

## Seeking Opportunities in Crisis



# **Seeking Opportunities in Crisis**

Trilateral Cooperation in  
Meeting Global Challenges

**The Trilateral Commission**  
Tokyo Plenary Meeting 2009

Copyright © 2009 The Trilateral Commission  
All rights reserved.  
ISBN 978-0-930503-92-5

The Trilateral Commission was formed in 1973 by private citizens of Europe, Japan, and North America to foster closer cooperation among these three democratic industrialized regions on common problems. It seeks to improve public understanding of such problems, to support proposals for handling them jointly, and to nurture habits and practices of working together. Since the commission's inception, the European group has widened with the ongoing enlargement of the European Union, the Japanese group has widened into a Pacific Asia Group, and the North American Group now includes members from Canada, Mexico, and the United States.

See our website for more information: <http://www.trilateral.org>

North American Chairman	JOSEPH S. NYE, JR.
European Chairman	PETER D. SUTHERLAND
Pacific Asia Chairman	YOTARO KOBAYASHI

North American Office  
1156 15th Street, NW, Suite 505  
Washington DC 20005  
USA

European Office  
5, rue de Téhéran  
75008 Paris, France

Pacific Asia Office  
c/o Japan Center for International Exchange  
4-9-17 Minami Azabu  
Minato-ku, Tokyo 106-0047  
Japan

# Contents

Foreword .....	1
Remarks by Prime Minister Taro Aso .....	3

## **I. Responding to the Global Economic Crisis**

---

1. The Global Financial Crisis: The Road Forward.....	9
<i>TOYOO GYOHTEN</i>	
<i>E. GERALD CORRIGAN</i>	
<i>RUDI BOGNI</i>	
2. Future Directions for Global Economic Recovery.....	22
<i>EDMOND ALPHANDÉRY</i>	
<i>ZHANG YUNLING</i>	
<i>LUIS TÉLLEZ</i>	
3. The Threat of Protectionism to Global Recovery .....	32
<i>PETER SUTHERLAND</i>	
<i>NARONGCHAI AKRASANEE</i>	
<i>SUSAN SCHWAB</i>	

## **II. The Economic Crisis and Regional Cooperation in Asia**

---

4. Prospects for Regional Development in East Asia.....	47
<i>JUSUF WANANDI</i>	
<i>JOHN HEWSON</i>	
<i>YANG JIEMIAN</i>	
<i>RAJIV SIKRI</i>	
<i>HITOSHI TANAKA</i>	
<i>KIM SUNG-HAN</i>	

5. The Japanese Economy .....	66
<i>YOSHIMASA HAYASHI</i>	
<i>NAOKI TANAKA</i>	
<i>SACHIO SEMMOTO</i>	

### **III. New Opportunities and Challenges for Trilateral Partnership**

---

6. Afghanistan-Pakistan: Implications for the Trilateral Partnership ....	75
<i>GORDON SMITH</i>	
<i>MASASHI NISHIHARA</i>	
<i>STEFANO SILVESTRI</i>	

7. The New US Administration: Meeting Challenges, Managing Expectations.....	83
<i>R. NICHOLAS BURNS</i>	
<i>YOICHI FUNABASHI</i>	
<i>WOLFGANG ISCHINGER</i>	

8. The Intellectual Underpinnings of the Trilateral Partnership in the 21st Century .....	97
<i>HENRY KISSINGER</i>	

### **Appendix**

Program .....	107
---------------	-----

## Foreword

THE 40TH PLENARY meeting of the Trilateral Commission was held in Tokyo, Japan, on April 25–26, 2009, with more than 170 participants and guests, the largest group to ever come together for a Pacific Asia meeting. They met amidst fears that the global financial crisis would be more intense than any economic downturn since the Great Depression eight decades earlier, and these concerns seemed to imbue them with a sense of shared resolve. Many of the participants remarked that the need for greater global coordination has now become stronger than ever, and the conference discussions focused in a forward-looking manner on ways to work together in recovering from the crisis and to take advantage of the opportunities it presents to institute more stable and equitable economic practices and improve governance around the world.

Twenty-five policy experts from the Trilateral Commission member countries helped set the tone for the discussions with a series of thought-provoking presentations over the course of the conference's two days. They were joined for one session by Japanese Prime Minister Taro Aso, who outlined Japan's response to the crisis. It is also worth noting that the 2009 plenary marked the first time that commission membership was expanded further to include China and India, in recognition of their growing influence in world affairs and to continue to encourage their participation—along with the other Trilateral Commission countries—in joint responses to the central international challenges of our time.

One underlying theme of the meeting was that global governance is in a period of transition away from domination by the United States and Europe, and this transition might be further accelerated by the way in which the financial crisis was exposing the fissures in the system of US-led capitalism. As Henry Kissinger put it in an extraordinary closing speech, we have seen “the shift of the center of gravity of international affairs from the Atlantic to the Pacific.”

It was no surprise that a second core theme in almost all of the conference discussions was the nature of the economic crisis and the need for a joint response. In three sessions, prominent speakers debated the origins of the financial crisis, the measures being taken around the world to limit

its spillover into the real economy, and the potential for the crisis to fuel protectionism. There was a sense that stimulus measures and efforts to introduce new financial regulation were not being sufficiently coordinated and widespread concern that global trade liberalization is likely to remain stalled for the immediate future. However, many of the participants felt there is still time to take coordinated steps to remedy the failures at the root of the financial crisis, provided there is sufficient political will among the Trilateral Commission member countries.

Another major issue that was raised repeatedly, both in one dedicated session as well as in a host of others, involved the challenges of stabilizing Afghanistan and Pakistan and encouraging the emergence of more moderate societal forces in these countries. Participants from North America, Europe, and Pacific Asia generally agreed on the urgency of this task, but there was considerable consternation over what constitutes an effective and appropriate response. This led several participants to express their concerns that disagreements over the role of the international community in this region and differing levels of commitment to efforts in these countries may prove to become a major irritant to relations among the Trilateral Commission member countries.

Finally, there was one overarching sentiment that colored many of the discussions but was both surprising and encouraging in juxtaposition to the pessimism that might be expected with such severe challenges facing the international community. This was the sense of hope and optimism that pervaded the exchanges during the conference. To a number of participants from different countries, this was connected to the advent of the Obama administration and the sense that positive change is on the horizon; in fact, numerous speakers concluded their remarks with declarations that their countries need an “Obama,” too. But, more broadly, this feeling of optimism was associated with a refreshing feeling that many of the main obstacles to international cooperation could be overcome now that the stakes are so high if sufficient political leadership can be mustered in the Trilateral Commission member countries.

This report compiles the presentations made at the meeting in an edited and condensed form in order to record these important discussions and to promote further exploration of these pressing issues. We owe a debt of gratitude to the speakers who shared their insights with us and who have permitted us to include them herein. Also, we wish to express our deep appreciation to the indefatigable staff of the commission secretariats, who organized the meeting as well as compiled and edited this report.

## Remarks by Prime Minister Taro Aso

*Prime Minister Taro Aso welcomed the members of the Trilateral Commission to Tokyo and then addressed the global economic crisis, calling on the world to draw lessons from the crisis on how to create a more resilient global economy and system of governance.*

### RESPONSES TO THE GLOBAL ECONOMIC CRISIS

THE WORLD IS NOW facing an economic crisis said to come once in a century. To overcome this unprecedented crisis, we need an unprecedented approach. We must use our wisdom and choose creative ways to tackle the crisis. This meeting is indeed very timely, since its main theme focuses on global economic recovery.

Since World War II, the world economy has consistently become more globalized. Finance has also become more technically sophisticated. Overall, this brought us prosperity never seen before in our history. It also became the basis for the recent rapid growth of emerging economies.

The world has been moving towards economic and financial globalization and liberalization. Yet, because of the current crisis, we can even hear talk of reservations to this trend. However, I will not take such a pessimistic view. Instead, my belief is this: we can and should learn from this crisis. We will surely have fresh perspectives and develop new policy tools and rules. And, we can create a more resilient world economy and system of governance.

International efforts are already underway to make these things happen. Key examples are the G20 summits in Washington in November last year and in London earlier this month. Japan has been contributing in ways befitting its position as the world's second-largest economy, and I take pride in that. Japan's contributions are in the areas of policy and of providing the financial resources to make these policies a reality.

## MACROECONOMIC POLICY AND MEASURES TO ADDRESS FINANCIAL MARKETS

Now, let me talk more specifically about macroeconomic policy and measures to address financial markets.

First, as for economic policy, Japan learned major lessons through its experiences in the 1990s after its “bubble economy” burst. In those deflationary times, we saw very few borrow money. This was despite a zero-interest policy. Against this background, the government had to raise capital from the private sector in the form of debt and mobilized large-scale fiscal spending. We had no other defining policy than that. Japan shared that experience with other countries at the summits in Washington and London.

The G20, as a whole, committed to fiscal expansion of more than US\$5 trillion and to raising output by 4 percent cumulatively by the end of 2010. This can be found in the communiqué of the London summit.

Japan has already undertaken fiscal outlays of US\$120 billion in total to respond to this crisis. We are also now considering new fiscal measures of US\$150 billion. In this way, we are undertaking the largest economic stimulus possible under Japan’s current fiscal conditions.

As for supporting financial markets, countries are now taking measures to maintain their banking systems. For example, they are supplying liquidity, making capital injections to financial institutions, and disposing of bad loans.

In addition to these, Japan announced at an early time last November that we were ready to give a loan of up to US\$100 billion to the IMF. This is to help support emerging economies and middle- and small-scale countries that are deeply affected by the crisis.

This Japanese initiative was expanded at the London summit this month. The G20 agreed on a US\$500 billion expansion of the IMF’s NAB [New Arrangements to Borrow] fund and a new allocation of SDRs [Special Drawing Rights]. This will significantly help to push up the limits on the liquidity being supplied to the world’s financial markets.

At the London summit, we also agreed to expand trade finance globally to at least US\$250 billion. Japan has already committed to US\$22 billion of additional measures in this area.

Moreover, to address problems in the governance of financial markets, the major countries agreed to implement policies based on the lessons learned to date. These include expanding the regulation and supervision of hedge funds and introducing registration of credit rating agencies.

## OPPOSING PROTECTIONISM

In the Great Depression in 1929, countries put their own interests first. They expanded trade barriers, devalued their currencies, and quickly moved towards protectionism. The result was a shrinking world economy. It also led to World War II.

In the current crisis, we must firmly oppose protectionism. The leaders reaffirmed this resolution at the summits in Washington and London, and this fact is very significant.

## A NEW GROWTH STRATEGY

It is also important for us to move forward in creating a post-crisis economic growth strategy for the medium to long term.

Over the last decade or so, the world economy has enjoyed high growth against the backdrop of two things. One is the expansion of global imbalances between the trade-surplus countries and the trade-deficit countries. The other is the excessive credit and excessive consumption in trade deficit countries.

The current financial and economic crisis urges us to reform our economic structure and to search for a new balance. Adjustment of the world economy is indispensable.

In this context, it is no longer realistic for Japan alone to return to a growth trajectory that depends on export of traditional goods. I have announced Japan's new growth strategy, called "Strategy to Create the Future." This strategy presents the postures towards which Japan's industries should aim.

In this strategy, I set three goals. First, Japan should use its technologies to lead the world in a low carbon-emission revolution. Second, Japan should be a global pioneer in creating a society of vitality, good health, and longevity. Third, Japan should exercise its "soft power," including in such fields as animation, computer game contents, and fashion.

By 2020, Japan will make concentrated public and private investments towards these goals. We will also take bold systematic reforms.

## THE GROWTH OF ASIA

It is also necessary for the world economy that Asia grow robustly, as a center of growth open to the world.

I have proposed a “Growth Initiative towards Doubling the Size of Asia’s Economy.” This is based on the viewpoint of “trans-border growth in Asia as a whole.”

We will strengthen Asia’s growth potential and expand its domestic demand. We will do this by creating a Comprehensive Asian Development Plan for regional infrastructure.

For instance, now it takes two weeks by ship from Ho Chi Minh, Vietnam, to Chennai, India, through the Strait of Malacca.

But the two weeks can be reduced to 10 days if a road from Ho Chi Minh to the Andaman Sea is developed. If the time spent in crossing borders, such as customs clearance, is shortened, the 10 days can be further reduced to 8 days.

Another example: In India, by connecting Mumbai and Delhi with a freight railroad corridor, distributing time between the two cities can be shortened from 10 days to only 3 days.

We will also increase consumption by improving social institutions, such as by creating social safety nets.

To do this, I announced that Japan is ready to provide ODA of up to about US\$20 billion and trade insurance at a scale of US\$20 billion to support Asia.

## EXPECTATIONS TOWARDS THE TRILATERAL COMMISSION

We can certainly overcome this crisis. And, at the same time, we should interpret this crisis as a window of opportunity for the next era. History shows us that when we overcome a crisis, a new order is created for greater development and prosperity.

Distinguished members of the Trilateral Commission, may I conclude my remarks by expressing my high expectations for forward-looking and constructive discussions at this Tokyo meeting. I will be thrilled to hear from you intellectual inputs with rich insights as you have always demonstrated in this commission.

*Taro Aso became the 59th prime minister of Japan in September 2008.*

# I

RESPONDING TO THE  
GLOBAL ECONOMIC CRISIS



## **The Global Financial Crisis: The Road Forward**

*By April 2009, the world economy seemed to be stabilizing after a gut-wrenching financial crisis that originated in the United States and rapidly spread around the world. Many observers sensed that the crisis was starting to drive fundamental shifts in the world financial system, but it was still unclear how these changes would be manifested. In this context, three leading figures from Pacific Asia, North America, and Europe gathered to reflect on the lessons to be drawn from the current crisis. Toyoo Gyohten, who was then serving as a special advisor to the Japanese prime minister; Gerald Corrigan, who had played a key role in US banking regulation as head of the Federal Reserve Bank of New York; and Rudi Bogni, a former UBS executive, debated the root causes of the current crisis and the reforms that would be necessary to prevent future crises.*

*TOYOO GYOHTEN*

ONE CRUCIAL ASPECT of the current financial crisis is its strong relation to several structural and fundamental problems in the world economy. The current crisis has exposed and hastened these problems in various ways. Thus, we need to keep a longer and broader perspective while dealing with the crisis.

I will briefly touch upon four problems. First, how should we anticipate the evolution of the current global imbalance structure and how should we adapt ourselves to these changes? For many years, household consumption has been the main engine of American growth, contributing 70 percent of its GDP. Robust consumption was financed by the rising market values of housing and equities and by easy credit. The consumption induced imports and resulted in a growing current account deficit. The US current

account deficit reached almost 7 percent of its GDP, and the external debt accumulated to trillions of dollars. Global imbalances became the order of the day. Many economists reckoned that the situation was unsustainable and predicted the collapse of the dollar.

However, doomsday has not arrived. Rather, exporting countries enjoyed surpluses, which boosted their economies. Surplus countries invested their dollar receipts in US Treasury bonds, keeping US long-term interest rates low and enabling the United States to consume more. It looked like an ideal world. Alas, the current crisis has broken this happy cycle. All three pillars that supported US household consumption have collapsed. Consumption is forced to decline, and exports to the United States also dropped. The process of adjustment implies that the global imbalances will be moderated, at least for a while. The question is whether the world economy will find a new equilibrium at a lower rate of growth or whether it will succeed in generating new demand and thereby achieve a better savings and investment balance at a higher level of growth. Success in this area will depend on each economy's efforts to develop a new growth model, even at the painful cost of internal restructuring.

Second, what will be the future of the financial service industry? The important lesson we have learned from the current crisis is that the role of finance has expanded too much. Indeed, an abundance of liquidity, coupled with sophisticated financial engineering, has created a whole array of exotic financial commodities, and new markets and new players came along with these.

Certainly, the age of finance brought about new income and new employment. Many people welcomed the arrival of the age of the new economy. However, in hindsight, there was excessive leveraging, excessive risk taking, and excessive greed. Now that the financial bubble has burst, corporations and households are struggling to deleverage; regulators are calling for a structured supervision of the financial industry; and politicians and the media, on behalf of the public, are demanding the crucifixion of financiers. Many financial institutions have been nationalized or quasi-nationalized. All in all, the landscape of the financial service industry has undergone a tremendous change as a result of the crisis.

Now, where do we go from here? Will traditional, relationship-oriented commercial banking come back as the mainstream while the activities of investment banking, hedge funds, private equities, and others are subdued? The pendulum that swung to the extreme of deregulation has clearly reversed its movement. Will it move to the extreme in the opposite direction, namely, re-regulation? Will the trend of global banking shift

toward home-market banking, encouraged by financial protectionism? How can we reestablish the minimum level of moral standards in the financial service industry? Can we accomplish this by education or do we need policing and punishment? These are some of the issues upon which we need to form our own views.

Third, how will the international monetary system evolve, or more specifically, what is the future of the current *de facto* dollar standard? It is obvious that the dollar will remain the key currency for the world in the foreseeable future. The simple reason is that there is no other currency that can replace the dollar now. The international value and influence of a currency is determined by the aggregate power of the issuing country, including its economic, military, diplomatic, technological, cultural, and—very importantly—ideological power. It also needs a market that functions as the currency's international financial center. The dollar took over the role from the pound sterling at the end of the World War II and Wall Street replaced the City as the world's financial center. Now, the dollar has no apparent contender.

The worrisome thing, however, is that the hegemonic power of the United States has suffered a considerable loss during the past decade. The growing current account deficit stirs up global uneasiness. The mishandling of geopolitical issues, particularly in the Middle East, has seriously hurt the credibility of the United States as a global leader, both at home and abroad. Some of the emerging economies, particularly the BRICs (Brazil, Russia, India, and China) together with the oil-exporting countries, have enhanced their economic and political presence and become more vocal in global affairs. The current setback of the American financial industry has dealt additional blows. Thus, the leadership of the United States has become less secured, creating a rather uncomfortable situation for the world. When the leader's authority starts to wane but there is no credible successor, the inevitable outcome is increased instability in the international financial situation. Will the dollar be able to regain its strength and credibility? We need to start to prepare for what will happen in the event of US failure.

