubble which eventually burst -- the real trigger for stagnation.

This – persistent currency undervaluation, not appreciation –– should be the real lesson drawn by today's policy makers in China and elsewhere in Asia.

China's caution on RMB appreciation may be driven by other factors. Some in China are concerned that too strong a currency will lead to credit bubbles. There is also worry about how to deal with the Trump Administration: when the RMB depreciates, the US calls it 'intervention'; when it appreciates, it is 'market-determined'. Overall, the People's Bank of China's goal is for the exchange rate to be more flexible, market-determined and basically stable.

Currently, the Chinese economy is slowing substantially as deleveraging takes place and liquidity dries up – rather like Japan in the 1970s. The national savings rate has dropped by around 8 percentage points as the economy rebalances – though, at 44 per cent of GDP, it may still be too high. The current account surplus is now less than 2 per cent of GDP, much lower than levels prior to 2008. These changes will require many in the region to update their framework for thinking about China.

The lessons from Japan go even wider, as many Western countries look increasingly 'Japanese' (with anemic growth, ageing populations, high public debt and debt-deflation).

Many Asian economies responded defensively to QE with sterilised foreign exchange intervention. In a number of cases this has fueled credit booms, which may now unwind messily as global interest rates rise. Other downside risks for emerging Asia include the prospect of higher oil prices and the US-China trade war, which is beginning to impact trade volumes and is affecting investor confidence across the region.

Global imbalances persist. Curiously, many countries which require a current account deficit to access funds for investment continue to run surpluses. This is no longer a China story – South Korea, Thailand and Singapore now collectively contribute more to current account imbalances than does China. With reserve accumulation receding across the region, imbalances are increasingly driven by portfolio flows. But the latter are slowing, leaving countries in the region with high current-account deficits vulnerable.

This raises two questions for developing countries in Asia. Firstly, can the region's ample national savings be put to better use? Intra-regional portfolio flows are only 15 per cent of total cross-border portfolio flows in Asia. Rather than investing in equities in the US and Europe, can these funds be redirected to investment in much needed infrastructure across the region? Secondly, given the negative market reaction to current account deficits for emerging economies, how can these economies fund their growth without the risk of markets turning on them? One answer is to focus on getting the investment climate right, both for infrastructure investment and foreign direct investment in greenfield projects. This is crucial for attracting private finance – so far only 20 per cent of total infrastructure finance in Asia.

Session 2: Trade, Investment and Connectivity in Asia

The US-China trade war is about much more than economics. At its heart, it is about great power rivalry. Three questions framed this session's discussion: How did we get here? Will it last? What are the consequences?

For the first time in more than 70 years the US has a viscerally protectionist president. President Trump's election is the result of fifty years of income stagnation among white males without a college education. The Trump administration is interpreting the rules of the trading system in ways to maximise narrowly perceived US interests – for example, imposing Section 301 tariffs on Chinese imports, and justifying steel and aluminium tariffs on national security grounds citing Article XXI of the GATT. The Trump administration is determined to make the US market less open to foreign competition, reshore manufacturing production and employment, and hinder offshoring from the US.

The problem is also on the Chinese side. China regards itself as a developing economy (with per capita income of USD 9,000), but it is too big for the rest of the world to be treated like any other developing country. Government and market behavior in China has systemic consequences. Chinese industrial policy has become more interventionist and protectionist, but China expects unimpeded market access abroad. That is no longer tenable.

The US is not alone among advanced economies in accusing Beijing of infringing the intellectual-property rights of foreign firms, forcing technology transfer to Chinese firms, and hugely subsidizing 'national champions'. The dilemma for Western firms is that they have become highly dependent on the Chinese market – not least US tech firms that supply high-end components to Chinese firms. Hence 'decoupling' would be very difficult and costly. The US overestimates its ability to control global technology flows; trying to control China's access to technology is a loser's game.

