

**IMPLICATIONS FOR THE STRATEGIC
ARCHITECTURE OF THE ASIAN HEMISPHERE**

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As the progenitor of the APEC Leaders' Meeting, Paul Keating's thoughts about the organisation were pertinent, particularly as the views in this major speech were given just two years after he had left the prime ministership and the effective 'secretaryship' of APEC. The conference held in Shanghai just before the Kuala Lumpur meeting of APEC gave him the opportunity to reflect upon and provide guidance to the organisation. Paul Keating says the 1997 Asian crisis was one of the world's biggest economic challenges since the Second World War and that the crisis marked China's re-entry as a major participant in the international system. He argues the Washington-based institutions—the IMF, the World Bank and the G7—had demonstrated an incapacity to supervise the system and to put effective remedial policies into place.

It is very good to be here in Shanghai which is one of the great cities of the world. But it is also an ideal place to hold a conference like this at this time.

When we look back on this, the Asia economic crisis, one of the most important things we will remember about it is the way it marked

China's re-entry as a major participant in the international system. During the crisis, China has been a creative shaper of responses. It has looked beyond its own borders and its own immediate interests. This is not an easy task for a developing country facing as many challenges as China. But the message it has sent the region by holding back from a competitive devaluation of the RMB, by active participation in the IMF packages of support for its neighbours, and, above all, by its own continuing commitment to policies of reform and openness, is a welcome one.

This session of the conference is about APEC, and especially the prospects for the November Leaders' Meeting in Kuala Lumpur under the chairmanship of Dr Mahathir Mohamed, the Prime Minister of Malaysia.

Many issues will be on the agenda for that meeting, but one fundamental question will be answered there: whether, as an institution, APEC has reached the end of the road.

It is important to set out clearly what is at stake here.

First, this region is experiencing its most serious economic challenge since the end of the Second World War. The region as a whole has moved into recession.

According to the World Bank, no nation in the past 50 years has experienced such precipitate economic collapse as Indonesia. The economy of the world's fourth most populous country may shrink by 20 per cent this year. Thailand's GDP is likely to fall by 7 per cent, South Korea's by 6 per cent and Hong Kong's by 4 per cent. The Daewoo Economic Research Institute estimates that domestic consumption in South Korea plunged 28 per cent during the first half of this year compared with 13.4 per cent in the United States during the height of the Great Depression. Regional stockmarkets have fallen more than half since their peak.

Second, this economic crisis is already producing devastating social consequences. Tens of millions of Asians have been pushed back into poverty. Human suffering is growing daily. Every child who drops out of school, or misses out on a vaccination against a debilitating disease, will have a human lifetime's impact on the economies and societies of the region. The crisis has also reignited ugly ethnic divisions in societies like Indonesia's.

Third, these economic and social problems can spread beyond national borders and generate security tensions. Bilateral relationships in Southeast Asia have already been strained by the economic crisis. We can expect more of this.

Fourth, the Asian crisis has now spread and threatens to have a global impact. Deflation is a looming problem. Japan has just posted its worst economic growth figures since the Second World War. Russia and Latin America face dangerous strains. Wim Duisenberg of the European Central Bank acknowledges that the international turmoil will have a 'dampening effect' on European growth. Too much weight is placed on the continuation of unwavering strength in the United States economy at a time it faces what is likely to be a debilitating political crisis. As Alan Greenspan said recently, the United States cannot forever be an oasis of prosperity.

APEC's November meeting should be an ideal vehicle for coordinating action to address these problems. APEC represents all the key Asia Pacific economies. The two largest economies in the world—the United States and Japan—and the most populous nation—China—are members. So are the developing economies which have been most directly affected by the crisis. Unlike the IMF or the G7, APEC allows the voices of all those affected to be heard.

But unless the APEC forum can show in November that it has the will and capacity to do something about Asia Pacific economic cooperation during the worst crisis of the past half-century, it might as well pack its bags, declare that a decade is enough, and let its officials move on to more productive enterprises.