Fourth, how can we reduce and reverse the ominous trend of protectionism? The global credit crunch and the global recession are inflicting serious pain upon businesses and households around the world. Voters and politicians can easily unite in campaigning for protectionism in areas including production, trade, finance, immigration, and intellectual property. Globalization is no longer viewed as the financier, but it is now viewed suspiciously as something that brings benefits to the privileged but evil to

the underprivileged. However, we should understand that we cannot stop globalization unless we cut off all means of communication and information. Protectionism, which tries to block the natural flow of value, would distort the sound mechanisms of the world economy and create enormous damage for all.

Now, let me conclude with a brief comment on the Asian situation. When the current crisis became a serious issue in the spring of 2007, many Asians did not expect it would hit them immediately and directly. Asian financial institutions as a whole were not dealing with securitized financial instruments as actively as their counterparts in American and European markets; thus, Asians thought that the collapse in the prices of such instruments would not have a devastating impact on their balance sheets. Also, during the last two decades, Asia made significant achievements in building up an integrated supply chain within the region. Networks involving the vertical division of labor made Asia one whole production center for consumer goods. Intraregional trade and investment grew to reach the level of NAFTA and the European Union. The Asian economy was thought to have become relatively independent from the United States and Europe.

This is why the argument of decoupling was popular with some Asian economists. However, it did not take long to discover the fallacy of this argument. Indeed, Asian holdings of subprime-backed loan instruments were not too large, but when the collapse spread to all kinds of securitized commodities, Asia was certainly not immune. Also, when the credit crunch hit the world and American and European investors and lenders pulled back their money, Asia was one of the major victims. More importantly, although Asia as a region became an integrated production center, the end buyers of the production were outside of the region, namely, the United States and the European Union. The collapse of demand in those markets dried up orders with Asian manufacturers. The 1997 Asian crisis was caused by the large inflow and then the large outflow of short-term capital, but during that crisis, Asia could recover from the crisis through the strong expansion of exports to the United States and the European Union.

It is ironic that Asia has to suffer again from the volatile fluctuation of outside demand. Asia saves a lot but its savings have to be invested in foreign assets, notably in US Treasury bonds, because Asia still lacks efficient, large, stable, and liquid financial markets and financial institutions of its own. Asia produces a lot, but its products have to be sold outside of the region because Asia lacks adequate domestic demand to consume the products. Thus, with the 1997 crisis and the current crisis combined, Asia

has learned a serious lesson, namely, that Asia has to endeavor to become more self-reliant, both in finance and in the real economy. In a sense, this was the silver lining of the crisis.

There is no question that Asia has enormous potential. Countries like China and India have huge populations with unsatiated demand, while countries like Japan have matured but own a large amount of investable financial assets and have advanced technology in the areas of environmental protection and energy conservation. The critical challenge now is how to aggregate this potential into a workable regional arrangement. Evidently, obstacles are in abundance. Competing national interests, rivalries, and even competition and all sorts of divergences need to be addressed. It is, indeed, a daunting historical challenge. Yet, I would argue that the stumbling block that Anglo-Saxon capitalism hit in the current crisis must have valuable lessons and also encouragement for Asia.

One thing that is clear is that after the current crisis, the world will never be the same. The United States will change, Europe will change, and Asia will change. It is evident that globalization was the most important undercurrent as the current crisis developed. However, we have to recognize that globalization is a process, it is not a value itself, and in the world of finance during the last two decades or so, many new values were created and people enjoyed them and even worshipped them.

Part of the problem with the current crisis is that some of the values that have spread all over the world through globalization were rotten. The popular criticism against globalization is not really against globalization itself; it is against some of the globalized values. The burst of the bubble in 2007 was an event in which those rotten values perished. We are all suffering through the crisis; yet, through the process of recovery, we need to distinguish which values have perished and which survive. When we try to rebuild global finance, it is certainly necessary that we have a new set of regulations, institutions, market infrastructures, commodities, and players. But, it is equally important that we have a structure built upon a new set of durable values.

*Toyoo Gyohten currently serves as special advisor to the Japanese cabinet and special envoy of the prime minister. He is also president of the Institute for International Monetary Affairs and a senior advisor for the Bank of Tokyo-Mitsubishi UFJ.*

## *E. GERALD CORRIGAN*

It is common for observers to note that the events of the past 20 months or so are widely seen as—and it is often stated this way—the worst since the 1930s. But, I submit to you that were it not for the wholly unprecedented scale of central bank and governmental intervention over this time period, I suspect we would be able to drop the qualifier and we would not be saying “the worst since the 1930s,” we would be saying “the worst of the worst.”

It is in that context that I propose to do two things. The first is to try and distill the underlying causes of the events of the past 20 months. Now, we all recognize that the housing bubble, particularly in the United States, was the practical cause. But the underlying causes are much more complex: 1) global macroeconomic imbalances; 2) systematic mis-pricing of credit risk over a long period of time; 3) leverage in its many forms, some of which are extraordinarily complex to even begin to get one’s arms around; 4) weaknesses in the infrastructure of the global financial system, the plumbing of the system if you will; 5) the unmistakable evidence of severe shortcomings and failures in risk management in the private sector and official oversight in the public sector; and last, but certainly not least, 6) distorted incentives, which, of course, is where the compensation issue comes into play.

Second, against the backdrop of those half a dozen fundamental or underlying causes, we can categorize the lessons that we either have learned or should be learning from this unhappy chain of events into five groupings.\*

## MACROECONOMIC POLICY

Public officials in general, and monetary authorities in particular, cannot ignore the potential damage growing out of large-scale asset price bubbles.

Persistent and sizeable global imbalances in trade and current account positions—and their implications for capital flows—are unsustainable even if the channels for adjustment are difficult to anticipate. When the adjustment is accompanied by pervasive excesses in the credit system—as was the case leading up to the crisis—the likelihood of a long and painful adjustment increases geometrically.

---

\* What follows is the last section of a paper presented at the meeting, the full text of which can be found online at [www.trilateral.org/AnnMtgs/PROGRAMS/o9tokyopdf\\_folder/Corrigan\\_financial\\_crisis.pdf](http://www.trilateral.org/AnnMtgs/PROGRAMS/o9tokyopdf_folder/Corrigan_financial_crisis.pdf).

Sustained periods of abnormally low nominal and real interest rates in the face of broadly satisfactory patterns of macroeconomic performance will, inevitably, contribute to the tendency of financial markets to overshoot.

Perceived structural changes in macroeconomic “laws of nature” regarding potential growth, inflation, and unemployment are often exaggerated or, even worse, illusory.

The specific timing and triggers of systemic financial shocks having macroeconomic and macro-financial implications are, and always will be, virtually impossible to anticipate, thus requiring ongoing initiatives to strengthen the “shock absorbers” of the financial system so as to be in a stronger position to contain and manage such shocks when they occur.

## FINANCIAL SYSTEM

In the United States (and elsewhere) the sharp rise in the size of the financial sector relative to GDP and the even sharper rise in profits generated by the financial sector should have been recognized as prominent “red flags” that all was not well.

In comparing, from a distance, the large integrated financial institutions in the United States and Europe that experienced major financial problems with the relatively few such institutions that escaped the worst of the crisis, it seems clear that aggressive appetite for risk taking and acute shortcomings in management (broadly defined), not differences in business models among such institutions, were at the root of the problems.

Weaknesses in financial “infrastructure”—the plumbing of the financial system—were of critical importance in amplifying systemic risk.

Disclosure practices across wide segments of the financial system are seriously compromised by “information overload” that is importantly driven by concerns about litigation and regulatory risk. Moreover, even under the very best of circumstances, it is extremely difficult even for highly sophisticated professionals to digest and assimilate information about contemporary financial practices and institutions. In other words, the case for enhanced transparency is overwhelmingly clear, but this goal also requires greater clarity and simplification.

The emergence of classes of large and often powerful “near banks” altered the dynamics of the overall financial intermediation process in ways that have substantially complicated the channels through which contagion risk elevates systemic risk. Thus, as a matter of public policy, near banks must be the subject of some higher degree of official oversight. One result

of the near bank phenomenon has been the emergence of a credit system with multiple classes of participants with differing interests in workouts and restructurings.

## INDIVIDUAL FINANCIAL INSTITUTIONS

The precepts of sound corporate governance that require direct and continuing participation of the highest levels of management in the risk management process and the absolute independence of critical control personnel are essential prerequisites for stability that were not always adhered to.

While it is self-evident that failures in risk management occurred, it is equally obvious—and perhaps more important—that failures in the basics of risk monitoring also occurred.

Regardless of the point in the business or credit cycle and regardless of the accounting methods used, the “art” of valuation and price verification requires a huge commitment of highly skilled and independent personnel. Accounting practices, including fair value, were not a major cause of the crisis but were contributing factors to the amplitude of the credit cycle. At the worst point in the crisis, it was apparent that investors had lost confidence in financial reporting amid concerns that loss recognition on the part of some financial institutions appeared to be subject to elements of uncertainty. Looking forward, care must be exercised to ensure that efforts to modify accounting policies and practices do not fall victim to the law of unlimited consequences by further undermining confidence in financial reporting.

All parties to the development and use of high-risk structured credit products—including the rating agencies—failed to perform sufficiently rigorous credit and potential loss diligence in a setting in which various forms of leverage were either not understood or were given insufficient weight. Structured credit products such as CDOs [collateralized debt obligations], CLOs [collateralized loan obligations], and their derivatives created a condition in which even relatively modest adjustments in market conditions produced large losses which in many cases will not be reversed by subsequent recoveries.

More than a few individual financial institutions did not fully appreciate the dynamics of the relationship between capital contingencies and liquidity contingencies in circumstances in which liquidity disintermediation did result in de facto insolvency even in the face of seemingly adequate capital.

## SUPERVISORY POLICY AND PRACTICES

As a matter of both policy and practice, the focus on the public policy goal of enhanced financial stability must be elevated so that we can better understand and anticipate contagion and systemic “hot spots.” While the approaches adopted to achieve this objective will vary from country to country, central banks must play a major, but not necessarily exclusive, role in this effort. Under any circumstances, it will be very difficult to articulate the mandate of a “systemic supervisor” and even more difficult to execute such a mandate.

In the United States, and perhaps in other countries as well, regulatory restructuring is seen as a necessary element of the effort to strengthen financial stability—driven prudential supervision. While necessary, restructuring is not a sufficient condition for success. What is also needed is an alteration of the philosophy of prudential supervision in the direction of a much more principles-based—as opposed to a rules-based—framework of supervision. While some rules are necessary, more emphasis needs to be placed on case-by-case judgments concerning the ability of major institutions to withstand severe shocks. The recent work of the Senior Supervisors Group is an excellent example of a constructive shift in both supervisory philosophy and practice.

More effective prudential supervision will also require substantial additional resources with particular emphasis on highly skilled, experienced, and well-compensated personnel.

Enhanced cross-border coordination of prudential supervisory policy is obviously needed but will be very difficult to achieve in practice, in part, because in the future, issues concerning sovereign prerogatives will command even greater emphasis.

There are areas such as capital and liquidity in which simplified and yet more rigorous minimum standards must be developed as a single integrated discipline.

## THE LEGACY OF THE CRISIS

The necessary and unprecedented scale of central bank and government intervention—particularly in the United States—triggered by the crisis brings with it material medium-term risks of higher inflation and a persistently larger role of the government in economic and financial affairs that threatens to crowd out private investment and, worse, private initiative.

For this reason, it is not too early to focus considerable and realistic attention on the specifics of exit strategies that will wind down these official interventions as circumstances permit. On the central bank side, exit strategies will—to an extent—be relatively easy because elements of the rise in central banks' balance sheets will be self-liquidating over time.

At least in the United States, the wind-down of double-digit deficits and federal spending levels relative to GDP that are well in excess of long-term experience will be extraordinarily difficult to achieve even as growth returns. For a period of at least the next several years, the welcome rise of the personal savings rate will be more than offset by the significant rise in government dis-savings, thus leaving the United States with a continuing and large negative savings rate.

The understandable political backlash of the crisis directed at Wall Street brings with it an element of concern that badly needed reforms could result in regulatory overkill that might compromise the financial intermediation process in ways that could undermine long-term economic performance.

As a result of the crisis, the long-standing leadership position of the United States on economic and financial affairs has been badly damaged. While this setback is likely to be at least partially reversed over time, the setback will complicate further the already complicated task of strengthening international economic and financial policy coordination.

*E. Gerald Corrigan is chairman of Goldman Sachs Bank USA. He formerly served as president of the Federal Reserve Bank of New York.*

## *RUDI BOGNI*

The pilgrim asked the farmer, “How do I get to Rome?” And the farmer responded, “I would not start from here.” That is how I feel and how most people involved with the management of the crisis feel. However, as a finance sector practitioner, I believe there are a number of questions that have not been answered in the past few months. Worse, many have not even been determinedly asked. I will put to you a few of them.

First of all, is Basel II dead or alive? Basel II is in my view a deeply flawed regulatory environment. It was knifed in the back in October, but nobody

has certified its death and nobody has named its successor. Assets are being valued today in derogation of IFRS [International Financial Reporting Standards] rules that make it difficult to compare them. So, how should we compare them? What is worse, how should we compare liabilities when, in some environments, liabilities are devalued and, in other environments, they are not devalued?

Competition rules were also killed, namely in the case of Lloyds TSB and HBOS in the UK but also by government intervention in other countries. Do we still believe in the rule of law and the assertion that competition rules should apply? Or should they not apply?

There are other questions. Rating agencies—were they victims? Should they be helped? Or were they culprits and should they be assisted in redeeming themselves?

We heard for a month or more about the troubles with the monoline insurance companies. We heard about recapitalization and investments, but nobody hears anymore, nobody reads anymore, about the monolines. Are they safe and sound, or are they not?

Fannie Mae and Freddy Mac were clearly instruments of Congressional policy. Are they private institutions? We clearly don't know what they are at the moment. And how can one deal safely on a contractual basis with something when one does not know whether it's a private institution or an instrument of Congressional policy?

And more fundamentally, we all realize that leverage was a big problem that caused the crisis, but why should government leverage be in any way more virtuous than private leverage? Somebody ought to explain that to me.

We all believed we had put Marx to bed, but it seems that we did throw away Marx with the bathwater in two particular respects. In terms of what happens to profits in a competitive environment, we all seem to have forgotten in recent decades that profits should tend toward zero as competition works. And yet, we all expected return on equity for banks to reach 25 percent. Something did not make sense. Either we did not have competition, or our expectations for returns on the financial services industry were totally mad.

Another important aspect concerns the Western world. We have a strange situation in the Western world where the replacement cost of unskilled human labor is negative. It costs us to keep alive unskilled labor because we can easily, cheaply, at zero cost, import it from third world countries. So something is eminently wrong in the economic political infrastructure of our Western world, and the financial crisis was I think in a sense a consequence of what is wrong with that.

I sometimes despair when I hear some superannuated economist rediscover the concept of banking as a utility, a financial utility. We have been saying for ages that banking is a financial utility, but what does that mean? An electrical utility, you will teach me, is based on redundancy. If you don't have redundancy of capacity in the broad network, you have blackouts. And yet Basel II did exactly the opposite. It took out the redundancy from the financial services industry. So how can we blame the practitioners for taking advantage of a system that allowed them to print money when it was set up that way? I believe that Jamie Dimon's letter to shareholders on the 23rd of March 2009 was very enlightening to those trying to understand the crisis. The problem is that the press did not give as much coverage to it as to many other crazy ideas that are being floated. I believe that we have to remove the theological baggage to find a way forward.

This idea about unified supervision—I think it is total madness. We have had unified supervision for banking, at least at the big bank-sector level. Has it helped us? Not very much. I believe in competing supervisory environments, with smart regulators who can kill the arbitrage possibilities as soon as they see them, but not jumping all on the same boat to the point that then it collapses and it sinks. I have to laugh about this fixation with offshore financial centers. The problem is not offshore centers; the problems are the fiscal policies of major governments. And what is more, it is hypocritical when we all know that the biggest offshore financial centers are London and New York.

One big question is whether we can live without leverage and that, I think, is key to deciding the way forward. And the way forward is really a political decision, not only at the government level but also at the level of individual citizens. The management of liquidity for me is the fundamental key to the solution and to the way forward. The fact that the management of liquidity globally has been subject to strong political wishes not to have bad news in my view has contributed substantially to engendering the crisis. But the more important thing is the leverage. Can our Western democracies work without leverage? I maintain that they cannot, that the political promises that have been made can only be maintained by a high level of leverage as long as somebody funds that leverage. So, I maintain that it has been the Chinese workers and the Indian workers who have been financing our leverage and have allowed us to pretend we can keep the promises we made.

Going forward, I believe that the realignment of asset values and liability values to their cash flow potential is essential unless we want to generate the next bubble simply by fending off this crisis. I think we have to exorcise a

lot of demons if we want to go forward and exit the crisis. But I do believe that the financial crisis was fundamentally a symptom of a deeper political crisis. In other words, what do we want to be as modern civilizations and what can we afford to be?