For many years Beijing incorporated foreign firms in its development strategy. Much of China's manufactured exports were made by foreign MNEs or were part of MNE-dominated global supply chains. Chinese exports did not compete with Western exports. Hence foreign firms in China were the Chinese government's allies in lobbying for market access in the West. But this is coming to an end as the Chinese government gives more preference to Chinese firms at the expense of foreign MNEs. *Made in China 2025* is an ambitious industrial-policy strategy that aims to make Chinese firms – a combination of SOEs and private firms with strong government ties – dominant in key high-tech sectors.

We are set for a long period of friction between the US and China. Chinese and US mercantilism will make it difficult to reach consensus. The Trump administration will not be satisfied merely if China reduces the bilateral trade deficit and buys more US soybeans and aircraft. The US wants Beijing to abandon its industrial policies – to become more like the US. But this is unlikely to happen. Hence prospects for a bilateral agreement that will last are dim. But it is still crucial to get back to a broad understanding for harmonious coexistence, notwithstanding inevitable disagreements and conflicts. That requires compromise on both sides.

The US-China trade war is eroding the basis on which international trade and global supply chains have deepened over the past few decades. The Trump administration is actively seeking to undermine elements of the international trade architecture. Its tariffs on Chinese imports, and on aluminium and steel, are questionable under WTO rules. Future tariffs on automobile imports would be even more damaging. US blockage of new Appellate Body appointments has brought the WTO's dispute-settlement mechanism close to collapse. But the US, EU and Japan think China is flouting the spirit and letter of WTO rules, especially on subsidies, SOEs and technology transfer. Other countries could well follow with 'copycat' protectionism that would further undermine the WTO. In short, we are in a new environment of more uncertain and unpredictable norms and rules for international trade, which will impact negatively on real-world investment and trade.

Globalization has contributed to the great success of China, India and other emerging market economies. In the US and Europe, many citizens have felt left out and lost confidence. Globalization is being challenged in the West. But it is important to develop a globalization narrative for Asia, not just for the West. There is a good story to tell. The world outside the US also needs to respond by committing to deeper international integration. The TPP-11 (CPTPP) is one such response. RCEP is another. If necessary, there should be more plurilateral agreements without the US.

Some participants challenged the view that US engagement of China has failed. The whole premise of US engagement towards China was that China would look more like the US. Certainly China has not converged towards a US-style political system. But integration into the global economy and its rules, not least WTO rules, has made China more of a market economy with rising living standards. Economic distortions have been reduced gradually on a dual track – faster for the private sector, slower for the public sector. Data shows the private-sector economy continues to increase its share of the national economy in terms of production, profits, innovation, bank credit and employment. The West is frustrated this is not proceeding faster. But it needs to be patient. However, other participants countered that the role of the state has increased, not diminished, since the GFC and President Xi's accession to power.

The picture looks different on US trade relations with its long-standing trade and security allies. The protectionist impulses of President Trump and his senior trade advisers have been constrained by business and other countervailing interests in the US and partner countries. Damage has been contained. The US has renegotiated agreements with Korea (KORUS), Mexico and Canada (USMCA), and is negotiating with the EU. Changes to KORUS and NAFTA have been far less radical than many feared. Talks have started with Japan on a bilateral FTA. Japan has played a careful hedging role – leading the revitalisation of TPP-11 while also improving its relations with China.

Discussion of trade, investment and connectivity in Asia should also encompass *East Africa*. The West will eventually realise how it lost Africa to China. China has been investing heavily in African infrastructure for 18 years through its policy banks and SOEs, while the West has neglected Africa. The new megatrend is the integration of *East Africa* into the Asian economy. Increasingly, East African trade, investment and connectivity are with Asia, not with West Africa. China is centrally engaged, but so are ethnic Indian trading diasporas. The latter connect East Africa, the Middle East and South Asia, with Dubai as the commercial hub.