APEC might loll around in the corners of Asia Pacific consciousness for a while yet, but unless it can deliver results this year, in these dangerous circumstances, it will have demonstrated only its own impotence. Its pronouncements will no longer be taken seriously. Sometimes organisations lose sight of what they are there for. They become institutionalised and formalised, and the process becomes more important than the goal.

If that happens to APEC it will be a great tragedy. It will rob the region of an institution which is probably irreplaceable in its current format, and one which is

capable of facilitating political and strategic dialogue at a time when this is badly needed.

When I wrote to other APEC leaders in 1992 suggesting that we strengthen APEC's institutional structures by adding an informal Leaders' Meeting, I had strategic as well as economic purposes in mind. I believed the absence of any mechanism in this part of the world to enable heads of government to meet collectively was a real inhibition to the development of the Asia Pacific. We were missing out on the benefits of frequent informal contact, and the insight and opportunities that come from it, which the Europeans got through the EU, or Latin America through the OAS.

I also believed that only meetings at the level of leaders could give APEC the political horsepower it needed to develop a really ambitious economic and social agenda. The leaders' engagement in these annual meetings raises the political stakes and increases the pressure for significant outcomes.

So, thanks to President Clinton's invitation to his colleagues to meet in Seattle in 1993, the Asia Pacific has a structure in place which can provide leadership during this crisis, if the will is there to exercise it.

It has to be said that APEC's record so far has not been good. As a source of ideas and responses to the Asian crisis during the past year, APEC has been the invisible man.

Leaders will meet in Kuala Lumpur in a very different atmosphere from Vancouver twelve months ago. Month by month, the economic indicators have been adjusted downwards and the contagion effects of the crisis have become clearer.

A debate has been opened up within the region on the subject of where blame lies for the economic slump. Does it lie with speculators and outside interests who have abused the growing economic openness in the region? Does it lie with inadequate financial structures, and corruption and cronyism in some regional economies? Does it lie in unrealistic and overly restrictive demands by multilateral organisations like the IMF?

This is a very good debate to have. It is impossible to look back at the scarifying developments in Asia over the past twelve months without concluding that the policy responses of governments and international institutions have been seriously flawed.

If the consequence of addressing the sort of capital-account problems a number of regional countries experienced is to plunge the region, and possibly the world, into recession, then either our understanding of what is happening or our prescriptions for dealing with it are seriously flawed. There must be a better way of responding to such events than by pushing millions of people back into poverty.

APEC in Kuala Lumpur will inevitably and properly be caught up in discussing these questions about economic openness and its consequences, if only because Malaysia, the host nation, has reimposed capital controls.

For my part, I am all in favour of policy responses which accept different paths and different speeds, which acknowledge that political and social environments vary from country to country and have to be handled in different ways. In fact, that is what the APEC approach has been about from the beginning. It is what distinguishes it from other multilateral economic organisations. APEC's diversity of membership requires it to exercise such flexibility.

But it is vital that all those paths lead to the same destination, and that progress along them is steady. And that destination, in my view, must be a world in which trade and investment and ideas move freely and openly around. That is the core of the Bogor Declaration.

Why should we choose that destination? Because it offers the greatest growth prospects to lift the millions of people in the Asia Pacific who still live in poverty into a better life. And because, in the end, it is the only way technology will let us move.

We are living in an Age of Convergence. This is more than simply the economic and financial process of globalisation. Globalisation is one form of convergence—a convergence in the way goods are made and distributed and in the way capital is allocated. Between 1980 and 1992 world trade grew at twice the rate of world output, and more than one third of all international trade is now conducted by firms trading within their own structures. Foreign direct investment doubled between 1988 and 1993.

But the Age of Convergence is broader. It encompasses the radical social and political realignment brought on by technological changes and the information revolution.

Convergence blurs the margins of many aspects of our lives. Barriers erode and elide. Technologies merge. And as they do, the nature of the work we do changes, and the way we live our lives and conduct our social relationships change. That is as true for a farmer in rural Thailand as for an industrial worker in the American Midwest.

At the international level, convergence is breaking down formerly impervious barriers between nation states.

We can't un-invent the information revolution. Neither can we stop its consequences, or channel them in one preferred direction. Technology takes us inevitably, irrevocably, in the direction of a converging world.