*Rudi Bogni was CEO of private banking for UBS and currently serves as senior independent director of Old Mutual, chairman of Medinvest International, and member of numerous corporate and philanthropic boards.*

## **Future Directions for Global Economic Recovery**

*The crisis that rocked the world financial system in the autumn of 2008 was rapidly transmitted to the real economy and, by spring 2009, growth rates had plummeted throughout the world. Edmond Alphandéry, former French economy and finance minister, related how the crisis hurt the European Union, while also noting that it created several opportunities to strengthen the role of regional European institutions. A leading Chinese academic, Zhang Yunling, explained how China's economic dynamism has managed to help cushion the blow to other Asian countries. Meanwhile, Luis Téllez, chairman of the Mexican stock exchange, described how trade served as the transmission mechanism to spread the crisis to Mexico and cautioned against overly political and protectionist intervention in the market. The session was moderated by Deryck Maughn.*

### *EDMOND ALPHANDÉRY*

I WILL FOCUS my remarks on the European Union and the crisis. This global systemic crisis requires public decision making at two main levels: the state level, because only governments have the political legitimacy to levy taxes and decide public expenditures; and the global level, because what is needed most is cooperation and cohesion among countries around the world. This is what the April 2nd G20 meeting was for.

This explains why there have been so few initiatives by European institutions for European members themselves. I think that there are good arguments for better use of regional-level institutions and that this crisis is an opportunity for the European Union itself to deepen ties among its members.

Let me start by sketching out a quick picture of the current economic and financial situation in Europe. Despite the recent flurry in the stock exchange and the so-called “green shoots” of recovery, I do not think that there is much room for optimism in Europe, at least for this year. Industrial

production is plunging in Europe, and unemployment is on the rise as world trade growth has plummeted.

The transmission mechanisms of the financial crisis have played with different intensities on the various European economies. We can, therefore, observe discrepancies among the countries. The German economy is paying a high toll in the crisis because of its high sensitivities to the world trade collapse, and other countries like the UK and Spain feel the pain of highly depressed housing markets.

It was clear during the preparations for the last G20 meeting that views across the Atlantic concerning policy proposals for addressing the crisis were not converging. The fact that the countries of continental Europe feel reluctant to adopt large fiscal stimuli rests on strong economic arguments. Their high levels of public and social expenditures act as more powerful automatic stabilizers than is the case in the United States. Also, as the IMF points out, such “fiscal stimuli are more effective with moderate debt levels ... Countries with debt levels of 60 percent or more of GDP should expect no benefit from fiscal stimuli.” This is because European households will expect higher taxes to be necessary to fund the soaring public deficit and therefore will raise their rate of saving.

There are also some discrepancies on the monetary front. Although the monetary authorities have all put in place lax monetary policies, central banks acted not only through their policy rates but also by expanding their balance sheets. This impressive move was made necessary by the huge increase in demand for base money by the banks during the second half of 2008 and the decrease in the velocity of the circulation of money by the public at large. It is crystal clear that the central banks are anxious not to repeat the US Federal Reserve’s mistake of the 1930s when it did not foresee the dire consequences of its refusal to adjust the monetary base to the needs of the economy, leading therefore to the deepening of the crisis.

There is an explanation for the discrepancies in the conduct of monetary policy across the Atlantic. The banking sector is playing a greater role in continental Europe than in the United States in providing credit. Securitization is much more developed in America. At the European Central Bank (ECB) Council, even though the debate is currently open, mainstream members are reluctant—at least for the time being—to accept a zero interest rate policy and quantitative easing. While the US Federal Reserve and the Bank of England alike side-stepped the banking sector with programs of acquisition of private and even public bonds, the ECB embarked on non-conventional measures through the banks by supplying them with unlimited amounts of liquidity at a fixed interest rate.

Another difference across the Atlantic is visible in the treatment of “toxic assets.” While the US administration clearly favors public-private partnerships and market mechanisms and is reluctant to nationalize banks, European authorities are putting in place a bank-by-bank approach and are ready, if necessary, to take significant public stakes in their capital, even to the point of their nationalization.

Now, what could the contribution by the European Union institutions be to a solution to the crisis? We first have to acknowledge that European leaders and the European Union presidency quickly realized that the global crisis needed a consultative approach at the global level, and they deserve credit for their role in calling for the last two G20 meetings.

Even as we search for answers to the current crisis, the European Union may claim credit for some of its past achievements. After all, the euro prevents euro-zone member states from competitive devaluations, which were common practice in the pre-euro period. Without the euro, we would surely see the threat of competitive devaluations coming back. We also created a single market that aims precisely to create a level playing field for European firms that is free of any protectionist measures and obstacles to competition. The European Union deserves credit for these achievements at a time when the worst danger the world is facing is the temptation of protectionism. However, the European Commission has not been at the forefront since the start of the crisis, and few initiatives have been taken for the member countries as a whole by the European Union institutions.

My own feeling is that we should probably make better use of the European Union-level institutions to tackle some aspects of the crisis. Four topics come to my mind where the European Union could bring added value.

The first is removing toxic assets from the bank balance sheets. If there is any consensus among economists, it is that we need coherent and comprehensive action to restore functional institutions’ balance sheets before there is any hope of a sustainable recovery. In this respect, I think that the European Union should assist in the national cleanup of member states, not only because cross-border banks have a transnational dimension, but also because one of the duties of our European institutions is to avert breaches to competition.

The second is the regulatory environment. We have an opportunity to enhance the European framework to help ensure European financial stability. The de Larosière report suggests the creation of a European Systemic Risk Council for macroeconomic supervision and a decentralized European system of financial supervision for micro-prudential supervision. Let us

hope that we will be able to overcome “beggar-thy-neighbor” national approaches and make the choice to seek an “enhanced, pragmatic, sensible European cooperation for the benefit of all.”

The third is the Eastern and Central European emerging countries. When one looks at the issue of financial stability in the world, one should not overlook the regional dimension, especially for Europe. Europeans should be more involved in the search for better financial stability in the countries around the euro zone. Initiatives such as balance-of-payments facilities, macro-financial assistance, and bilateral swap facilities should be encouraged.

Last but not least, there is the issue of macroeconomic cooperation. This is an important issue because global macroeconomic imbalances are the underlying cause of the crisis. What is needed at the global level is reallocation of demand from countries with current account deficits, mainly the United States, to countries with structural excess supply like China or Germany. We have the same problem of macroeconomic cooperation within the European Union itself: between Germany and France and between Italy and Spain, among others.

Will the crisis be the catalyst for a more stringent political framework to enforce macroeconomic discipline among member states? Some believe that such expectations are not politically realistic, but it is important to keep in mind that the European institutions were born after World War II precisely to avert any new crisis between the European countries. Each advance in our institutions has been triggered by the necessity for the European Union countries to face crucial issues collectively. This current crisis gives us the opportunity to further enhance the regional level of governance in Europe.

*Edmond Alphandéry is the chairman of CNP Assurances, Paris. He formerly served as the minister of the economy and finance of France.*

## ZHANG YUNLING

I want to focus on three points: 1) the current crisis, 2) the Chinese economy, and 3) the Asian economy. Concerning the current crisis, I think that we all understand that the financial and economic crisis first started as a subprime

credit crisis in the United States, quickly spread to the financial sector and by contagion to the wider US economy, and then expanded from the United States to the global level.

This crisis is actually a reflection of a long-term accumulation of global imbalances. We have witnessed the imbalance of the real economy and the virtual economy, the imbalance between production and consumption, and the imbalance of financial innovation and supervision. This crisis touches upon the basic structural problems of global economic development.

Concerning the Asian economy, the main effect has been to real economic growth. There are big differences as compared with the 1997 financial crisis. In 1997, problems in the regional financial sector spread by contagion to the real economy. Yet, the recovery of the regional economy seemed to occur more quickly than expected because outside demand was still very strong. Most of the Asian economies quickly accumulated trade surpluses and improved their currency exchange and financial sector situations.

However, the current crisis in fact stems from declining external demand, so the declining trend will probably last longer than expected. For the Asian economy, future growth may come instead from internal demand, so Asia will need to enact large structural changes in its economic growth model in the future.

Similar to the other Asian economies, Chinese economic growth has been seriously affected by the declining demand. This appeared to occur very suddenly for China because in the first half of last year, Chinese macroeconomic policy still focused on cooling the economy to control inflation. But, in the second half of the year, Chinese leaders suddenly had to “warm up” the economy to prevent deflation.

The government responded to this shift very late. I think that the Chinese government and many of the economists did not realize the severity of the impact of the crisis on the Chinese economy. The government started to lower interest rates in September but only by a small margin. It was not until December that the government introduced its first large stimulus package. Due to double-digit rate declines in foreign trade from November onward, Chinese industrial growth has exhibited a substantial declining trend for five consecutive months.

This crisis further demonstrates the problems of Chinese economic growth. In the past 10 years, the high Chinese economic growth rate has increasingly relied on external demand. For example, the share of exports in the economy increased from 30 percent in 1998 to 60 percent in 2008, while the internal consumption share dropped from 45 percent to 36 percent in the same period. Of course, this was not the fault of Chinese

policy because, due to the restructuring of the regional economy, foreign direct investment increasingly moved to China. China became a center of production assembly—based on cheap Chinese labor and its potential markets—for Asia and for the world.

However, there were large structural problems in this model. We realized this before the crisis, but it was not as urgent until now. The recent policies enacted by the Chinese government have had some positive results already. The GDP growth rate was down to 6.1 percent in the first quarter of this year—compared with 6.8 percent in the fourth quarter of last year—but from February through March there has been an improvement. For instance, industrial production in March increased by 8.3 percent, fixed investment capital increased by 28.6 percent, retail sales increased by 15.9 percent, and both exports and imports increased in March as compared with February. Within the first quarter GDP growth rate of 6.1 percent, internal demand contributed 4.3 percentage points, investment contributed 2 percentage points, and foreign trade contributed -0.2 percentage points. We see that internal demand, stimulated by government policy, played a role in keeping the Chinese economy growing.

However, Chinese economic recovery still faces two major problems. One short-term problem is the continuous need for stimulative policies to increase internal demand in order to prevent further economic downturn and secure a reasonable growth rate. It seems that this aim can be realized. The Chinese government promised an 8 percent GDP growth rate, though there are some more pessimistic predictions that only 7 percent is possible. It appears that there will be an even higher growth rate next year.

The main problem in the medium and long term is that the Chinese economy needs a major structural change in order to create an internal demand-led growth model. China needs to increase its social expenditures, to increase the income level of its rural population, and also to enhance the capacity of Chinese enterprise and innovation. This process will take a long time. As I mentioned, this problem was realized even before the crisis and led to the adoption of some measures. Now that the pressure is much stronger, the outlook has gone from “need to change” to “must change.”

Finally, there is the issue of the Asian economy. The Asian economy still relies on external demand, and this dependency became even stronger after the 1997 Asian financial crisis. This is the time to think about possible changes, and in my view, Asia needs to undertake three major efforts.

The first effort is to further liberalize the market and to improve production factor mobilization. For instance, Asia must move as quickly as possible to establish an East Asia Free Trade Area.

The second effort is to strengthen regional cooperation to improve the regional infrastructure network. For instance, regional leaders have already agreed to set up a regional investment fund, to which the Chinese government has contributed US\$10 billion. This regional infrastructure network can improve the development foundation and environment, especially for the less developed economies.

The third thing the region needs to do is to strengthen regional financial and monetary cooperation in order to integrate the regional system with the international system. It is a positive sign that the region is ready to establish a monetary system based on the Chiang Mai Initiative network, but this effort is not enough.

Lastly, I would like to speak about the role of the Chinese economy. I think that Chinese economic growth is playing a very positive role in supporting regional economic growth. The Chinese market has already become the first, second, or third largest market for most of the regional economies. Chinese imports from the region have increased sharply in February as compared with January, which is a positive factor for the region.

More efforts are needed in Asia. We are living in a globalized world and the Asian economy will continue to be interdependent with other parts of the world, so we need to increase our internal mobility and strength. And, Asia needs to support gradual and stable reform of the international system rather than any sudden, big changes.

*Zhang Yunling is a professor at the Chinese Academy of Social Sciences (CASS) in Beijing and serves as the director of the Academic Division of International Studies of CASS.*

## *LUIS TÉLLEZ*

I will speak briefly about what led to the current economic and financial crisis, the response of policymakers both on the monetary and the fiscal fronts, and the effects on globalization. I will also draw some parallels to the Great Depression and to what happened in Mexico during the 1995 crisis.

It is clear that what precipitated the current crisis was a downturn in home prices that led to large losses among banks and other financial institutions

as well as among households. From the macro side, a disequilibrium was created due to an unprecedented growth in the assets of emerging markets that financed the US current account deficit. Given the integration of financial markets, this has had an impact over the rest of the world beginning with Europe.

The transmission mechanism has also been through trade. This is a balance sheet recession precipitated by a financial crisis that has been synchronized across the globe. There has been a drastic drop in consumption, a halt to lending, and a fall in the net worth of households. To replenish balance sheets, savings—which were 1 to 2 percent of GDP in the United States—have increased to around 5 percent. Given that there is still uncertainty about home values, that equity markets are still around 40 percent below their peak values, and that income has decreased and unemployment has increased, it will be difficult to replenish balance sheets in the short term. This negative wealth effect will have a protracted effect over consumer spending—which amounts to 70 percent of GDP—and therefore it is my impression that it will take time for the economy to recover.

According to the IMF and the OECD, this could be the longest and deepest recession since the Great Depression. In the Great Depression in the 1930s, GDP fell approximately 30 percent in four years and unemployment levels reached 25 percent. We have seen countries in Europe that are close to a 20 percent decrease in GDP or have already reached a 20 percent decrease, as is the case in Spain. In Mexico, we are seeing a decrease in industrial production that is faster than the one that we had in the 1995 crisis. Industrial production has decreased by more than 10 percent per month for the last two months and this rate of decline will probably increase.

The response from monetary and fiscal authorities has been rapid and extensive. Since August 2007, the US Federal Reserve has flooded the markets with liquidity, and other central banks have done the same. The ammunition of the monetary authorities is almost spent, and therefore they are moving to expand their balance sheets and to increase the number of lenders.

There has been extensive monetary policy coordination. For example, the Mexican private sector was able to participate last week in a dollar auction funded by the swap facility that the Bank of Mexico established with the US Federal Reserve. Liquidity is being provided across countries, which represents a very positive response from the monetary authorities.

On the banking side, I do have my questions. I think that the Troubled Asset Relief Program was too timid to solve any problems and that the public-private partnership put forward by the current US administration

will take time to be implemented. Authorities will have to wait to see what will happen with these public-private partnerships, which will have negative effects over the rest of the economy. The problem of undercapitalized banks will remain. It seems that ideology has played a part in not adopting an outright solution like the one used during the financial crisis of 1995 in Mexico. At the time, the government created a trust and cleaned up the balance sheets of the banks, which started lending again in 1996 once the economy recovered due to a large export boom.

During the Great Depression—as Schwartz and Friedman have brilliantly written—monetary conditions as a result of US Federal Reserve actions led to the depression. There was no international coordination, which led, just as one example, to the collapse of the financial system in the Austrian economy and other Central European economies. In the case of the 1995 Mexican financial crisis, the reaction was very fast due to the cleanup of the balance sheets. By 1996, banks were already lending again and the economy had recovered due to the boom in exports.

The fiscal response to the crisis has also been extensive and started with the Bush administration. I think that the current issue will be an execution one. In the Mexican economy, we started with a very extensive infrastructure program, which has been difficult to execute because it has been difficult to channel the fiscal resources. This process has also been slowed by a discussion in the United States as to whether this should be completed through infrastructure projects or through tax reduction.

There are also issues of fiscal sustainability. Debt-to-GDP ratios will increase to the highest levels since World War II. The debt comes not just from traditional fiscal expansion but also from the fiscal resources that have been used to save the financial system from collapse and—something that I have never seen before—from specific interventions to avoid the collapse of certain sectors such as the automobile industry. This is the case not only for the United States but also for other economies like the European Union and some Latin American economies.

One has to look back to the Great Depression and to the New Deal policies to understand that fiscal stimuli do have implementation problems. There is the case of the Civilian Conservation Corps during the Roosevelt administration, which faced severe execution problems. Policies were not consistent at that time and private investment was disincentivized due to political reasons. As a result of the New Deal and the cost of World War II, the debt-to-GDP ratio increased to over 100 percent. Due to economic growth, the debt-to-GDP ratio decreased from about 125 percent in 1946 to 50 percent in 1965 without having a significant impact on the economy.

In the case of Mexico, the bailout program came with a cost of 20 percent of GDP.

Trade has been decreasing at a faster rate than income. This has been due partly to disruption in trade finance through legal and formal restrictions.

It is difficult to undo the supply chains that have been established during the last 20 years. Manufacturing integration in automobiles and other durable goods between Mexico and the United States is a good example. Today's news that Chrysler is going bust is going to have a significant economic and political impact in Mexico. Protectionist tendencies surfaced in the US presidential primary last year, but they have dissipated. Whether we see a backlash against free markets will depend on the depth and the length of the crisis.

However, we are seeing nationalistic tendencies in many countries over different policies, like "Buy American," "British Jobs for British Workers," and in Mexico, "compra lo hecho en México." During the Great Depression, trade collapsed as the result of explicit trade policy restrictions like the Smoot Hawley tariffs, and it was not until the 1950s that these restrictions started to be undone through the creation of a multilateral trading system.

There has been a substantial amount of international policy coordination, and it has been profound in terms of financial and monetary conditions. However, the London summit did not produce important results except for the replenishment of IMF resources. The enhanced IMF facility has already been accessed by some countries like Mexico, which received US\$47 billion, and Poland, which is asking for US\$20 billion. China's role is very important in this matter.

Finally, the boundary between states and markets is an important issue to examine. There have been political issues that have arisen about the fairness of the whole process, and as a result the limits between the states and the governments are being discussed. Inequalities and the perceived unfairness of resources being funneled to financial activities are being questioned so that the free market fundamentals are currently under scrutiny. One has to remember that after the 1930s we had a redefinition in the role of the states based on the Keynesian intellectual construct, which dominated economic policy decisions until the Reagan and Thatcher years.