Session 3: Productivity, Structural Reform and Regional Integration in Asia

The recent IMF Regional Economic Outlook suggests the need for Asia to reconsider its growth model. China has not exited labour-intensive activities as fast as Japan did. Asia is still too dependent on non-Asian demand. Productivity growth is critical, but is the productivity machine slowing down or stuck?

A major rebalancing of the Chinese economy had taken place since 2008. Growth has slowed down substantially. While China's current account surplus was 12 per cent in 2007, in the first half of 2018 it was almost zero. Economic growth before 2008 was mainly driven by exports and investment, but now consumption accounts for 75 per cent of growth.

With GDP per capita approaching USD9,000, China is approaching the middle income trap. Total factor productivity and capital efficiency are declining; the incremental capital-output ratio was 3.5 in 2007 and 6.3 in 2017 – capital efficiency has almost halved in a decade. The economy is no longer as competitive in labour-intensive manufactures. The transition from old industries (such as SOEs in heavy industries in northern China) to new industries (such as the new tech industries in the southern coastal regions) is ongoing. There is more private-sector innovation and domestic value-added. But eliminating old industries is getting more difficult politically. Implementation of reforms announced at the CCP Third Plenum in 2012 has been slow, especially on SOEs. Focusing on supply-side reforms and allowing the private sector to flourish would help the Chinese economy become more efficient.

Ironically, many Chinese economists see benefit in acceding to the Trump administration's demands for China to open its services sectors, strengthen IP rights, discipline subsidies and improve the efficiency of state-owned enterprises. These are the same reforms they have identified as helpful to future economic growth. Ideally, external pressure (this time led by the Trump administration) would accelerate market reforms domestically, just as WTO accession did for China in the 1990s.

ASEAN's productivity performance is lagging compared to the 1990s. But growth in the core ASEAN-6 has been strong and steady, before and after the GFC (around 5 per cent per annum). Catch-up growth in the poorer ASEAN-4 economies (CLMV) has been very good, especially Vietnam. Supply-side reform is picking up across the region, as better country rankings in the World Bank's *Doing Business Index* and the *WEF's Global Competitiveness Index* show. After twenty years of underinvestment, public investment on infrastructure is increasing in Indonesia and Thailand. FDI is returning in export-oriented manufacturing sectors in ASEAN, including the relocation of operations from China to Thailand, Vietnam and Malaysia.

As for debits: Some ASEAN countries have seen a deceleration in private-sector investment, notably Malaysia. And large, undisciplined inflows of cheap migrant workers have prevented Singapore and Malaysia from upgrading business processes and improving productivity, while depressing wages at the lower end and increasing income inequality.

ASEAN economic integration has been rather disappointing, not going much further than tariff elimination on goods trade. Progress will be incremental and patchy at best. Smaller-scale sub-regional integration is more promising, such as the Greater Mekong Subregion, and Thailand's cross-border relations with Myanmar, Cambodia and Laos. Singapore-Iskandar has similar potential, but largely unachieved so far.

The outcomes of *India's* economic reform agenda are mixed. The introduction of a Goods and Services Tax (GST) was the culmination of 10-15 years of effort to secure agreement from the states. The GST, though with messy and delayed implementation, is opening up trans-state movement of goods enormously and reducing operating costs for firms. Subsidy administration costs should decrease with direct cash transfers to individual accounts. On the other hand, the fiscal and current-account deficits are too high, investment too low, and demonetisation was a serious policy mistake.

Some participants thought that PM Modi had missed an opportunity by not being bold enough on economic reforms. India's economy would have grown even faster if the BJP government had undertaken land and labour-market reforms. India's agriculture sector has enormous scope to modernise and improve productivity through internationalisation – there are lots of opportunities to improve food certification and export sugar, spices and horticulture products.