But support for economic openness does not require every economy from Chile to China to adopt the same policy responses at the same time. Globalisation is a process, not an outcome.

The first question to be asked about APEC's response to Asia's current crisis is whether it, or any other institution, can do much about it. Does what is happening simply reflect powerful underlying economic forces which are beyond any effective policy response? Is there, in the end, nothing useful we can do beyond sitting back and waiting for the Invisible Hand to finish slapping us about the head?

Obviously I believe there are things we can do. Bad policies got us into this crisis—the absence of effective prudential regulation, policy decisions to tie various Asian currencies to the US dollar, misguided and damaging responses once the crisis was upon us. In the same way, better policies can help us find our way out.

It is true that APEC cannot solve the problem alone. But it can identify and coordinate more effective responses. It can focus debate. It can change the mood of the marketplace and the dynamics of regional recovery.

I believe the Kuala Lumpur meeting needs to deliver results in five areas.

First, a primary aim of the meeting should be a reassertion of the idea of APEC as the embodiment of an Asia Pacific community. In the traumatic events of the past twelve months, this has often been overlooked. But if ever there was a need to reinforce such a sense of community this is the time. Economic strains in individual economies are causing countries to focus inwards again, to blame external forces for their problems.

This renewed commitment to the idea of community should be at the centre of the Kuala Lumpur outcome. I don't mean by this simply a rhetorical sentence or two in a joint declaration talking about the value of cooperation. Instead, the meeting itself should be used as a genuine exchange between the leaders to refocus themselves, and through them the people of the region, on its underlying interdependence. That can be one of the great benefits of the APEC format in which leaders meet together without officials or formal agendas.

Whatever the flaws in the responses to the economic downturn have been, at every stage we have been reminded of how interdependent the regional links are. The United States and Japan are critical to any recovery. The United States remains the key export market for the region. Japan's recession deepens the crisis for its neighbours, and, despite its problems, it remains a vital source of capital. China's policy responses, as I said earlier, will have a significant impact on its neighbours. Most of the direct financial support to the economies which are suffering most, even when channelled through the IMF, has come from regional partners including Japan, Australia and China.

The Kuala Lumpur meeting will do a great service if it reminds regional leaders of that truth and its consequences.

A second outcome from Kuala Lumpur should be to provide practical evidence that the region is not putting up the shutters and turning inwards, that it remains committed to a process of continuing openness. But this requires action if it is to be believed, not just assertions.

Last year in Vancouver the APEC leaders proclaimed that APEC's goals, including the achievement of free and open trade in the region by the dates set out in the Bogor Declaration, were 'ambitious and unequivocal'. They designated fifteen major sectors for 'early voluntary sectoral liberalisation', with nine to be advanced through 1998 with a view to implementation beginning in 1999.

There could hardly be a clearer test of APEC's continued commitment to openness than whether it delivers on this promise.

If it does so, APEC will have sent a powerful message of optimism about recovery in the region. But if it not only fails to take its trade commitments further, but actually backs away from a commitment made by leaders only twelve months ago, the organisation's credibility will suffer a further damaging blow. Some of the larger APEC members, including Japan, are showing a reluctance to acknowledge this fact.

Third, APEC has to show that it offers something to the weakest economies as well as the strongest ones. APEC has always had a development as well as a trade dimension, and this is the time to step that up. Other organisations like the World Bank and the United Nations, as well as bilateral aid programs, may have a more central development role, but if APEC members are to continue to be committed to the process of liberalisation, the nexus between economic openness and development needs to be reinforced in the consciousness of all regional countries.

In this area, education should be a priority for APEC because human capital is at the core of everything the economies of the region might want to achieve. Even if it is outside its usual area of operations, APEC should coordinate action to keep children and young people in education through this crisis, whether through scholarships or large-scale technical assistance.

Fourth, APEC should try to coordinate a broad response to getting trade flowing again. This is a natural extension of its trade facilitation agenda. Necessary banking reforms are shrinking the sizes of banks and, as managers are forced to review their loan portfolios, trade finance assets are often among the first and most easily discarded. As we saw in South Korea, this can have a devastating and almost instantaneous effect on trade, and through it on the broader economy. APEC is a good forum in which to exchange experiences and coordinate policies on this issue.