*Luis Téllez is a former Mexican secretary of communications and transportation. He currently serves as chairman of Bolsa Mexicana.*

## The Threat of Protectionism to Global Recovery

*Amidst fears that the global economic crisis might give rise to a new wave of protectionism, three prominent experts discussed the world trade agenda. Peter Sutherland, the first director of the World Trade Organization (WTO), lamented that the apparent failure of the Doha Round of trade negotiations had helped place the world in a situation in which defenses against protectionism have been weakened. Nonetheless, he and Susan Schwab, former US trade representative, agreed that there is broad consensus among world leaders that a return to protectionism should be avoided, and both held out some hope for the eventual resumption of moves toward more open global trade along the lines of the Doha Round. Narongchai Akrasanee, chairman of Thailand's export-import bank, argued, however, that there is little utility in focusing on the Doha Round and that, at least for Asian countries, the real key at the current time is to strengthen regional free trade agreements. The session was chaired by Barry Desker, dean of Nanyang Technical University's S. Rajaratnam School of International Studies.*

PETER SUTHERLAND

THERE HAVE BEEN two major phases in the development of multilateral trade negotiations. The first one was the original General Agreement on Tariffs and Trade (GATT), and that was essentially a dialogue among the wealthy, industrialized countries of the world. While there were many other member countries in GATT, they were largely disregarded in the sense that they were often allowed to retain trade restrictive policies, almost as a quid pro quo for geopolitical involvement on one side or another at that time. Two prize examples in my view are Egypt and India, which retained extremely protectionist policies throughout the period right up to the 1990s and some would say to a continuing extent after that time. This was often part of an implicit bargain in regard to political issues and global positioning on those political issues.

In the 1990s, we had the conclusion of the Uruguay Round negotiations that ultimately led to the creation of the WTO in 1995. That was the beginning of an enormous change that has been characterized in the context of globalization after the collapse of the iron curtain. We saw a general recognition that import substitution as a mechanism for economic development did not work, that the command economy did not work, and that the market economy essentially did work.

This general recognition was first signaled in a 1987 memorandum by the Chinese government to GATT. The memorandum explicitly and definitively expressed the view that China's experiment in terms of economic development had failed and that the successful development of China demanded an acceptance that competition was required in order to create efficiency and innovation. This recognition irrevocably changed the global economy as well as the politics of the world in a very fundamental way.

The negotiations that then took place led to the creation of the WTO, and the WTO was different from GATT in one very specific respect. It created a mechanism for judicial adjudication on trade disputes that could actually work. The previous mechanism required unanimity—in other words, the acceptance of the defendant of his own guilt—which was not easily achieved, as one might imagine. By January 1995, we found ourselves in a situation in which a golden period in the integration of the global economy, and arguably a golden period of political cooperation, was being achieved. The WTO itself became a lightning rod for this debate. You can all remember Seattle, Cancun, and the other demonstrations around the world arguing that the WTO and this multilateral negotiation mechanism was something that in some way damaged the interests of the poor in the global society.

This golden period of the 1990s and early in this century led to the creation of a global society, which we now wish to retain. The effect of it has been considerable. It has created supply chains that operate in a way that has never before in history been seen. Academic economists might argue that the period between 1870 and 1914 saw globalization of a kind, but it was nothing like this. Our interdependence became more and more apparent through foreign direct investment of very significant amounts, particularly moving between the developed world and China.

Then we were hit by the tsunami of the financial crisis. The effects of this are already evident. They have been evident in elections and in the debates that preceded the election of President Obama in the United States, when the Democratic Party made various interventions that suggested a degree of protectionism as an option that was being seriously considered. Public opinion also moved—for the first time in a very long period of time—decisively

in favor of protectionism against open trade both in the European Union and in the United States. This was a predictable reaction to the dislocation of recession. A Gallup poll in the United States demonstrated this, and similar polls in Europe disclosed the same direction. In Europe, protectionism was evident not merely in opinion polls but also in referendums. The French referendum, which rejected the European Constitution, arguably did not reject the institutional reform of the European Union but instead rejected globalization, Turkish accession to the European Union, and greater mobility of people through migration. It created, in other words, a clear perception within the European political clout that there were great difficulties in opening up to the world in one way or another.

Notwithstanding this, in the intervening period, the WTO contained and maintained a discipline in relations across the globe that even its most positive supporters did not believe would be possible. The dispute settlement mechanism, which is the court direction of decision making regarding trade, was called into question and used by the member states—of which there are now 154—very significantly to resolve disputes. It is particularly to the credit of the United States that the most powerful nation on earth was prepared to submit itself to an adjudication process that, while intergovernmental rather than supranational, could be portrayed as having an effect on national sovereignty. When Clinton was putting the legislation through Congress, I recall speaking, as WTO director-general, to Newt Gingrich—who was for a time apparently leading the opposition to the creation of the WTO—on this issue of sovereignty.

However, the United States not merely accepted but actually played a very positive role in creating the WTO and the dispute settlement mechanism that gave power to very small countries to take proceedings against the United States. It has consistently applied those rulings rather well and so, to their credit, have the European Union and the developing countries. For the first time since the inspired period of institution building that followed World War II, we created a mechanism for cooperation that went beyond rhetoric and intergovernmental meetings and actually involved decisions with real consequences reached objectively by a judicial mechanism. I think that this is an enormous step forward in global governance, with implications for various other aspects of intergovernmental relations, both political and economic.

There have been a whole series of steps taken around the world during the current economic collapse that have interfered with the purity of the decision making that took place in the Uruguay Round. The first aspect of that, which is rather more general than protectionist, is the issue of the

Doha Round. The Doha Round, which has been running since 2001, is one of these long-standing sagas like the Uruguay Round. It is reasonably ambitious but not enormous in its implications. However, it became a debate about development when it should never have been a debate about development. Development should have been part of it, but the idea that trade negotiations could be entirely one sided was never realistic and neither was it desirable. The failure of the developed countries to insist on a liberalization program globally in earlier decades was and is part of the reason for a number of major economies failing to grow for a very prolonged period of time. The liberalization that has taken place in the 1990s and the early parts of this decade has resulted in 1.5 billion people in developing countries being taken out of poverty.

The Doha Round failed or has failed to date. This is a blow, in my opinion, to the credibility of this fragile plant that has been created, and it is a serious blow, particularly at this time. I think the players who were involved in the final failure included in particular India, China, and the United States. Looking at the debate from the outside, I would have to say that India has had particularly great difficulty accommodating the need for liberalization. It is happening and I think that Prime Minister Singh is deeply committed to it. It is dangerous to point fingers, but I am not so sure that the trade negotiations were conducted in the same positive spirit. One could also raise questions about the understanding and involvement of China in this regard. I think it is very much in the interest of China and India to lead this debate rather than to be perceived as reluctant followers. The United States is also open to criticism in regard to the failure to conclude the agreement. I think that the Doha Round could have been concluded. I think that we were within a very small area of disagreement ultimately but that at the end of the day, political considerations, particularly in India with the forthcoming election, disrupted the conclusion of an agreement that was very much in the interests of the world as a whole.

Where are we now? We are now in a situation in which our defenses against protectionism have been weakened. During the November 2008 G20 meeting, it was agreed that nobody would introduce further defensive or protectionist measures. Of the G20, 17 have introduced such measures in the interval. Tariffs are being raised around the world, and non-tariff measures, such as anti-dumping proceedings, have become far more prevalent than they were before. Some famous old mechanisms have been used to disrupt trade. For example, there is one well known to the French, who used to insist that all goods of a certain kind come through Poitiers. It is now the case in Indonesia that a series of products can only be introduced

through certain ports and airports. China has banned various goods for alleged safety reasons. It might surprise our Italian members that Italian brandy was included in that list, and it might surprise some of our British guests that some British sauces were also included. The European Union, for its part, returned to one of its favorite themes of the past—one particularly annoying to developing countries—by introducing new export subsidies for butter, cheese, and milk powder. Subsidies have been introduced in various parts of the world, not merely for banks but also in the area of car manufacturing. One can look to the United States in that regard and also to Canada, which matched those subsidies that were being permitted in Detroit. The list goes on: China, Argentina, Brazil, Sweden, and Italy have all introduced both direct and indirect interferences with trade.

Yet, there has been only limited evidence of significantly increased tariffs or non-tariff barriers. While we have had a very significant number of protectionist measures—such as the American Recovery and Reinvestment Act in its initial format until clear signals were given as to its unacceptability by the Obama administration—I think that my conclusion would be that we have not intellectually rejected in any way the conclusion that we reached in the 1990s globally that the market economy system is the only system that can provide for growth, innovation, and employment. I think that the United States in particular has played an important role in continuously reiterating its commitment to that principle of opening markets. In many ways, it was a leitmotif of the latter days of the last administration, and it has been maintained in the present administration in terms of the public positioning of the United States on these issues.

Today we are on the brink. If the tide of interference with the functioning of the markets continues and develops, then we could disrupt one of the most positive developments in modern economic history. If, on the other hand, the attitude identified at the meeting of the G20 in April is more than rhetoric—as I believe it actually is—then it would be wrong to conclude with a negative view. I do not believe that we are in danger of going over the cliff. I would love to see us concluding the Doha Round. I would like to see us reinforcing the instruments for multilateralism that are provided by the WTO. I think that at the end of the day there is a universal acceptance that we can never go back to the 1930s—to the Smoot Hawley Tariff Act and to the disruptions that led to so much harm to mankind. I do not believe that we are going to take that negative step.

*The European chairman of the Trilateral Commission, Peter Sutherland was director-general of GATT and the WTO.*

## NARONGCHAI AKRASANEE

I am going to make basically two points and then I will elaborate on these two points. The first is that we are now seeing export order shortfalls and credit defaults in East and Southeast Asian economies. These are, in fact, more serious problems than the impact of trade protectionism as of now. The second point I will make is that the regional free trade agreements (FTAs) in East and Southeast Asia could help lessen the impact of global recession and open more opportunities for intra-regional trade in East Asia.

It is obvious that the Asian economies have relied on exports as the main engine of growth for many years now: the newly industrializing economies since the 1960s, ASEAN since about the 1970s, China since the 1990s, and Indochina since the late 1990s. This global trade liberalization occurred first through GATT and now through the WTO. I would like to emphasize that the exchange rate policies of weak currencies have made export-led growth policies very successful in East Asia. This has happened because of two consenting adults agreeing to do the same thing: the United States and the European Union willing to buy and buy and the East Asian economies willing to sell and sell and forever accumulate foreign exchange reserves.

We have two things happening at the same time. We have the production network organizers forever organizing cheaper products for the Western markets, and we have investment bankers always organizing better returns for financial products and forever seeking commission. I was myself a production organizer and also an investment banker at one time. I used to ask my friends, "What is our mission in life?" And my friends said, "Our mission in life is commission." So I continued selling more financial products. This explains exactly what we are seeing today.

Looking at the performance of the East Asian economies, I think it can be agreed that progress has been made in all areas. In fact, some infrastructure in Asia is now much better than in the European Union and the United States. I think those who have traveled through East Asia can agree with me that what they see here in this area is much better than what they are familiar with in Europe and the United States. We can say that the third world has become the new world, whereas the European Union and the United States are becoming the old world.

However, the export-led economy of East Asia is now turning from being the big solution for development to the big problem of development at present. I think this is because of the pattern and the structure of our exports.

Exports by the developing East Asian economies have been concentrated in three main markets: the United States, the European Union, and Japan. The share of exports to the United States, the European Union, and Japan from ASEAN used to be 47.4 percent of ASEAN's total exports in 1995 but has fallen to 32.7 percent in 2007. The share of exports to the United States, the European Union, and Japan from East Asia used to be 46.2 percent in 1995 but has fallen to 35.1 percent in 2007. Yet, these numbers do not tell the full story. If one adds indirect exports—particularly through China or through other countries in the region—the exports of East and Southeast Asian countries, not including Japan, to the United States, the European Union, and Japan account for about two-thirds of their total exports. This is the reason why the slowdown of export orders from the United States, the European Union, and Japan has become a problem.

Now, is this due to protectionism? As of today, I have seen no evidence of the real impact of protectionism on our export performance. I think that everyone is a sinner in this case. Both developed and developing countries are coming up with measures that are considered protectionist. It is interesting to note that for developed countries, there are many new subsidies, but for the developing countries, protectionist measures are mainly about trade barriers and trade protection. This is understandable because advanced economies are supposed to have a lot of money, and so they can subsidize. Developing countries, not having as much, cannot subsidize as much. Nevertheless, I think both sets of measures can be considered examples of the rising trend of protectionism, even though their impact on export performance in East and Southeast Asia is still not felt as of today.

From the last quarter of 2008 to the end of this first quarter, every one of us has been seeing exports falling at an average of about 20 percent, which is significant by our standards. The problems seem to be about the inability to pay and the inability to order, so we are now coming up with a number of measures to help exporters—export insurance being one, buyer's credit being another—and we thought perhaps that these trade credit facilities discussed at the G20 meeting in London, by way of the IMF or other organizations, should be very useful. I am from the Export-Import Bank of Thailand. In Asia we have these export-import banks, which are now setting up "buyer credit facilities" among themselves so that their customers can rely on export-import banks for their buyer's credit for the time being. This is only an interim measure, but we hope that it will help our exporters.

Turning to another emerging aspect, I believe that the global financial crisis will have an impact on intraregional trade in Asia. I raise the question, could FTAs in East Asia help? People who subscribe mainly to WTO

principles may not like the idea of regional and bilateral FTAs, but in East Asia we have many FTAs. This has been a major source of my employment in the last decade as I have done studies on all of Thailand's FTAs. It is unfortunate that we pay little attention to the WTO, but in Asia we have AFTA, the ASEAN Free Trade Area, now almost fully functioning, and by the year 2015 we will have a community, for which we have already signed a charter that is now in effect. Services are being liberalized much faster than I had thought earlier. For example, professionals are now able to move more freely among ASEAN countries.

At the same time, we have ASEAN agreements with China, Korea, Japan, and others that have already been put into effect. The Japanese have FTAs with individual countries as well as with ASEAN as a whole and they are all functioning very well. We are already seeing trade expand because of these FTAs. As far as the India-Thailand FTA is concerned, it has been working so well that India may have to put the brakes on it, saying "please slow down Thailand; you are selling too much to us."

What this means for people in the region is that they now have better incomes because of the globalization of trade liberalization policies. They have more income and they like the products that we produce and sell to each other. When I hear about Japan putting more emphasis on building infrastructure for trade in East Asia and when I hear about China increasing its spending on infrastructure for East Asia, I think these trends will all lead to increased East Asian trade and production networks.

I would very much like to see greater multilateralization of existing regional and bilateral FTAs, and for that I would like to see the WTO dispute settlement mechanism included in the FTA practices in East Asia. We now have more disputes among us, yet the dispute settlement mechanism is still not properly functioning. While they are taking a vacation from the Doha Round—I think sometimes it is a waste of time to complain and lament about the Doha Round taking too long—perhaps experts from the WTO could come and help us make our FTAs work better. If that is the case, I think we could expect to see growing intraregional trade in East Asia that could help lessen the impacts of the global economic recession on our economies.

*Narongchai Akrasanee is chairman of the Export-Import Bank of Thailand. He has served in various public and private capacities, including as minister of commerce and as a member of the Thai Senate.*

*SUSAN SCHWAB*

I am going to address three topics: 1) global prospects for protectionism, 2) the Doha Round, and 3) the current state of US trade policy and trade politics with the Obama administration.

While I am somewhat alarmed by what I see, I am by no means panic-stricken. If one looks at the drop of trade flows that has taken place, and it has indeed been dramatic, it is almost entirely attributable to a drop in demand, as distinct from protectionism and even as distinct from a drop in trade finance.

However, I am concerned that we will roll back some of the gains that we made in the 1990s in terms of trade liberalization and in terms of attitudes about trade liberalization. The enemies of trade liberalization, who have been there all along, now have additional ammunition to use, whether it is in the United States, China, the European Union, or India.

Above all, I think we need to be concerned that we are not going to be able to harness trade as a means to bring us out of the current global recession, whereas we might have been able to do that under other circumstances. I believe that the G20 pledge has in fact been quite beneficial. It has been often quoted that 17 of the 20 G20 members that signed on in November have taken 47 protectionist actions. I should note that it is 17 out of 20 because we did not have data for the other 3. It is a pretty consistent pattern.

Yet even that initial “name and shame” exercise, which has become much more pronounced following the G20 meeting in April, had a real dampening effect. When leaders get together and say, “We’re not going to be protectionist, we’re not going to take protectionist actions,” and then discover that they are in fact doing it, or their legislatures or their bureaucrats are doing it, then they have to pay attention—particularly since they know that they are going to be seeing each other later on this year.

When talking about the kinds of measures that have been taken by different countries, the most serious measures have not been inconsistent with WTO guidelines. There is a real line that has been drawn between that which is consistent with the WTO and that which is not consistent with the WTO. Words do count here. Whether or not you are talking about new market-distorted measures, the WTO has in fact created a ceiling for protectionism.

It is extra-WTO actions that are the ones that are the most worrisome, the gray areas, such as export and domestic subsidies, various versions of industrial policy, accelerated use of anti-dumping and countervailing

duties, the creation of harassment tariffs in the name of combating unfair trade practices, and certain types of import licensing. Currency manipulation is in fact another form of protectionism in its broader sense, as are immigration restrictions, labor actions in terms of mobility of labor, and the SPS, or sanitary and phytosanitary measures, being used all around the world—for example with the European Union embracing the “precautionary principle,” whereby if one cannot prove that it is good, then maybe it is bad, and therefore it should be stopped. The net impact of these kinds of actions is a sort of negative slide but not a dramatic reversal of what had been a very strong and positive trend.