It is important to differentiate India's growth and productivity challenges. States differ widely in stages of development. Half of Tamil Nadu's population is urban, agriculture is 10 per cent of its GDP, manufacturing is expanding, and it is primarily a services-based consumption economy. Uttar Pradesh – predominantly poor, agricultural and rural, and with a population of 200 million – is at the other end of the spectrum. Tamil Nadu workers are on average older and more skilled; North Indian states have a much lower median age, and their workers are much less educated and skilled. The lesson here is to think of structural reforms at a more local level, tailored to local conditions.

Infrastructure is crucial for economic development, as China has shown so successfully. But the scale and sequencing of infrastructure construction matter. Getting the model right is vital: governments need to ensure they have the institutional capacity to manage complex public-private partnerships if they choose such arrangements.

China's Belt and Road Initiative (BRI) is an umbrella without geographical restrictions. It has a grand vision but no central coordination mechanism, rather consisting of proliferating bilateral projects. Pakistan shows BRI's credits and debits. Its BRI-provided infrastructure is good. But it has increased the investment rate without increasing the savings rate, thus widening the current-account deficit, and increased public debt, forcing Pakistan to go back to the IMF. It would be positive if more BRI projects were not done bilaterally but through the Asian Infrastructure Investment Bank (AIIB) – a multilateral institution with high governance standards.

One of the widely held assumptions about infrastructure is that the key constraint is financing. On the contrary, there are plentiful savings available in many recipient economies. The problem is often the regulatory environment. For example, progress on the Jakarta-Bandung railway contract won by the Chinese is only being made three years down the road – the constraint is not money but land acquisition.

Services will play a greater role in economic growth and job creation, especially as manufacturing becomes more automated and less labour-intensive. This will encompass trade, IT and the digital economy. Enhancing productivity in services sectors is crucial. But services sectors are restricted and stuck in low-productivity traps. 'Industry 4.0' blurs the separation of manufacturing and services and increases the demand for higher skilled workers. This means closed services sectors with low productivity will become an increasing drag on economic growth.

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Session 4: Inclusive Growth in Asia

Economic growth is both *inclusive* and *exclusive*. High, sustained growth has dramatically reduced poverty (less than 10 per cent of East Asia's population now lives on less than USD 3.20 a day), and improved material lives and life-chances for most people in Asia. But it also creates losers, ranging from Marx and Engel's handloom weavers to workers in the US rust belt. And it increases the visibility of inequality. So what is 'inclusive' about growth? The World Bank's perspective is that it reduces extreme poverty, promotes social mobility, and provides protection from adverse economic shocks. How is East and South Asia's experience different from that in Latin America, Eastern Europe and Central Asia? What are the key differences within Asia? What are the policy levers that matter most for inclusive growth?

Pockets of extreme poverty remain. Income inequality within countries is rising across the region, bringing with it a fall in social mobility and opportunities. A large population lacks economic security – just above the poverty line, but remaining vulnerable to economic shocks which could easily send them back to extreme poverty.

One participant was skeptical about targeting income distribution as a policy goal. The factors that determine indicators, such as the Gini coefficient, are varied and complex, with great scope for unintended consequences from fiddling with those factors. That includes rent-seeking and corruption, with the political process appropriated to favour powerful individuals and groups. Note what has happened with affirmative-action policies in South Africa and Malaysia. Rather than focusing on particular outcomes, it is preferable to concentrate on the 'rules of the game', emphasising transparent, general non-discretionary rules and supplying broadly available collective goods. Political competition in liberal-democratic systems is generally more responsive to ordinary voters' concerns, not least to supply public goods, than alternative political systems.

A central challenge remains to convince the beneficiaries of globalization – not least those who have recently emerged from poverty – of the virtues of market economies, openness to trade and regional cooperation. This is hard. The standard approach of inequality statistics, notably the Gini coefficient, means little to the public. The role of social media complicates the message.

We need a *narrative of inclusive growth* to demonstrate the shared benefits of openness. It is important to decouple the positive aspects of openness from the less positive, such as the financial innovation behind crises and contagion. Legitimate critiques of aspects of globalization should not generate a backlash against those aspects which continue to do good.