Fifth, APEC should help shape the broader international debate on some of the questions thrown up by the Asian crisis, including the management of capital flows.

Such a debate is also taking place in other international forums like the G7, the G22 and various UN bodies. Does it matter whether APEC is also engaged in it? I believe it matters greatly.

APEC's broad membership of developed and developing economies gives it a distinct viewpoint on these matters and its members include those most seriously hurt by the crisis. But, most importantly, the only way we will achieve effective changes to global institutions for the twenty-first century is if all those affected are included in the dialogue.

Over the past year scepticism about the prescriptions of wise, Washington-based international economists has understandably risen. International economic diplomacy needs to be opened up. The face it presents to the world is a great deal more secretive, exclusive and arrogant than that of its more traditional political or

trade counterparts. Broader debate in APEC—not just among finance ministers—is one way of addressing this problem.

One of the distinctive things about APEC is the importance of the chairmanship. As it is such a loosely structured organisation, without a powerful secretariat or formal processes, its outcomes are shaped heavily by the approach adopted by the country chairing it. Like all his predecessors, Dr Mahathir will have an important personal role in shaping the outcome. He has a chance to deliver some fresh region-wide initiatives which will also shape global developments at a critical moment. The results of the meeting will be an important reflection on Malaysia's role in the world.

But APEC will find success harder to achieve this year because of its expanded membership. As Prime Minister, I was opposed to Russia, Chile and Peru joining APEC, not because of any animus to those countries but because I believed they would shift its focus away from the vital economic, strategic and political links which govern the relationship between East Asia and North America and which are so critical to APEC's original members.

I was also opposed to Asia-only bodies—a judgement that has been reinforced by this crisis. The United States and its relationship with Japan and the other economies of Asia, including China, will be central to recovery. These are problems which bridge the North Pacific and they require bridging solutions.

The question of APEC's membership is directly relevant to the architecture of the post-Cold War world.

Last year I described the decision to invite Russia to join as an act of international vandalism. My argument was not that Russia should be kept out of this part of the world. I don't believe in a new containment strategy for Russia any more than I believe in containing China. North Asian security can't be resolved without Russia, and eventually it will have a great influence on the Asia Pacific economy.

But the decision to admit it to membership this year was taken without serious thought about what was good for APEC. Its membership changes the agenda, adds a major country whose current economic links with the region are miniscule, and makes harder, by sheer weight of numbers, the chances for genuine dialogue in the Leaders' Meetings.

Russia's membership was supported by the United States in part, I believe, to atone for another bad decision—to expand NATO to the borders of the old Soviet Union. This sent a signal to Russia that it wasn't wanted as part of the European system. Instead it was offered APEC membership as a consolation prize in the Asia Pacific.

I hope I am wrong and that Russia and Peru will demonstrate that APEC has become a central part of their foreign policy and a major shaper of their international economic policy, but I doubt it. Better, however, an APEC with the wrong membership than no APEC at all.

The global institutions we created after the Second World War fail to reflect the demands of the age we have entered. This has been apparent for a number of

years. Reform of the United Nations was on the international agenda earlier in the decade, although nothing much has happened. It is absurd, for example, that membership of the United Nations Security Council has no place for the second- and third-largest economic powers in the world, Japan and Germany, and that membership is still coterminous with the possession of nuclear weapons.

The events of the past twelve months—economic and strategic—have reinforced the structural problems of our key institutions. The IMF, the World Bank, the G7, have all revealed weaknesses in doing jobs for which they were not designed, in a world which has fundamentally changed since the end of the Cold War.

The United States is revelling in its unipolar moment. Its leadership has been, and remains, essential. President Clinton's announcements last week, including the special meeting of the G22 to examine the financial architecture of the twenty-first century, were enlightened and welcome.

But the United States cannot bear the weight of leading the world alone, and in a healthy international system it should not be expected to do so. Equally, it has to accept leadership from others, and not just when it has already pointed out the direction it wants the rest of us to go in.