However, I think of more concern is the damage that all of this is having to forward momentum. The kinds of protectionist actions being taken are harder to undo than overt increases in tariffs, for example, or the imposition of quotas. They are much more insidious and much harder to combat, such as the kinds of protectionist amendments showing up in US legislation.

This leads me to the Doha Round. Fortunately, the Doha Round continues to inch forward. Unfortunately, it was in trouble from the day it was launched and it is probably in even more trouble today. I would say that the current situation gives us a window within which to step back and address some of the underlying flaws in the negotiating framework that precluded real forward momentum in the Doha Round and that allowed certain actors to ensure that we never got the kind of traction that President Bush and others, such as President Lula, really wanted to see. The impact of the Doha Round in the current circumstances is more psychological than substantive. Even had we reached a Doha Round modalities agreement last year, it probably would have been five to seven years before there was an actual impact in applied tariff reductions. Yet, there are elements of the negotiation that clearly are in our interest to move forward on an accelerated basis.

At the end of the day what brought the negotiations to a halt over and over again was the fundamental question: what is the responsibility of the advanced developing countries in the global trading system? This has implications, for example, for climate change and the post-Kyoto Protocol discussions. The advanced developing countries are very much at the table and in the inner circle of decision makers. Brazil, India, and China have as much say as the United States, the European Union, Japan, and Australia in that limited group of countries that were tasked with coming up with a package that our 145 other colleagues in the WTO could agree to.

Therein lies a question about the contribution to development that trade agreements make and how we differentiate between the most advanced developing countries and the less advanced developing countries. The Doha Round ultimately comes down to decisions being made by two dozen countries (including the European Union as one entity). This is a very finite number of countries.

But it suffers from a seriously, and perhaps fatally, flawed negotiation structure and has done so for a number of years. It is formulaic and, up until a year and a half ago, all the negotiations were about negotiating—not substance, but negotiations about negotiations. The formulas have so many loopholes in them that at any given point in time, no country actually knew what was on the table, so the assumption was that everything that one cared about on an offensive basis would be taken away by one's trading partners and everything that was most import sensitive was going to be damaged. Virtually every country came to the table in a defensive frame of mind, rather than looking at their offensive potential and the potential, globally, going forward. The fact that 153 countries have to reach consensus, and that nothing is agreed until everything is agreed by every country, permits one, two, or a handful of countries to hold the entire round hostage forever.

Finally, the complexity of the negotiations is such that even if and when the leaders say, "I want a Doha Round deal," they cannot deliver it because their ministers and bureaucrats are able to use the complexity to ensure that the deal does not come together. It is one of the ironies of the structure.

Beyond Doha, what are the implications of some of the bilateral and regional deals being negotiated around the world? I am more worried than I am optimistic about their potential. It is obvious why bilateral regional deals have moved ahead. They allow parties to negotiate around their sensitivities, they are convenient, and they allow them to avoid multilateral and sometimes enforceable objectives. It is really nice when two countries that are both import sensitive in agriculture get together and enter into an FTA because they do not have to do anything in agriculture. There are many exclusions, various flavors and qualities, and much unevenness in the FTAs that have been negotiated to date.

Yet, FTAs have been a vehicle for 1) getting agreements done that open markets, unlike the Doha Round up to this point; and 2) setting precedents in areas that are not covered by the Doha Round—such as services and investment, because even the most optimistic scenarios about the Doha Round would expect very limited impact on trade in services. With

FTAs, parties do not have to deal with the lowest common denominator, the country that does not want to do anything and that is spoiling it for everybody else.

Let me close with a quick commentary about American trade policy and politics. It is still evolving. There were bad signals during the campaign, but there have been some good appointments and there have been some more positive statements, most recently by my successor two days ago, about the Obama administration's trade agenda. Yet the picture in terms of actions is decidedly mixed. On the "Buy American" clause in the stimulus package, it took the administration a long time to come out and agree that it was a problem. They scaled it back but only to a certain extent. Other examples included the Mexican trucks issue, visa provisions in the stimulus package, and the secretary of energy's statement that the United States is going to need to impose a carbon tariff in the context of a cap and trade system. If one wants to point to perhaps the most dramatic and risky potential in global trade, it is on the environmental side, the potential in the cap and trade system for countries to decide that they need to make sure that their domestic industries stay competitive when these new restrictions are imposed; therefore, the price has to be laid off on their trading partners—the environmental excuse for protectionism.

I believe that the Obama administration would like to be pro-open trade in its outlook and activities. I think that may be mainly for foreign policy reasons, but whatever the reasons are, it is a good thing. However, they face major challenges. One is reconciling campaign rhetoric, and some constituencies would say campaign commitments, with open trade policy objectives.

Second, and most significant, is a huge split in the Democratic Party over trade. There is a knockdown, drag-out fight going on in the United States within the Democratic Party over where it should be on trade policy. What became very clear in the Clinton administration, and was most certainly the case in the Bush administration, was that if the president of the United States and the administration were not actively engaged, then there will be, at best, no protectionist actions but also no forward trade-liberalizing movement. We saw this in the Clinton administration with the efforts they had to undertake to get NAFTA and the Uruguay Round through Congress.

In the Bush administration, there were various FTAs that we moved through (14 to be precise), and 3—which mainly open markets for US exports—that the Democratic leadership in Congress refused to move. These include agreements with key allies and partners—Colombia, Panama, and

Korea. We also took the first dispute settlement cases to the WTO against China, settled longstanding cases with Canada over softwood lumber, and fixed domestic laws like the Foreign Sales Corporation and the Byrd Amendment when we lost the dispute settlement fights in the WTO. The test for the Obama administration will be how hard they will fight for a pro-trade agenda, because that will make the difference between being able to deliver on a pro-trade agenda or not.

*Until January 2009, Susan Schwab served as the US trade representative. She is currently a professor at the School of Public Policy of the University of Maryland.*

# II

THE ECONOMIC CRISIS AND  
REGIONAL COOPERATION IN ASIA



## Prospects for Regional Development in East Asia

*There has been a growing sense that Asia is occupying an increasingly important position in the international system; however, interstate cooperation remains nascent and Asia is remarkably devoid of strong regional institutions. In a session chaired by Harvard professor Joseph Nye, six of Pacific Asia's leading experts discussed various aspects of the effort to build a regional community. Jusuf Wanandi and John Hewson both focused on economics, with Hewson calling for the establishment of a regional investment fund and Wanandi arguing that renewed efforts must be put into strengthening transpacific institutions such as APEC, since strictly Asian institutions have failed to respond effectively to the financial crisis. Yang Jiemian and Rajiv Sikri, meanwhile, appealed from individual country perspectives for stronger regional cooperation. Yang explained that China wishes to be a good neighbor and partner to others in the region, and Sikri argued for an expanded understanding of regional community that embraces the growing role of India. For their part, Hitoshi Tanaka and Kim Sung-han focused on the various security threats facing the region, emphasizing the need for a multilayered and nested set of regional and subregional institutions to advance security cooperation.*

### *JUSUF WANANDI*

TWO QUESTIONS OF importance have to be raised in relation to regional developments in East Asia. To begin with, what is the impact of the economic crisis on regionalism in the Asia Pacific and East Asia? Also, what can regionalism do to solve the crisis? This is a global crisis and therefore the solution also has to be global, and the G20 is the appropriate forum for this. But, regional institutions are important as building blocks that give the G20 its legitimacy because they enable more countries to be involved, indirectly participate, and provide feedback, as well as disseminate the G20 decisions to the respective regions and their members.

The problem now is that existing regional institutions in the Asia Pacific and East Asia are not yet adequately equipped to deal with the crisis and to give support to the G20. The ASEAN+3 process should be the best-equipped forum because it has come about in response to the region's efforts to create self-help mechanisms to deal with a possible future financial crisis. However, this process has been slow. Already, in 2007, the ASEAN+3 finance ministers agreed to strengthen the Chiang Mai Initiative (CMI) by transforming the bilateral swap arrangements into a multilateralized CMI. In Beijing in October 2008, on the sidelines of the Asia-Europe Meeting (ASEM), the leaders endorsed that idea, but after six months of effort, this new fund of US\$120 billion is still only on paper. Even if it were to become operational, this fund alone would not be sufficient to help overcome the impact of the current global crisis in the region. What the region needs is to have sufficient funding that enables regional countries to undertake effective and coordinated counter-cyclical measures or stimulus packages.

It was unfortunate that the ASEAN+3 leaders were again unable to come together in the second week of April 2009 to step up and coordinate their efforts due to Thailand's internal political problems. But that was not the only problem. Even during the process to strengthen the CMI, through multilateralization and increasing its size, it was not easy to get the finance ministers to come together to forge an agreement on its operationalization.

This shows that East Asia is not really ready to move into practical co-operation when needed. And while it is fashionable to talk about the shift of economic power toward East Asia, as has been mentioned by Kishore Mahbubani, this region is not ready to take over leadership anytime soon. First, there is not enough trust among the big powers in the region. Second, it does not have the institutional structure and rules to do so. Third, the region does not have enough intellectual capacity yet to lead, even on regional issues, much less on global issues and global cooperation. East Asia might need two to three decades more to prepare itself for that kind of intellectual leadership and to lead both regionally and globally together with the other big powers such as the United States and the European Union. Instead, the new system of global governance will be based on the existing foundation of rules and institutions but adjusted to new challenges with the input of some of the leading countries such as those in the G20, including, of course, countries from East Asia.

APEC [Asia-Pacific Economic Cooperation] was also found wanting in the 1997–1998 Asian financial crisis. Since then, APEC has had a hard

time redefining its objectives to be relevant to the region. The reaction to the terrorist attacks of September 11 made it possible for President Bush to divert APEC's attention to issues other than the economy, such as antiterrorism and human security.

Since then, APEC has been looking for ways to recover from its malaise. First, East Asia should be an active caucus in APEC and should strengthen APEC, which can ensure US engagement in the East Asia region. Second, the APEC Summit should be led informally by a group of eight larger countries, the G20 members in the region, that also could deal with strategic political and security issues. This group could meet before the summit to define the objectives and analyze the trends in the region. These eight countries are the United States, China, Japan, India, Russia, Korea, Indonesia, and Australia. This suggests that India should be invited to become a member of APEC. Since this group is informal, it should not create too much of a reaction from the others. Since it would be based on an existing institution, this arrangement would prevent the region from starting all over again in its search for a new regional institution.

Also, since East Asia is an important part of APEC, the United States does not need to be directly involved in ASEAN+3 or the East Asia Summit, although the United States is seriously considering signing on to the Treaty of Amity and Cooperation.

In doing this, we are going to strengthen APEC, which is what everybody wishes for, as it is the only regional institution to cover both sides of the Pacific. It has the United States in its membership, and it has transpacific vehicles to work on financial and economic crises in the medium term. East Asia can work more directly with the United States through APEC. This is the right time to do so as the Obama administration is shaping US policy toward East Asia in a positive direction.

Having the members of the G20 from the Asia Pacific meet before the APEC Summit could fill a lacuna in the architecture of East Asia by involving the United States, and at the same time it could address strategic political and hard security issues as well.

APEC has a real chance for renovation because we do not yet have a transpacific group addressing financial issues that could respond to future crises. Transatlantic cooperation is already active with the existence of a strong European Union. East Asia has made some first steps with ASEAN+3's CMI, but a transpacific arrangement could be more effective in overcoming future crises.

However, such cooperation is not only meant to overcome the crisis but, more importantly, to respond to the medium- and long-term challenges

that the crisis has brought about, such as the need for structural changes, the creation of a social safety net, and the enhancement of the national resilience of each member country.

APEC is in the process of restructuring itself to have a more professional and enlarged secretariat. Furthermore, the three like-minded governments of Singapore, Japan, and the United States will lead APEC in the next three years to come, and Indonesia will chair in 2013, after Russia. As is the case in such regional institutions, the convener of APEC will play a leading role in the organization and its activities. PECC [Pacific Economic Cooperation Council] can support these efforts with studies, research, and networking. It can also contribute to a strengthened Asia Pacific region, and this year PECC will organize a large conference, together with the government of Singapore, to identify the issues that the region is likely to have to address in the next three to five years.

*Jusuf Wanandi is co-founder and vice chair of the Board of Trustees of the Centre for Strategic and International Studies in Jakarta.*

## JOHN HEWSON

First, I want to comment on the crisis from the point of view of the Australian experience, and second, I will make general comments about regional developments and regional prospects.

Australia went into this crisis better prepared than many other developed countries. In policy terms, we had a substantial budget surplus of about 2 percent of GDP; we had high official interest rates of approximately 7.25 percent; and we had a new popular and very activist government. In those terms, we were in a very strong position going into the crisis.

The government has already moved very quickly to introduce two stimulatory packages, and the budget will bring a third stimulatory package on May 12. These stimulatory packages had a fairly heavy concentration of cash payments to individual lower- to middle-income earners, either through the tax system or through the welfare system. Our exchange rate has come down from about 98 cents to about 70 cents due to several factors working in our favor.

However, our experience in the last few years was built around the resources boom—that is our bubble—and that has burst with the collapse of commodity prices. Although we had the best terms of trade in 40 to 45 years and we had an unemployment rate that was at a 30- to 35-year low, that situation is unraveling very quickly. While the stimulatory packages have been put in place quite decisively, they are only buying the government time in terms of the ultimate impact on the economy.

In fact, most commentators in Australia now say that our worst is yet to come and that our economy will actually slow down quite dramatically over the course of the rest of this year. We have already had one quarter of negative growth if one looks at aggregate GDP. The feeling is that we will now have several quarters of negative growth, even with the cushioning of the exchange rate, as commodity prices are negotiated down, export prices are negotiated down, and export volumes go down.

If one steps back from the Australian economy, one can see that the resources boom hid some significant structural problems. One was that our monetary policy has been misplaced and misguided for some time. The Reserve Bank raised interest rates rapidly to very high levels and kept them there too long with the expectation that they could bring inflation back within the target range of 2 to 3 percent. Inflation though, being driven by international prices rather than domestic cost and demand conditions, was not going to come down unless the global economy slowed down. We had interest rates pushed to 7.25 percent in official terms and held there for quite some time. We also had an inflation rate that rose to 5 percent, relative to the target range of 2 to 3 percent.

If one considers the resources boom in our economy, these high interest rates hit very hard and pushed some parts of Australia, especially the industrial base of Australia, into recession. Going back to the middle of last year, the non-farm economy was actually in recession. States like New South Wales, which are more industrial based than resource based, have fallen very significantly into recession, with unemployment levels now more than one percent above the national average. We had a two-speed economy: a resources boom driving parts of Western Australia, Queensland, and parts of South Australia; and the rest of the country suffering under very high interest rates. This has led to a large amount of tension that is unfolding right now and will be for the next several months.

In terms of stimulatory packages, as I said earlier, a large amount of the money was given by way of cash handouts. We have had two stimulatory packages of about five percent of GDP so far, a substantial part of which has been in cash handouts. But it is quite clear that not much of that was

actually spent. In fact, a fair amount of it was saved: US\$10 billion was put into the economy in the form of cash payments in the December quarter, and private sector savings rose by US\$15 billion in the same quarter. People have been using the money to repay debt, such as mortgages or credit cards, and reduce their exposure.

I think we are entering a very difficult period. The government has done a lot in terms of the banking system. It started out as a strong system: well capitalized, well managed, and very profitable. Only four major banks dominate the system, which is a pretty effective cartel. On top of that, the government gave a 100 percent government guarantee on all deposits, which allowed the banks to borrow offshore with the government's AAA credit rating. It set up specific banks or support mechanisms to deal with exposures in the commercial property market, and it has allowed the banks to borrow from the government at very attractive interest rates. Thus, the government has poured a lot of money into the banks.

The banks, on the other side, have not actually cooperated. They have not lowered interest rates as much as the official interest rates have come down, and in fact, for some business loans they have raised interest rates. They are certainly re-pricing credit or rationing credit. This is another source of tension. Although the rates have been reduced from 7.25 to 3 percent, there are still tensions from high interest rates—as 3 percent is still seen as fairly high—and the banks have rationed credit on top of that. This is a very significant challenge for the government going forward with a new budget coming in.

The important factor from now on in Australia is the pace at which unemployment picks up. It has gone from 3.9 percent to 4.7 percent so far in aggregate terms, and in some states to nearly 7 percent. The expectation is that it will rocket up to 8 or 9 percent very quickly. This will drive the political response from a government that won an election claiming to represent the interests of working Australians. I think that we are in for a very interesting time. We should do better on average than most countries in this crisis simply because we started from a better base and the government moved quickly, but the management from now on is going to be the determining factor.

The other thing I want to do is to make a couple of general comments. The first is that while there has been a large focus on recovery, I have to ask the question, “recovery to what?” Presumably we are not going to bail out the banks just to let them go back and do what they used to do. The kind of debt-based growth that we got used to was unsustainable in a debt sense and in an ecological sense as well. It is time that we think about a

new model coming out of this that we should be seeking to build. I would be looking for a lower carbon, low debt economic recovery, but I do not see a lot of focus on the nature of what that economy would look like. We have a very advanced debate in Australia about moving to an emissions trading system, but it is still a peripheral debate in terms of what sort of economy we should be moving toward. I would rather have low carbon factories than debt-based factories as the basis of our recovery.

In terms of regional development, there is quite an active debate continuing in Australia about the appropriate regional architecture from an Australian perspective. Our government has embraced the concept of a new Asian community, and we have had people traveling around the region trying to drum up support for that without a lot of success. We have a prime minister who speaks Mandarin and that is seen as a plus, except when he has gone to China on his overseas trips and excluded Japan, which was seen as a minus. There are a lot of sensitivities in terms of the nature of that debate.