We should also be mindful of the political cleavages that underpin populist movements. This goes beyond the breakdown of political alignments in North America and Europe. Globally, new cleavages are opening, or reopening, based on geography, ethnic division, education attainment, class, age and gender. Inequality occurs across all these dimensions, and they must be included in considerations of inclusive growth.

The Mastercard Center for Inclusive Growth (MCIG) focuses on the role of productivity in inclusive growth. The productivity of an individual is rarely determined solely by their individual skills, training and capability. Much more important is how they are connected to complementary inputs. This may be embodied knowledge, such as machinery or infrastructure. It may be codified knowledge, such as information technology or the internet. Or it may be tacit knowledge, such as know-how and experience-based learning.

Growth comes from increasing productivity. This means increasing the connections between individuals and the sources of embodied, codified and tacit knowledge. Crucially, any form of social discrimination removes access to networks of knowledge, impeding productivity as well as the capacity for individuals to better their own situation.

The early East Asian development experience centred on improved access to embodied knowledge. Making further progress will rely on improving access to networks of tacit knowledge, an approach the MCIG describes as 'democratising productivity'. The most fundamental change in technology is that much tacit knowledge has become explicit, codified knowledge. Tacit knowledge has become embedded in software packages; using it puts an even greater premium on education and skills. But remaining tacit knowledge is still important; with increasing codified knowledge, it just becomes both more valuable and harder to access. This presents a challenge for policy makers.

SMEs are important to build connectivity. Yet they are increasingly challenged by data protectionism. Reduced access to data impedes the ability of SMEs to build and access networked information. It shifts the playing field in favour of large companies. Data protectionism fragments value chains and further concentrates benefits in the digital giants, such as Facebook, Google and Alibaba, who can exclude others from their own networks.

The way forward may be to democratise data – a coordinated global approach to treat data as a public good that is free, accessible and anonymized. This will be challenged. Privacy must be protected, and global coordination will be difficult. But if successful it will open up opportunities for startups and SMEs to build the networks that connect individuals with the knowledge they need to generate productivity gains.

Two other sources of Asian growth will have a big impact on inclusiveness. The first is the *growth of cities*. Emerging metropolitan regions in China and elsewhere in Asia bring huge opportunities for agglomeration benefits. But good planning is needed to ensure that the benefits are widely shared.

Secondly, growth through *regional economic integration*. In 19th century, trade 'followed the flag'. However, in Asia today, trade follows infrastructure and intra-regional regional FDI. Regional trade agreements remain important, but securing the benefits of regional integration will rely on better connectivity across the region. FDI also plays a role in spreading economic growth beyond cities to rural areas. Again, good planning will be required to ensure the benefits of regional integration are widely shared.

Session 5: Asia in Regional and Global Economic Governance

Perhaps this is the most uncertain time in the international economic system since 1945. The foundations of the global trading regime are being challenged. No region has more at stake than Asia, where an open global economy has supported both political security and economic growth.

ASEAN is emblematic. It comprises 3.5 per cent of global GDP but 7 per cent of the world's exports: trade, FDI and global supply chains have been engines of its growth. Its growth still depends on access to external markets. As a group, despite many weaknesses, it is a living example of regionalism as a building block of multilateralism and global integration. ASEAN must remain outward-looking and engaged, alongside deepening intra-regional integration.

A US decoupling from China would threaten to unravel *Asian economic integration*, thereby damaging regional growth, established supply chains and well-established rules. Asia's response will be important. Asian voices need to be louder. Asian countries no longer have the option of sitting back waiting for the big powers to sort themselves out. Countries in the region hope that the US-China relationship will not be defined wholly in adversarial terms. But this is uncertain. Previously deep bilateral dialogues have been washed away, and acrimony has spilled over into regional institutions, especially APEC.