The recent entry of India and Pakistan into the nuclear club was another reminder of how high the stakes are. The senior adviser to the Indian Prime Minister on defence and security issues wrote in defence of the nuclear tests that India was 'assigned a particular place in the world order and not treated as a subject responding to our own interests'. It is not necessary to support India's decision to test—which I strongly oppose—to acknowledge the more general frustration.

A larger and more sustainable role has to be found for China, India and Japan. And with the EU's expansion and the creation of the euro, Europe needs to address the fundamentals of its own structure, including the rotating presidency, to see how it can act more effectively beyond its own continent.

It seems to me that one absolute precondition for recovery in Asia and for a healthier global environment is systemic change in Japan.

Japan lies at the core of Asia's problems. It now accounts for 70 per cent of East Asian GDP, up from 60 per cent before the crisis. Yet instead of pulling the rest of the region along, Japan is in the eighth year of a structural recession and heading for at least ten. When the world's second-largest economy is unable to help global growth, we have an unsustainable situation.

Japan's economy has recorded its worst growth figures since the Second World War. But for the first twenty days of July it had a merchandise trade surplus of \$US6 billion, a rise of 84 per cent on the previous year.

Even as its economy contracts, Japan's national policy game has remained on track: more and more exports to the world product markets, and the sustenance of large current-account surpluses underpinned by high domestic savings.

The Liberal Democratic Party conscripted two generations of Japanese to save in order to fund the big industrial companies which then marched out to conquer the product markets of the world. Instead of calling on domestic demand, the LDP has maintained its focus on these core economic objectives for 50 years. It did not change economic direction even when its success guaranteed it a fair share of world trade. There is no evidence it can change track now.

In 1995, after the currency reached 89 yen to the United States dollar, the US Treasury let Japan off the restructuring hook by intervening to support a lower yen. Yet when the financial systems of the other Asian economies started to seize up under the strain of the subsequent appreciation of the dollar against the yen, the US Treasury, with the IMF, demanded strong structural medicine for the Asian Tigers of a kind earlier American actions had absolved Japan from applying.

The only thing which will get Japan out of its present problems is a complete reform of the political system to dismantle the cosy, amorphous alliance between officials, politicians, bankers and industrialists and to make politicians more accountable to the real interests of Japanese electors. Fiscal stimulus won't do it. Since 1992 the Japanese government has spent nearly \$US700 billion on stimulus packages which have failed to stimulate.

This system has to change. And, as it changes, a more balanced relationship needs to emerge between China, Japan and the United States, one in which Japan and China can develop a relationship which is not mediated almost exclusively through the prism of the United States—Japan relationship.

APEC has already had a role making this triangular relationship healthier. The informal meetings between President Clinton and President Jiang at APEC leaders' forums since 1993 no doubt made arrangement of President Clinton's successful visit to China easier, and its outcomes more productive, if only because each side was working with much better knowledge of the other's positions.

In APEC, the Asia Pacific region has an institution which, with the right leadership, provides an enduring framework for regional relations into the twenty-first century. Despite its recent expansion of membership, it has the right scope and the right aims.

It has an ambitious trade and economic agenda which requires constant tending.

Beyond that, this crisis has again demonstrated how intertwined are economic, political and security issues. It is inevitable that the political and strategic dialogue which now takes place in the ASEAN Regional Forum will, over time, flow upwards to the APEC structure and that the Leaders' Meetings will provide an umbrella over the ARF as well.

But if that is to happen, it needs to survive this crisis.

I remain a long-term optimist about Asia and about the world. I believe the problems we are seeing are transitional and that the world is on a long convergence-generated upswing.

But the intervening period is going to be dangerous and complex. It will require committed and imaginative leadership. Without it, we could easily replicate the mistakes which made this century so dire.

Nothing was predetermined about the twentieth century's savage pattern of world wars and global depression. Bad decisions shaped developments and bad decisions will do so again.

For its part, APEC needs to recall its own objectives set out in the Seoul Declaration. These are 'to sustain the growth and development of the region for the common good of its peoples and in this way to contribute to the growth and development of the world economy'.

That is the test—APEC's own test—which the leaders face in November.