From our point of view, an Asian regional grouping makes sense, and Australia would want to be a substantial player in that grouping. Whether it is APEC or ASEAN+1, +2, +3, or +6 is a very real debate, and I do not think that in these circumstances of a global crisis—calling for global responses—that we should spend a lot of time on that particular infrastructure right now.

My final comment is that there are two key focuses within the region. The first is to make sure that we persist with the process of trade liberalization and that we do not slide back to protectionism. Secondly, it is about time that we seriously looked at the development of Asian infrastructure and at the creation of an Asian investment bank. A lot of surpluses are generated in this region in China, Japan, and perhaps the Middle East more broadly. Infrastructure is a fundamental requirement to meeting the Millennium Development Goals and a fundamental aspect of pulling the region out of recession. I think there is an opportunity to think about how we might marshal those funds that are generated in Asia to the benefit of Asian infrastructure development.

There are many ways in which we could do that. We could expand the role of the Asian Development Bank so that it becomes a true bank rather than just an aid agency. We could also develop a new institution with the support of a fairly wide cross-section of the community in Asia. A number of countries have established sovereign wealth funds and are investing their money in particular ways to their own national interest, but it seems to me that there is a sense of community that would make it possible to

develop an Asian infrastructure institution or an Asian investment bank that could actually channel those surpluses to the productive base of the Asian economy.

*John Hewson is chairman of GlobalDC in Sydney.*

## YANG JIEMIAN

It is my pleasure and honor to share with you some of my personal perspectives on the prospects for regional development in East Asia, which includes both Northeast and Southeast Asia in geographic terms, plus two special actors, the United States and Russia.

### EVOLVING CONTEXT OF REGIONAL DEVELOPMENT

Compared with the past, East Asia is confronting new environments both inside and outside of the region. First of all, the ongoing global financial crisis and economic downturn has made most states in the region concentrate on domestic economic and social issues. Affected by the current crisis, most countries are struggling to overcome the difficulties and strive for an early recovery.

In addition, the financial crisis is also exerting a powerful impact on strategic thinking and political preferences. Most of the actors are showing pragmatism in combating the financial crisis and economic downturn as their first priority. All the major actors in the region—China, Japan, South Korea, and ASEAN—realize the necessity of the “three Cs”: consultation, coordination, and cooperation at the global level as well as at the regional level. The United States, under the leadership of President Obama, expresses its willingness to listen and cooperate with its East Asian counterparts as well.

However, East Asia obviously lacks sufficient and competent mechanisms to cope with the challenges of the times. The region is still wavering between the 10+3 formula and the East Asia Summit as the main mechanism for regional economic and political cooperation. From time to time, ASEAN is confronted with the instability of some of its member states, and the

Six-Party Talks on North Korea nuclear issues faces deadlocks and threat of termination.

Finally, while some perennial problems remain to be solved, some new nontraditional security challenges are looming larger. Maintaining peace and stability on the Korean Peninsula has always been a great challenge for the region and for the world at large. Maritime disputes among some regional countries have also become recurrent issues.

## TASKS CALLING FOR JOINT REGIONAL EFFORTS

With the pressing challenges of the financial crisis and economic difficulties as well as the mid- and long-term challenges of regional integration, East Asia should work together in the following aspects:

Firstly, East Asian countries should coordinate their domestic economic and foreign policies in order to overcome the current economic difficulties. In this time of globalization, the fiscal and monetary policies of the countries concerned are closely interconnected. The East Asian countries are in the same boat, and they need to adopt concrete and timely efforts in this spirit. As Chinese Premier Wen Jiabao recently pointed out at the Boao Forum, Asian countries should not only manage their own economies well but also join in efforts to make Asia an engine for global recovery. Each country's stimulative policies should not turn into energy-wasting and environment-damaging policies. While being cautious and prudent by not interfering with one another's internal affairs, East Asian countries should also take measures to promote social and political stability.

Secondly, East Asia should turn the present challenges into opportunities for enhanced inclusive regional cooperation. While we cannot be certain what exact changes will take place in the post-crisis era, we can expect the emergence of a multi-polar world and the need for strengthened regional cooperation in East Asia. Therefore, East Asia must prepare for this new situation by maintaining its characteristic way of building consensus through consultation, by consolidating and developing the cooperation in place, and by adopting an open attitude toward cross- and inter-regional cooperation. East Asia must find constructive ways to work with countries that show strong interests in regional development, such as the United States and Russia. More importantly, East Asian countries should map out their future frameworks of economic, political, and security cooperation as a component of system building the world over.

Thirdly, East Asia should work out a new consensus on regional leadership. In a time of globalization and regionalism, leadership takes a new form. It is no longer monopolized by any single country and can be divided into a collection of sub-leaderships in areas such as politics, economics, security, and culture. To match this new situation, partnership among the quartet of China, Japan, South Korea, and ASEAN constitutes an important core force in promoting regional leadership and responsibility.

Last but not least, East Asia needs to seek institutionalized cooperation with other regions. In this period of peaceful transition, East Asia can play a leading role in promoting changes in the international system, together with other regions. For instance, East Asia should make full use of existing mechanisms such as APEC, ASEM, and the East Asia–Latin American Dialogues. In addition, China, Japan, and South Korea need to coordinate their cooperation with other regions, especially with Africa. East Asian countries should also participate more proactively in defining and designing future cooperation with other regions as well as in the global system.

Looking ahead at the prospects for East Asia in the next decade and beyond, we propose the following five principles and specific measures. Firstly, multilateralism and open regionalism should be the basis for future developments. Secondly, East Asia should develop strategic targets and roadmaps for the post-crisis system and the regional order. Thirdly, East Asia should work on institution- and mechanism-building measures to cope with transnational problems. Fourthly, East Asian countries should gradually shift from issue-driven cooperation to target-oriented cooperation, including on values and cultures. For instance, the principle of “non-interference in internal affairs” should be closely observed while means of “constructive persuasion” are explored. Finally, measures should be taken to encourage the development of civil society.

## CHINA AND THE FUTURE OF EAST ASIA DEVELOPMENTS

1. *Constructive interaction between China and East Asia is needed.* China’s interests in East Asia are consistent with East Asia’s overall interests, and the interactions between China and other East Asian actors are characterized by constructiveness and complementarity. Firstly, China plays an active role in various multilateral mechanisms in East Asia while continuing to develop bilateral relations with East Asian countries in the form of strategic partnership. Next, the major fields of interaction between China and other

East Asian actors have extended beyond economics to include security, diplomacy, and culture. Furthermore, China places increasing emphasis on institutional construction for East Asian cooperation. Finally, China is joining other East Asian actors in the exploration of the most effective approaches for overall Asian integration. Meanwhile, problems still exist in the interaction between China and other Asian actors, including concerns about potential instability in the regional order as a result of China's rise, anxiety about China's future status and role in Asia, disagreement on the solutions that China has proposed to settle territorial issues, and worries over the negative effects of the vast scale of China's trade and personnel flow abroad.

2. *China should further develop its strategic thinking on East Asia's future in an open manner.* The Chinese government has so far published policy papers on Europe, Africa, and Latin America but not yet on Asia or East Asia. The following is only the views of a Chinese scholar. In my humble opinion, on the basis of good-neighborly friendship and common development, China's chief objective in East Asia is to "build up a cooperative and co-progressive community," that is, with the joint efforts of all relevant parties, to create a favorable environment for China's modernization, construct effective mechanisms for the common advancement of various regional interests, enhance comprehensive regional security, foster common values in keeping with the characteristics of the times, and develop a more just and equitable regional order so as to push forward the establishment of "East Asian Community."

Specifically, China's strategic goals in Northeast Asia are to resolve the problems left over from the Cold War, maintain subregional peace and stability, and construct more effective economic and security mechanisms. In Southeast Asia, China aims to consolidate and strengthen its bilateral and multilateral cooperation with the relevant actors.

Concerning the relevant great powers, China's chief objective is to develop a mutually beneficial relationship on equal footing while further strengthening its positive, cooperative, and comprehensive relationship with the United States and advancing strategic and mutually beneficial relations with Japan. In addition to strengthening its strategic partnership with ASEAN as a whole, China should also further promote a comprehensive partnership between China and Vietnam as well as strategic partnership between China and Indonesia.

The general conditions are conducive to China's East Asia strategy, as evidenced by the rapid increase in its national strength, the successful

implementation of its policy of “Good Neighborly Friendship,” and the favorable environment and the growing regional cooperation mechanisms in Asia. At present and in the future, China needs to convince its East Asian neighbors that the emergence of China poses not threats but opportunities, not only by words but also by deeds. This is not an easy task, but I think that China will eventually fulfill this historical task with flying colors.

*Yang Jiemian is president of the Shanghai Institutes for International Studies.*

## RAJIV SIKRI

I would like to start with the issue of what constitutes “East Asia.” There is Northeast Asia, Southeast Asia, and then there is the East Asia Summit concept. Given the scale of the problems, we should get past these geographical limitations. We need wider cooperative frameworks if we are even to begin to try to resolve the enormous problems that confront the world. Every country brings to the table certain strengths, be it finance, natural resources, markets, or managerial and other technological skills. Given the logic of globalization and the acceptance that there is no decoupling in East Asia, we have to work together to get out of the present crisis.

I want to emphasize that we need a wider East Asia Summit framework, for want of anything better, rather than an ASEAN+3 framework. The trade aspects are the first important matter. Although the G20 agreed in November that there should be no protectionist measures, I do fear that we appear to be losing momentum, if we have not done so already, in the WTO multilateral trade negotiations. Reviving the trade talks will be the first challenge. The role of regional trading arrangements will also have to be squarely addressed because—while a multilateral rules-based system is the ideal one—even today a large percentage of global trade takes place outside the WTO framework. It is in East Asia that most of the regional trading arrangements are in force. Considering that Asia is a very dynamic and growing market, there is a special responsibility before Asians to see what contributions they can make toward resolving this crisis. The East Asia Summit, which has been twice postponed now, could be a principal forum to address this crisis. There is also talk about a Comprehensive

Economic Partnership for East Asia and the Pacific. We need to develop these ideas a little more.

In addition to the strengths of East Asia, I would like to focus on some of its weaknesses too. Some of these are geographical weaknesses. Looking beyond the major economies such as China, Japan, Korea, ASEAN, India, and Australia, we have to consider the following: how do we envisage a cooperative and stable framework unless we factor in difficult issues like North Korea, Myanmar, and—in South Asia—Bangladesh or Pakistan? We should not forget these countries as we consider what to do about regional cooperation, because it is going to be impossible to plan for regional cooperation ignoring these real issues.

One other issue that I would like to address is energy. East Asia may be experiencing rapid economic growth, but where is it getting its energy from? It is getting its energy mostly from Russia and the Gulf region, so in looking at the future of East Asia we cannot forget West Asia.

A second forgotten issue is water. Any reengineering project or river diversion project is going to create havoc. As it is, countries like India, Bangladesh, and the Southeast Asian nations are very worried. The glaciers are melting in Tibet and in the Himalayas. This is not a national problem but is something that we have to collectively think about. The fact that a particular geographical area forms part of a particular political unit today does not take away from the reality that hundreds of millions of people are dependent on an existence based on these rivers that has evolved over centuries. That existence could be in jeopardy, which would constitute not just a human but also a security problem.

A third issue is terrorism, with which we are all very familiar. Even with the best cross-national enterprises, how do we tackle it collectively without pretending that, depending on who the target is, there are some terrorist groups who are “good” and others who are “not so good”?

Then, finally, of course there are maritime security issues. All of us are linked by the oceans, the Indian Ocean in particular, so we must think collectively on how we can ensure security.

We need to look at some ideas for global economic stimulus. A focus on infrastructure is a very good idea from an Indian perspective. India is looking at several possible investments in infrastructure. If there is a lot of cash in Asia looking for a home, infrastructure is an area that could generate additional demand that could stimulate the global economy.

A second area of opportunity is in infrastructure projects that are connected with energy in the Eurasian space. These projects, such as pipelines, could transform this incipient “great game” under way there to a win-win

situation rather than a zero-sum game. We need to focus more on generating domestic demand as opposed to export-led growth. A country like India is quite important in this respect.

Finally, there are many challenges for India arising out of the fact that we are at the intersection of four arcs. The first is the arc of prosperous Asian countries. The second, to our west, is an arc of instability from India up to West Asia. The third is the arc of energy, which goes from the Gulf through the Caspian Sea up to Siberia. The fourth is the arc of communications in the northern Indian Ocean.

We need to see how to harmonize the contradictions of these arcs. I can do no better than to suggest that what we need is leadership and new thinking of the Obama kind. This is a moment in which we should realize that leadership is not just about military and economic issues. It is also about ideas. It has to do with ethics and morality. While we wring our hands about the financial crisis, if there is one word that describes why it happened, it is greed.

*Rajiv Sikri is a former secretary of the Indian Ministry of External Affairs. He also formerly served as the Indian ambassador to Kazakhstan.*

## HITOSHI TANAKA

I would like to talk about two immediate issues and one long-term issue. The first immediate issue is the need for a Japanese Obama. I would like to see more proactive diplomacy on the part of Japan and stronger political leadership in Japan. We all know that the general election is to be called in five months. Some people talk about the possibility of a May election, but most believe that the election will be called after the summer.

I have no convincing basis on which to speculate about which major party, the Liberal Democratic Party (LDP) or the Democratic Party of Japan, will win. One thing that is quite clear in my mind is that the LDP is going to lose its overwhelming two-thirds majority in the Lower House. This will make the Japanese political situation more complex because the LDP will not be able to use the two-thirds majority to enable legislation to be passed in both houses—even if it wins a majority of the seats—since the majority of the Upper House is now held by the opposition party. The

time will come when there will be some type of realignment of political parties or a grand coalition or partial coalition. What is important now is to consolidate strong political authority so that we can produce more proactive diplomacy and proactive policies. I am absolutely sure that within five months Japan will produce a more solid political authority.

The second immediate issue I would like to talk about is the question of North Korea. We all know that North Korea launched a missile, but I am very pleased that the international community has been able to produce solidarity in the form of the UN General Assembly president's statement which condemned the launch of missiles on the part of North Korea.

Having said that, we should not rush to war with North Korea. In the meantime, let us sit back and try to consolidate solidarity among the five parties: the United States, Japan, South Korea, China, and Russia. Having negotiated with North Korea for many years, I am convinced that North Korea will come back to the Six-Party Talks eventually, though it may take time and may be a bumpy process. Solidarity among the five parties concerned would be the best guarantee for us to make sure that North Korea will come back to the Six-Party Talks.

My second point is that we need to prepare for various scenarios. In particular, three countries—the United States, Japan, and South Korea—should be developing our thoughts in a discreet way in relation to a regional contingency plan against a possible irrational movement on the part of North Korea. Preparation would be the best guarantee against any irrational movement by North Korea.

Third, when North Korea comes back to the Six-Party Talks, there is a very strong need for the United States, South Korea, and Japan to have simultaneous and parallel negotiations with North Korea under the umbrella of the Six-Party format: the United States on the question of denuclearization of the Korean Peninsula; South Korea on a better North-South relationship; and Japan on the various issues that we have, including the abductions, economic cooperation, and normalization of our relationship with North Korea.

These three countries have different agendas, but these different agendas need to be negotiated by the parties concerned. I would like to call for three separate yet simultaneous parallel negotiations to take place under the umbrella of the Six-Party Talks. I am sure that North Korea will come back to the Six-Party Talks, so it is important to be ready for it. When we sit with North Korea in the Six-Party format, we need to be prepared for future scenarios to ensure that a comprehensive resolution will eventually be attained.

Third, I would like to talk about the issue of East Asian community building. We all know that East Asia is going to be, and already is, the center of growth for the world. We would like to see a stable East Asia and we would like to see stronger growth in East Asia, yet we need to acknowledge that the region has substantial problems. If one looks at China and India, there are issues of income disparity, political freedom, minority rights, the environment, and energy efficiency, among others. There is a strong affinity for growth, but at the same time we have huge problems to deal with. In order to address them, it is time for us to talk about substantive cooperation, rather than organizational issues such as the exact membership of the nations who would be involved in what we call “East Asia.”

There is a need for three substantive issues to be addressed in a very serious way in the region: 1) confidence building, 2) further East Asian economic integration, and 3) the question of nontraditional security issues.

First, to deal with the issue of confidence building, we need to utilize a trilateral format because the bilateral format sometimes does not function as well as it could. I would strongly urge the US government to join us in the establishment of a trilateral dialogue among the United States, Japan, and China. The United States and Japan have strong worries about future Chinese military capability, so it is time for us to talk about real confidence-building measures among these three nations.

Second, there is the issue of further East Asian economic integration. I would like to see the multilateralization of the Equal Partnership Agreements (EPAs). I would like to base this multilateralization on existing free trade agreements. Including the 16 countries of the East Asian Summit would create the best result for the multilateral EPAs.

Third, there is the question of nontraditional security issues. It is time for us to begin action-based cooperation in relation to such issues as disaster relief, counterterrorism, and counterproliferation of weapons of mass destruction. The Proliferation Security Initiative is a good exercise, but we must establish something that is inclusive of China, India, and other nations. I would like to see a stronger movement toward substantive cooperation on the question of nontraditional security issues, and for that we need the United States, because the United States has the largest military assets in the region.

*Hitoshi Tanaka is a senior fellow at the Japan Center for International Exchange in Tokyo. He formerly served as Japanese deputy minister for foreign affairs.*

*KIM SUNG-HAN*

I will focus on Northeast Asia within the context of East Asian regionalism. If one looks back at the history of Northeast Asia over the past three decades, economic integration was growing, but political cooperation remained stagnant. Indeed, the region's political cooperation has traditionally lacked formal, multilateral, and regionally exclusive institutions, thereby producing a so-called "organization gap" compared with Europe, the Americas, Africa, and even the Gulf region.