Asian economies should continue their agenda for greater openness and integration, if necessary without the US. But they still need to engage the US. This approach encompasses:

1) *Unilateral reforms* domestically – pursuing structural reforms to respond to the transformation of global value chains, raise productivity and improve infrastructure. Governments have to develop a better narrative on how economic reform helps to create jobs and inclusive growth. They should also be frank on the distributional and transactional costs of open economies.

2) *Regional integration* through WTO-plus FTAs open to other countries in Asia and beyond (i.e. 'open regionalism'), financial swaps, and cross-border infrastructure through the BRI and other initiatives. TPP-11 is important as a 'deep-integration', mega-regional FTA for market access and strong rules for 21st-century international trade and investment. It could expand beyond 11 members, and eventually welcome back the US. RCEP is likely to be a much weaker agreement, but even tariff elimination and simplified rules of origin in such a vast economic space would bring considerable benefits. And it is a litmus test of regional cooperation. Further progress is needed to implement the ASEAN Economic Community.

3) *Supporting the multilateral trading system*. Japan has finally emerged to display regional leadership, especially in reviving the TPP. The EU and Canada are engaged. Australia is leading on e-commerce negotiations with Singapore and Japan. Still, the EU, Japan, ASEAN and other middle powers (such as Australia) all need to carry more weight and uphold the rules-based system. This includes working with the US and China to resolve controversial issues, and to help them create a bilateral relationship that is not wholly adversarial.

One participant noted that multilateralising tariff preferences is a complementary approach to unilateral liberalisation. Countries with multiple FTAs could harmonise and multilateralise their preferences.

The failure of the WTO, including the Doha Round, is due to its members and not the institution. China's use of subsidies is a problem for global trade and the WTO – but other WTO members' use of subsidies is also contentious. WTO safeguard provisions also need reform to make them more usable as a safety valve for trade tensions. One participant argued that much US criticism of China in the WTO is legitimate and should have been addressed years ago. The challenge for other WTO members is to help the China and US to engage each other more constructively in the WTO. Hence recent EU-US-Japan, and EU-China initiatives, are welcome.

China is still a developing country and substantially different from OECD economies. But its economic size creates spillover effects. China should take more responsibility as a special developing country, in the WTO and other international forums, which would be positive for itself and the world.

Public Panel Discussion: The Great Decoupling: China, America and the Risk of a New Asian Economic Cold War

Chair:
James Crabtree, Associate Professor, Lee Kuan Yew School of Public Policy, NUS

Panelists:

Adam Posen, President, Peterson Institute of International Economics, USA
Yao Yang, Dean and Professor, National School of Development, and Director, China Centre for Economic Research, Peking University, China

Alicia Garcia-Herrero, Senior Fellow, BRUEGEL, Brussels, and Economist for the Asia Pacific, Natixis, Hong Kong
Alan Beattie, European Editorial Writer, Financial Times, Brussels
Ganeshan Wignaraja, Executive Director, Lakshman Kadirgamar Institute of International Relations and Strategic Studies, Sri Lanka

James Crabtree: Hank Paulson, in a recent speech at the Bloomberg New Economy conference in Singapore, talked of a new 'economic iron curtain'. Are the US and China on the brink of a new economic Cold War?

The panellists agreed that US-China tensions would persist for some time. Things might get worse before they get better. The truce between Presidents Xi and Trump at the G20 in Buenos Aires did not resolve the fundamental differences between the two countries.

Adam Posen noted the now widespread belief across the US political spectrum that China had exploited the international system at the expense of the US, and that China's economic and technological development constituted a threat to the US's national security and economy. This is more than an economic Cold War. It removes the barrier between national security and economics, bringing together the national-security and economic establishments in a much more hawkish stance on China. This goes beyond the knee-jerk protectionism of President Trump and his key trade advisers. The Democrats are even more hawkish on US-China trade issues. Before, the US approach was to resolve sectoral disputes with China. The Trump approach is to escalate sectoral disputes to cross-sectoral disputes and break long-established rules of the game, including WTO rules.