In this vein, we need to explore ways to construct a peace and security mechanism in Northeast Asia from an eclectic perspective that takes both realism and historical institutionalism as its epistemological basis. From the realist point of view, the European experience tells us that the precondition for formal institutions is great power balance. Such a balance has never been enduringly present in Northeast Asia, due to the complicated geopolitical relationships among Russia, China, Japan, and the United States, which make it difficult for regional organizations to emerge. Here we need to pay keen attention to who will play the role of power balancer, which is most likely to be the United States in terms of its geopolitical power and geographical distance from Northeast Asia.

Historical institutionalism, on the other hand, focuses on the determining role of preexisting organizational structures. In other words, new institutions are a function of prior institutional settings. If we follow the suggestion from historical institutionalists, it is necessary to keep the Six-Party Talks moving forward so that its setting may become the foundation of a Northeast Asian peace and security mechanism. A continuing leitmotif of the Six-Party Talks is the prospect that a resolution of the North Korean nuclear problem could set the stage for more institutionalized and enduring multilateral cooperation in Northeast Asia.

MAKING TRILATERALISM WORKABLE AND  
SAVING THE SIX-PARTY TALKS

There is a considerable likelihood that the Obama administration will engage in multilateral efforts to restore the US leadership role in East Asia. Moreover, with the recent improvement in China-Japan relations serving as a backdrop, Washington can also be expected to strengthen the cooperative structure by linking it to other strong powers, especially the

US-China-Japan three-way relationship. From the South Korean perspective, we do not oppose this kind of three-way “great power” cooperation, but the formation of such a cooperative three-way structure could create a situation in which Korea finds itself excluded from the formulation of key decisions, particularly related to the future direction of the Korean Peninsula. Again, we need to revive the Six-Party Talks, despite the North Korean declaration to withdraw, because the ultimate foundation for the Northeast Asian security cooperation mechanism would be the Six-Party Talks framework.

Against this backdrop we need to consider several points. First, a Northeast Asian peace and security mechanism should be seen as a supplement, rather than a substitute, for the system of bilateralism in the region for a considerable period of time. Bilateralism and multilateralism, even trilateralism, are not mutually exclusive concepts.

Second, Northeast Asia should reinforce the forging of a credible sub-regional CSBM [confidence- and security-building measures] mechanism. Examples include greater transparency in force modernization and enhanced coordination regarding nontraditional security threats.

Third, a “Northeast Asian Peace and Security Mechanism” should be pursued in a way that is consistent with and conducive to progress on the North Korean nuclear problem. A charter for a Northeast Asian Peace and Security Mechanism that emphasizes multilateral security cooperation and non-aggression could be used by North Korea to legitimize its nuclear power status. As long as inter-Korean relations remain unstable, real peace and stability in the Northeast Asian region will be remote.

Fourth, US attention toward Asia must be restored. It seems to me that the United States prefers so-called “Asian Pacific” regionalism to East Asian regionalism because Asia Pacific regionalism does not exclude the United States and the other Pacific countries such as Canada, Australia, and New Zealand.

Finally, China should create an image of the champion of East Asian regionalism plus, not minus, which means that China needs to go beyond East Asian regionalism to engage other Pacific countries, while Japan should be reminded of former Prime Minister Obuchi’s “human security diplomacy.” In my memory, Prime Minister Obuchi’s platform, which was based on human security diplomacy, was well received by other regional members. In this context, China could propose that the United States should join the East Asia Summit, though I am not sure whether this is a truly feasible proposal. In the meantime, Japan and South Korea should become role models for human security

cooperation. This is a good subject area for bilateral cooperation between Seoul and Tokyo.

#### EAST ASIAN COMMUNITY: MYTH OR REALITY?

In conclusion, there are significant differences between the security environments in Europe and Asia. Northeast Asia is faced with a dual challenge, stemming from existing traditional security threats as well as new ones. Although it might be premature to replicate the Organization for Security and Co-operation (OSCE) process and experience directly in Northeast Asia, the OSCE experience provides a useful lesson for addressing the region's dual challenges. In that sense, the need for enhanced cooperation between the OSCE and the ASEAN Regional Forum should also be emphasized, but all of these ideas and efforts should be implemented with a sense of realism. Otherwise, the building of the East Asian community will remain a myth, not a reality.

*Kim Sung-han is the director of the Ilmin International Relations Institute of Korea University in Seoul. He is also a professor at Korea University's Graduate School of International Studies.*

## The Japanese Economy

*In early 2009, Japan, the host country for the Trilateral Commission plenary meeting, suffered the most dramatic GDP decline of all of the major world economies as a result of the global crisis. In a session chaired by Bill Emmott, former editor of the Economist, Yoshimasa Hayashi outlined the massive stimulus package that he, as one of the ruling party's leading politicians, has been tasked with helping formulate in order to respond to this crisis. Both he and Sachio Semmoto, a well-known Japanese entrepreneur, also concurred that further structural reform is needed to make Japan's economy more competitive over the long term, especially reforms to encourage greater innovation and entrepreneurialism. Meanwhile, Naoki Tanaka, head of a prominent Tokyo think tank, predicted that the Japanese economy, which had just suffered the greatest GDP decline of all of the major world economies, is ready to bounce back strongly from the current economic crisis.*

### YOSHIMASA HAYASHI

AS LONG AGO as 1986, a report known as the Maekawa Report was published, calling for the transformation of the Japanese economy from a “single-engine” economy to a “dual-engine” economy. Now, a too-frequently asked question in my district is “Why did all of these problems start in the United States but now we in Japan have the most damaged economy?” In the last quarter, from October to December, US economic growth was minus 6 percent, Europe was minus 8 percent, and Japan was minus 12 percent. The people in my district are almost shouting at me, “What are you doing?” The answer is that we did not meet the hallmark goal that we set in 1986 to create a dual-engine economy.

This goal has not been totally neglected. We succeeded in enacting some reforms, and now we enjoy cheaper prices in Tokyo compared with those in London or New York. Japanese broadband services are now some of the best in the world, compared with not only the Western countries but also our neighbor Korea. As early as 2000, I still remember that NTT [Nippon

Telegraph and Telephone Corporation] was blamed for hindering broadband deregulation efforts, but since deregulation was enacted, we now have a better broadband environment in Japan. So, we did not completely neglect our goals, and Japan had been enjoying an improved economy for the five or six years before the current crisis.

However, the improved economy in a way prevented Japan from achieving its dual-engine economic goals by diverting people, money, and opportunities to the manufacturing and exporting sector of the Japanese economy. The sectors involved with domestic consumption, the service sector, agriculture, and the social welfare sector were not left behind, but we did not put too much emphasis on them. As a result, this March we have launched a new economic plan, which will be part of the supplementary budget for the 2009 fiscal year.

Since I was in charge of packaging the supplementary budget for the Liberal Democratic Party, let me briefly touch upon what we did with the ¥15 trillion stimulus package. Since fiscal consolidation is still on our minds, ¥15 trillion is seen as a significant amount of tax money. Before we decided on the ¥15 trillion package, we thought it was important have some consensus on what type of society we are aiming to establish using these very important monies. We came to consensus about having three pillars within the total stimulus package. The first pillar is the Green New Deal, with the goal of achieving a “lower CO<sub>2</sub> emissions society” in Japan. The second pillar is infrastructure building to realize the potential of Japanese society. The third pillar is achieving healthier and longer lives for Japanese citizens.

In terms of the first pillar, one measure that has received attention from the press is that we have decided to put a solar panel on every public school in Japan. There are almost 36,000 public junior high and primary schools in Japan. In the first three years, we are trying to equip half of these schools with solar panels, which will provide the energy used by the schools. At the same time, this will give the manufacturers of the solar panels a big boost that will encourage them to invest more in their production lines and also to reduce their prices for the private sector. When we put in the solar panels, the schools will also receive anti-earthquake upgrades and be equipped with broadband access. These three measures completed under the “School New Deal” represent one example of the reforms that we are planning to undertake under the Green New Deal.

Besides the solar panels, we are also looking into a new generation of automobiles. We are following the German policy of providing subsidies for people who trade in their old cars for new hybrid vehicles. And, if we get

the 2016 Olympic Games in Tokyo, every taxicab in Tokyo will be “greened” by then. In addition to the solar panels and energy-efficient automobiles, we are also trying to help the manufacturers of electric appliances—such as refrigerators, air conditioners, and digital TVs—become more energy efficient by subsidizing them for a 5 to 10 percent discount in taxes under an “eco-point” system.

In addition to the Green New Deal that we put into the stimulus package, the second pillar is infrastructure building to help realize the potential of Japanese society. In this case, infrastructure refers not only to highways and roads but also to science and technology. About US\$27 billion is to be distributed to 30 technology projects in the next five years, which I hope will give the science and technology field a great boost.

The third pillar concentrates on healthier and longer lives for Japanese citizens, focusing on the health insurance and elder-care insurance systems. People working in the elder-care system are currently paid very badly. Their salary is said to be ¥2 million per year, compared with the average Japanese worker’s salary of ¥4 million per year. If we raised salaries in the elder-care system, we would attract more people to work in that sector, which is one of the few sectors in Japan where I could say that the demand is stronger than the supply at this moment.

Under these three pillars—together with the emergency measures we had to include for financing and job protection—we came up with the ¥15 trillion stimulus package. We are scheduled to submit the stimulus package on April 27, but its success depends on how the opposition party will react in the Upper House, where the opposition party controls the majority of seats.

*Yoshimasa Hayashi is a member of the House of Councillors of Japan. Soon after the 2009 Tokyo plenary meeting, he joined the cabinet of Prime Minister Aso as minister of state for economic and fiscal policy.*

## NAOKI TANAKA

In terms of the Japanese economy, there are two very important questions. First, why did the Japanese economy shrink so fast even though securitization never took over here like it did in the United States? Second, how did

an economic crisis that originated outside Japan so directly affect domestic demand, given the relatively small share of exports in this nation's GDP?

I am going to pick two reasons for the rapid fall of our GDP. One reason is a steep cut of inventories by several influential Japanese companies. As you know, our economy has steadily recovered since 2003, and major Japanese firms invested in their plants and equipment in order to prepare for the demands that were arising in the pan-Pacific area. In this very prosperous area, influential Japanese companies had the confidence to prepare for a greater supply of important manufacturing parts and efficient capital goods. Since 2003, they have invested in plants and equipment with the idea that as this process continued, wage levels would increase, employment would increase, and there would be an increase in domestic demand. But this process was undercut by the global financial crisis.

Major Japanese companies have relied on supply chain management in the Pacific. After the Lehman Brothers crisis, they received important information about the steep fall of final demand in the United States, East Asia, and Japan. They had the good sense to anticipate demand decreasing almost by half, so they started to steeply cut their inventories, which was reflected in the huge decrease in Japan's GDP in the fourth quarter of last year and the first quarter of this year. Since this inventory adjustment is almost completed, Japanese industrial production will now increase in the quarter from April to June, and toward the end of this year economic recovery will continue in Japan.

There are a lot of economists here who might have concerns about the future course of our economy, but I have confidence in the recovery of the Japanese economy because our influential firms had good sense about the direction of global final demand, especially in the Pacific Rim area. After their recent inventory adjustment, Japan's firms are among the first challengers who are addressing the 21st century assignment: they want to produce eco-products and they want to produce energy efficient goods, so they are now preparing for that. Toward the end of this year, according to my judgment, they will restart investment in plants and equipment.

I have to say one thing about the characteristics of Japan's commercial banks. As you know, there are fewer toxic assets on Japanese commercial banks' balance sheets, but they have a problem with increasing their lending due to the "procyclicality" of Japanese commercial banking activity. To guard against systemic risk, Japan's commercial banks reduced their holdings of equities of Japanese corporations, which meant there were fewer mutual shareholdings between Japanese commercial banks and Main Street. However, the situation changed after that, as influential Japanese companies

had concerns about M&A activity from abroad. One example is the steel company ArcelorMittal. ArcelorMittal played a very important role in Japan, and its corporate value grew to three times that of Nippon Steel—the biggest iron and steel company in this country. So, in that situation, mutual cross-shareholdings reappeared. Influential Japanese corporations wanted to maintain close ties with their equity holders, so they requested commercial banks to raise their holdings of equities according to Japan's role. Five percent of equities is the ceiling that can be held by Japanese commercial banks, but because several influential corporations in Japan have had concerns about M&A, they made requests to a lot of institutions to raise their equity holdings. However, once the crisis hit our economy, the equity price of major Japanese companies collapsed, which would mean huge loss provisions for commercial banks and a halt to their desire to increase lending. This is the procyclicality of Japanese commercial banking activity.

However, the lack of liquidity is now coming to an end. In the latter half of this year, lending will increase and the Japanese government has prepared the money for capital injection. As much as ¥12 trillion was reserved for capital injection and the Bank of Japan was very eager to increase liquidity into the money market. The procyclicality of Japanese commercial banking activity will cease due to government capital injections and the activities by the Bank of Japan. So, toward the end of this year and early next year, Japan will be among the first observers of the recovery of the global economy.

*Naoki Tanaka is president of the Center for International Public Policy Studies in Tokyo.*

## SACHIO SEMMOTO

I can speak from my experience from the five companies that I have started so far. From my perspective as an entrepreneur and chief executive in Japan, why is Japan's economy not exciting anymore? The Chinese economy is more exciting, the Indian economy is more exciting, and that is why Japan has been passed. There are two reasons. One, we lack a hungry spirit. Number two, we lack entrepreneurs.

After World War II, Japan's economy was moving away from dependence on the *zaibatsu*—Mitsui, Mitsubishi, Sumitomo, and so on—to young,

aggressive entrepreneurial companies. The growth of the Japanese economy was driven by many young, aggressive, hungry entrepreneurs at the time. This gave birth to world-class companies like Sony, with founders like Akio Morita and Masaru Ibuka who started the company about 50 years ago at a high school nearby here. Panasonic (Matsushita), Toyota—I can go on forever with a long list. As a result, Japan dominates the world with the best consumer electronic products, cars, components, and so on. Exports dominated the growth of the Japanese economy for many years.

Japan became very rich, and its citizens had the highest savings ratio in the world, but we are now suffering from our success. We are no longer hungry. Young graduates have no entrepreneurial spirit. There are hardly any new young, aggressive, entrepreneurial companies that are challenging the global economy. The young entrepreneurial companies established after World War II now are all over 60 years old, and many of their founders have passed away—Matsushita-san passed away, Morita-san passed away, and Honda-san passed away. They have been succeeded by the so-called “salary man *shacho*,” or salary man president. They are inheriting the old successes, but many of them lack a hungry spirit and they are not willing to take risks; they are not willing to change at all. Some of them still enjoy having the incumbent brand and technology, but the majority of their successes are in the global market, which is ironic. They are facing strong competition from neighboring countries like China, Korea, Taiwan, and so forth. These countries have a local advantage over Japan, with cheap labor and cheap standards of living. More importantly, they are hungry for growth. Japan needs another paradigm shift to grow with a new group of young, aggressive entrepreneurial companies. If the Japanese economy continues to rely heavily on incumbent companies that are all suffering from fundamental cost issues, then we cannot generate new employment and we cannot challenge the world at all.

So, why is Japan not producing young entrepreneurs? As many people know, Japan lost 10 years of growth after the burst of the land bubble in the 1990s. The banks and financial institutions were too slow to restructure the bad loans, and the banks especially would not take risks to loan money to new start-ups. No venture capitalist (VC) could raise a large amount of capital in Japan. New graduates have little choice—they all want to join old, traditional, incumbent companies for job security. New graduates have no dreams of joining the new generation Google, YouTube, or Facebook. Top graduates choose government jobs or established companies.

When I started my first company, DDI 25 years ago, I could only get capital support from companies, not VCs. And when we asked the government

to deregulate the Japanese telecommunications industry, this deregulation created the world's second largest mobile market in value, over ¥9 trillion, including NTT docomo, KDDI—which I started—and now SoftBank. However, Japanese always have a tendency to close the domestic market. I think that this is wrong. For example, Japan adopted the second generation mobile standard, PDC [Personal Digital Cellular], which has technology that is superior to GSM [Global System for Mobile communications]. However, about 80 percent of the world uses GSM, and foreign cell phones often do not work here in Japan because of these closed policies of Japan. Now this policy has returned to kill its own industry. This Japanese standard totally killed handset and infrastructure companies in Japan, where there is no comparison with Ericsson or with the Chinese company Huawei, which is becoming a high-tech strong power.

When I started eAccess ten years ago during the burst of the global information technology bubble, we had no choice but to raise capital from overseas companies like Goldman Sachs or Carlyle—not from VCs in Japan. Another one of my companies, eMobile, has raised most of its shareholder capital from overseas once again, from Goldman Sachs and from Temasek, the Singaporean sovereign fund. Most Japanese VCs would not believe in a small startup like eAccess or eMobile. We are now a US\$2–3 billion company, but when we started no VC wanted to invest in us. Now we can challenge gigantic companies and like in the movies, a small army can win the war. We need hungry entrepreneurs. We need Japan to have better deregulation and more open policies. We are still a closed country. Otherwise, we are just watching and envying the success of our Chinese neighbors and suffering from an aging population.

Finally, in addition to the micro side, Japanese fiscal policy is weak as well. Japan is already heavily criticized by the foreign press, and has been called “Ja-pain” because of our weak political system. The Japanese government always repeats the same old story—stimulate the weak economy and spend public money. Japan wasted a lot of capital on many things—public works and building roads and tunnels that nobody used. Why? It may help elections to sponsor construction workers, but it is not helping the economy of Japan. All this spending and issuing of too many government bonds is already creating a lot of debt in Japan so that paying it back is becoming a dream today. We need to change Japan. We need strong leadership and new leadership. We need Obama here in Japan as well.