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Alicia Garcia-Herrero said many European countries had recently concluded that China's state-driven economic model had created distortions in the global economy and damaged European businesses. This is a sea-change from only a year or two ago. In an EU Commission paper from 2006, China was designated a 'strategic partner'. The US and China are fighting for technological hegemony – for example on 5G and Artificial Intelligence – but playing by different rules. The US's imposition of tariffs on Chinese products is aimed at reducing offshoring to China and facilitating reshoring to the US over time.

The panelists concurred that Chinese leaders seem willing to meet some of the Trump administration's demands. But Beijing would not compromise on its state-led economic model. Beijing would continue its subsidies for state-owned enterprises and support the *Made in China 2025* strategy to move China up hi-tech manufacturing value chains.

Adam Posen said the most likely scenario was that the trade war would not bring about most of the changes sought by the US, while making both China and the US worse off and frustrated. It would exacerbate productivity problems in both countries. There is an outside chance the US will go into recession, and that Trump economic and trade policies will be blamed. But he thought that the US will not go into recession anytime soon. There is an even more outside chance that the trade war will cause extreme visible dislocation in the US, with significant jobs lost and prices increasing. The least likely, but most appealing, scenario is that we will get back to the rules-based order. Most likely, the trading system will survive better than other parts of the world economy. Trade can continue even without the US.

Yao Yang said the US and Chinese economies are so interconnected that decoupling was not realistic. Forty per cent of China's trade surplus comes from US firms' production networks in China, and another 20 per cent from other foreign firms producing in China.

Ganeshan Wignaraja said the implications of the US-China trade war for Southeast Asia in particular were not all bad. The silver lining is the relocation of labour-intensive manufacturing (e.g. in garments, textiles, shoes, electronics and autos) from China to other Asian countries, such as Vietnam in Southeast Asia. In effect, the trade war will accelerate a structural shift that is happening anyway. At the same time, China is increasing its value-added production. And services is becoming more important in Asian value chains, though more structural reform is needed to take advantage of it.

Alan Beattie said the US is provoking a crisis in the World Trade Organization (WTO) by refusing to appoint judges to the Appellate Body. In the US there is a strong perception that the WTO judicial process was making up law. This goes back to the Obama administration. The Trump administration has a spectrum of views on the WTO. Some, like John Bolton, want to destroy the WTO and other international organisations that constrain the US. Bob Lighthizer is focused on the steel industry. He is OK with the WTO as long as it allows big reforms, such as much more open-ended safeguard provisions. In between are those who believe the WTO has done a reasonable job in constraining China by ruling against it in some cases. But they, along with the EU and Japan, want new rules to cover China's interventions, especially on subsidies.

He added that the multilateral trading system would not work so well without the US: there is no substitute anchor for the system. A hegemon in international trade needs a strong domestic foundation. China does not have that, which is why it probably will not lead even in Asia. This leaves the global trading system leaderless – a dangerous vacuum.

Adam Posen said that the Trump administration now has a coherent world-view but with unattainable goals. And it has upended the trade policy-making process, which is now extremely erratic, not just on China but also on relations with traditional allies. *Alan Beattie* added that this erraticism is counter-productive. If the Trump administration cooperated with the EU and others to combat China's interventions, it could encircle China. But the EU is less willing to do that because of erratic US behavior. *Yao Yang* added that a grand coalition against China is unlikely. Japan-China relations have improved recently, and the EU will not go full bore against China because German firms have huge stakes there.

Adam Posen asked what Asia could do to minimise the fallout from the US-China trade war and to be more of an economic bulwark. Asian countries should charge ahead with liberalisation and regional integration. That would make them more resilient and escape the productivity drag experienced by advanced economies. *Alan Beattie* said that countries should just get on with unilateral liberalisation. CPTPP is also promising. *Ganeshan Wignaraja* said smaller countries need to argue in support of the rules-based order and WTO framework.

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