*Sachio Semmoto is chairman and CEO of eMOBILE, which he founded.*

# III

## NEW OPPORTUNITIES AND CHALLENGES FOR TRILATERAL PARTNERSHIP



## **Afghanistan-Pakistan: Implications for the Trilateral Partnership**

*With tensions in Afghanistan and Pakistan spiraling upward, three defense experts identified instability in these two countries as one of the most critical challenges to cooperation among the Trilateral Commission countries. The lively session, which was chaired by John Negroponte, former US deputy secretary of state and director of national intelligence, focused on the steps that need to be taken to prevent further radicalization in the two countries, especially in light of concerns about the security of Pakistan's nuclear arsenal. Gordon Smith, former Canadian deputy foreign minister, explained why there is no easy military solution to the instability wracking the region, and Masashi Nishihara, the head of a Japanese think tank, argued that greater political will on the part of the Afghan and Pakistani governments is one necessary element of any military effort in the region. Meanwhile, Stefano Silvestri, the president of an Italian think tank, argued that much more serious efforts are needed to coordinate international involvement in the war in Afghanistan, which is currently too fragmented.*

### **GORDON SMITH**

MY BOTTOM LINE is that the likely implications of the present crisis in Afghanistan and Pakistan will be to add to strains among the Trilateral Commission countries and to compound existing problems. I will also argue that it is only through shared leadership of the key countries around Afghanistan and Pakistan that there is much hope for a better future, and I will try to establish why.

I do not think that it is necessary to spend much time on what is happening now in Afghanistan. I am going to give just two sentences from a recent report by Barnett Rubin and Thomas Pickering: "The governments of Afghanistan and Pakistan are at risk from a combination of violent insurgency, loss of public confidence, and economic crisis. These trends

threaten not only the loss of control by the Afghan and Pakistani governments but also the spread of terrorist safe havens and, in the most extreme situation, the loss of control over some of Pakistan's nuclear weapons or materials." I could go on and talk about the increasing number of attacks or the extent to which the Taliban is either controlling or has a permanent presence in Afghanistan, but I do not think that is necessary.

Let me, however, summarize what President Obama's policy review is trying to establish because I think that is important and not universally understood. President Obama has come up with a significantly more limited set of objectives for the United States and the allies fighting in Afghanistan, which is to focus on Al Qaeda and the reality that Al Qaeda is in the mountains of Pakistan rather than in Afghanistan. I also give importance to the fact that President Obama has emphasized a strategy of clear "hold and build," as distinct from "search and destroy." Consequently, democracy and nation building take a lower priority.

However, all that is needed is a threat to human rights of the kind that we saw with the recent Afghan legislation to invoke outrage in my country and in others. There must be a focus on how to deal with Al Qaeda and—with respect to the Taliban in Afghanistan—how to split off the hardcore elements of the Taliban from others who might be brought into a legitimate political process. Whether that is going to prove to be possible is anybody's guess.

Why do I say that these issues are going to add to differences among the Trilateral Commission countries? The first reason is that—even as President Obama is determined to go after the Al Qaeda threat in Pakistan—there are those from other Trilateral Commission countries who argue that while Al Qaeda is a global threat, it is not a threat that can be controlled by anybody in the mountains of Afghanistan. Some argue that Osama bin Laden, presuming he is still alive, is not able to fund or to direct its operations and that Al Qaeda is largely spreading through a process of self-franchising around the world. Therefore, I suspect we are going to see a debate as to whether a strategy of "decapitation," to use a rather direct phrase, is something that in fact would work to deal with Al Qaeda. Thus, I think that the first difference among Trilateral Commission countries will be on how to deal with the threat of Al Qaeda.

The second issue of difference is going to be about the required military effort. While the United States is increasing its military contribution in Afghanistan, there is very little indication that others are going to send in more troops. Even when other countries do send in troops, there are questions as to the extent to which they are going to be participating purely in

a training role and whether there will continue to be caveats on the way in which they can be employed. There have long been questions of burden sharing between the United States and Europe, and I think that burden sharing in different contexts is going to come back as a major debate on this issue.

The third point of difference is going to be with respect to Pakistan. I would like to quote one thing that President Obama said because the language is very tough. He said, “We will insist that action be taken—one way or another—when we have intelligence about high-level terrorist targets.” That says to me that if the Pakistani army does not act, then the United States will, through the use of drones, airpower, or perhaps troops on the ground. We have seen visits to Pakistan by the chairman of the joint chiefs of staff and Dick Holbrooke over the last couple of weeks, and I would describe the reaction that they have had as being mixed. Recently, there is increasing concern that—as a result of what has happened in the Swat Valley and around a town called Buner, which is about 100 kilometers from Islamabad—the Taliban have moved in, and the Pakistani military has not responded. I think that is going to be a very difficult issue, and Secretary of State Hilary Clinton has spoken out about it.

There are real issues as to whether the Pakistani government has the political will to deploy its military or whether Zardari has the authority to send the Pakistani forces into the mountainous areas in a way that will really go after the Taliban. If he does not, this is going to pose some serious challenges to the United States. I would expect that the United States is going to expect other allied countries to try to help in this process, but while a number of us have developed assistance programs in Pakistan, the United States has been pretty much on its own in terms of dealing with Pakistan. The reality that we have to deal with is that the Pakistani military is very reluctant to move into the Pashtun areas of Pakistan where the Taliban are.\* I would venture to say that the reason the Pakistani government is having trouble in the Northwest Frontier area is not because of lack of training or equipment but is instead an issue of lack of political will.

What can be done? I think that the only answer is to try to obtain a greater degree of regional cooperation to address the problem. When he was testifying recently in Washington, General David Petraeus said that “Af-Pak,” the mandate of Dick Holbrooke, is in fact “Af-Pak and India” and

---

\* The author notes that as a result of the Taliban pushing too hard and too fast around the Swat Valley and with the highly publicized killing of a rape victim, in fact, concerns in the general population about the Taliban have substantially increased and the Pakistani Army has begun fighting.

that India will be part of what Ambassador Holbrooke will be dealing with. Regional cooperation must also include China, Russia, the Central Asian states, and Afghanistan and Pakistan as much as is feasible. The regional powers want to contain—to the degree possible—the threat that is posed by the Al Qaeda presence in the mountains of Pakistan. Whether it is China, Iran, or Russia, Jihadi Islamic fundamentalists of the character that subscribe to Al Qaeda’s doctrine are not the people that these countries want to have around. I cannot think of a better illustration than the challenges posed by Afghanistan and Pakistan as to why we need a broader form of international collaboration to deal with these issues because there is no easy military solution in Afghanistan or in Pakistan.

*Gordon Smith is director of the Centre for Global Studies at the University of Victoria.*

### MASASHI NISHIHARA

I want to speak about the obstacles to trilateral partnership and also about whether we are doing the right things in the Pakistan-Afghanistan area. I think that Trilateral Commission countries all have a shared interest in stable governments in Pakistan and Afghanistan. I do think that there are some countries such as China and India that have additional reasons why they are interested in this area. China has a specific interest in the Taliban issue because if the Taliban become stronger, they may encroach into the western part of China where the Uyghur secessionist movements are strong and may encourage these movements. India has slightly different concerns. It would like to see a stable Pakistan, but it would like to see a much stronger Afghanistan than many of us may think. A strong Karzai government containing the Taliban and Al Qaeda forces would help to stabilize relations between India and Afghanistan, and that would help their national security.

Having said that, I would say that Pakistan has a different outlook on this. Pakistan probably does not want to see a strong or stable Karzai government. If the Karzai government controlled the Taliban, that would mean stronger relations between India and Afghanistan, which would sandwich Pakistan. Pakistan probably feels that it is in its national interest to keep

some of the Taliban forces alive, and this is why Pakistani militaries are not very clear about how they plan to deal with the Taliban in their country.

The second point that I want to mention is about how the members of the Trilateral Commission are doing in this area. As we see, the United States and NATO countries are providing the largest share of military force and official development assistance. The International Security Assistance Force (ISAF) is actively playing a role in controlling the Taliban while at the same time also providing non-military assistance. By contrast, Japan is reluctant to play a military role. It probably requires special legislation for it to play any military role in that area. Given the constitutional questions involved and the current political turmoil in Japan, it would be very difficult for the government to pass a new law to allow itself to send troops.

Instead, Japan is now actively providing economic aid to Pakistan as well as to Afghanistan. There was a Tokyo conference on aid assistance to Pakistan about a week ago. Japan's initiative has successfully resulted in more than US\$5 billion in pledges from about 25 participating countries. The United States and Japan each pledged US\$1 billion, and the European Union pledged about US\$700 million. This will help Japan make a strong impression about its commitment to stabilizing Pakistan. Many other countries will also participate in this area in the future. I think that it is very good for Japan to do this. Though it is not well known, Japan is actually playing a very active role in the non-military field in Afghanistan. Japan has assisted with building schools, paid the salaries of 8,000 police for half a year, paved roads, and assisted in the upcoming presidential elections in Kabul. I think this area will also help Japan in its discussions with the United States about how their alliance is working concerning Afghanistan.

The third point I wish to make involves the question of whether we are doing the right thing in Pakistan and Afghanistan. Can we prevent the Talibanization of Pakistan? Can we prevent Pakistan's nuclear arms from being taken over by the Taliban forces in the future? Can we develop sufficient infrastructure in Afghanistan or Pakistan in the near future so that the participating countries continue to feel comfortable in lending assistance?

Finally, it is clear that the United States will be more active in the future than in the past in the Pakistan-Afghanistan area. However, Pakistanis are not very enthusiastic about the United States playing an active role in the region. They need the aid money and they need help controlling the region, but they do not like to see US ground troops in the region. As the United States sends more unmanned vehicles to the border areas, further civilian deaths will increase anti-American sentiment. Can we really win

the hearts and minds of Pakistan in that area? I hope that Pakistan will not become a second Vietnam, though there are some similarities between the two situations. I hope that will not be the case, but first we will really have to see strong political will on the part of Pakistan and Afghanistan.

*Masashi Nishihara is president of the Research Institute for Peace and Security in Tokyo.*

### STEFANO SILVESTRI

“Af-Pak” is just the latest of many strategies that have existed for Afghanistan and Pakistan. In a way, we could say that we are in a situation of being “divided in fights and united in defeat” concerning several important areas. Considering Afghanistan, control of narcotics is one area in which we are failing. While the production of poppies has been limited to a smaller number of regions or provinces, the production in those regions is increasing, and in some cases the peasants are substituting poppies with the cultivation of hashish. In addition, we have been increasing forces since the beginning of the ISAF. The ISAF was supposed to be 9,000 troops. Between the ISAF and Operation Enduring Freedom, we now have troop levels almost 10 times that. Furthermore, dealing with Karzai is a difficult issue. Is Karzai an asset or a liability? He is something of both in a way and we are divided on how to address this situation. Finally, in my opinion, the proliferation of envoys is also symbolic of the divisions among the allies. Each country now has its own envoy for Afghanistan, and this is true not only for countries but also for international organizations: NATO, the European Union, and the UN. And yet, we do not even have a working contact group for Afghanistan currently.

These divisions apply not only to the coalition but also inside the various countries. We have a situation in which NATO and the United States European Command (EUCOM) theoretically should be in command of military operations, but EUCOM—which is one of the poorest commands of the American forces—certainly does not control the other two acting commands there, CENTCOM [US Central Command] and SOCOM [US Special Operations Command]. There is no unity of command, nor is there a single chain of command. This problem also applies within

the European forces. For example, the EU Police Mission (EUPOL) in Afghanistan is failing because the Europeans did not send enough men for this EUPOL mission.

At the same time, I must say that the Americans are doing it alone, in a different way and with different objectives. The initial idea was to build a civilian police and a military army in Afghanistan. However, the Americans are now trying to establish a constabulary police and a military police for territory control. Their approach may be correct, but the reality is that there are now two different missions and the Americans are enrolling some Europeans, such as the Germans, the Dutch, and the British, in their effort. With the current confusion over such a small mission of about 80,000 troops, how could we hope to win a war in this situation? In my opinion, it is already striking that we are not losing very badly.

Pakistan is the most critical issue currently. It is true that the Taliban and Al Qaeda are operating mostly from Pakistan and that Pakistan is acting as a safe haven for terrorist actions. What can we do with Pakistan? Apparently the United States is saying to the Pakistanis “either you do it or we will do it,” which means making a war on Pakistan territory without the agreement of the Pakistanis. Well, that is normally called an invasion and I do not know if that is really a very sound policy vis-à-vis a nuclear country with an unstable government but an important strategic role.

Of course, the Pakistani army could fight the Taliban and could even win. The problem for the Pakistani army is that it does not understand why it should do so. The idea of sending its army to fight the Taliban is highly unpopular in Pakistan, and it is also highly unpopular in Islamic terms. This would take the Pakistani military out of the border areas with India and out of Kashmir in order to concentrate its military force in the tribal areas. This is something that would clearly not be very well understood inside the country. If they destroy the Taliban, this may end up reinforcing Karzai, who is perceived in Islamabad as an ally of India and as an enemy of Pakistan. Why should they do that? It would look as if Pakistan was fighting a difficult proxy war for the sake of the United States and Europe without gaining significant benefits. The situation is not so much that we have to *convince* Pakistan but that we have to *give* something to Pakistan in exchange for their support. Can we give something to Pakistan in exchange for their support? Perhaps we can, but this is an issue that first must be discussed with the next government of India.

Finally, I have a few suggestions for the future. First, we should have a single civilian commander or viceroy for civilian policy in Afghanistan, whether through the UN, NATO, the European Union,

or some other body. I would suggest that the UN would probably be best in this case.

Second, we should have a single chain of military command. This would likely mean that the United States should end Operation Enduring Freedom and that the ISAF role in Afghanistan should be changed. I think that would be sound advice for the future.

Third, we should create a NATO-like regional political agreement, which should include China and India and also some difficult countries like Iran, the Central Asian former Soviet republics, and Russia.

Finally, we must clarify our strategy for Pakistan. For example, NATO could give a role to this new Turkish assistant secretary-general position that has been created to allow Anders Fogh Rasmussen to take the post of NATO secretary-general. A Turkish top representative certainly would be more credible both in Afghanistan and in Pakistan than any American or European envoy. Finally—I agree with the Americans here—we must transform the Afghan army and police force into a single territorial army for territorial control. This might be the most useful thing we can do for the future because a single territorial army may avoid doing what is being done today, which is allowing the existence of a number of tribal armies that sooner or later will start a war on their own.

*Stefano Silvestri is president of the Institute of International Affairs in Rome and a former under secretary of state for defense in Italy.*

## **The New US Administration: Meeting Challenges, Managing Expectations**

*Nearly 100 days after the inauguration of President Barack Obama, Nicholas Burns, Yoichi Funabashi, and Wolfgang Ischinger shared their assessments of his young administration in a session moderated by John Kerr, former UK ambassador to the United States. Burns, who previously served as US under-secretary of state, gave the Obama administration positive grades for its efforts to restore diplomacy and multilateral engagement to the heart of US foreign policy and outlined the daunting challenges that lie ahead. While stressing how high expectations and enthusiasm are for Obama in Asia, Funabashi, editor-in-chief of the Asahi Shimbun, one of Japan's leading dailies, listed several steps that the United States needs to consider in order to reengage in Asia. Meanwhile, Ischinger, a former German ambassador to the United States and to the United Kingdom, described the attraction that many Europeans feel toward Obama, and he called for a restoration of US global leadership that should also be matched by greater European partnership with the United States in meeting the pressing global challenges of the times.*

### *R. NICHOLAS BURNS*

PRESIDENT OBAMA IS reaching his 100th day in office this coming Wednesday and, in our country, since Franklin Roosevelt's (FDR) brilliant beginning as president in the spring of 1933, all subsequent American presidents have been held to his standard of a "First Hundred Days" beginning that is consequential in terms of reshaping American politics and American governance. I think most people would agree that no president after FDR has met that standard as well as he did.

There has been a lot of commentary in our country over the past week or so about how President Obama has been doing over the last 100 days. Nearly all the commentary from the left and the center and even some on the right argues that he has had a highly consequential first 100 days

in office and that he is off to a very fast start in articulating a new vision for government policy and perhaps even a restructuring of the way that we work. These commentators point to what he has done in just three months on the domestic front alone. He has put forth new policies to reform finance, the automobile sector, the health sector, the transport sector, and the education sector. He seems to have an entirely new approach to budgeting. Whether or not he achieves concrete results in any of this, the aspirational aspect and the sheer ambition to restructure governance and politics is really quite extraordinary. That is the first thing that I wanted to say. It is possible that a year or two from now most people will say that President Obama's beginning was the most consequential and the most important since FDR's in 1933.

I am here to talk about the foreign policy front. President Obama has had a very sure and impressive beginning. He has said that the most important foreign policy issue is the economic crisis, because we cannot have a successful foreign policy, much less defense policy, unless we have an economic recovery. We simply will not be able to afford the type of worldwide American presence and the number of initiatives that he has put forward in foreign policy if we do not regain our economic footing.

If one is looking for a theme, if one traces President Obama's statements and actions, many commentators have noted, and I agree, that the dominant theme is restoration. First, it is the restoration of America's influence and credibility in the world, which was apparent from the first moments of his presidency. The fact that he reached out to the Muslim world is a very good example. There was very little in the inaugural speech about foreign policy, but what there was focused primarily on the Muslim world.

There were three very sophisticated and layered messages in the inaugural address. The first message was essentially, "We respect the Muslim world and our hand is outstretched to the Muslim world," which needed to be said given the state of our relations with the Muslim world and the extraordinary fact that we are fighting two wars in Muslim countries. The second layered message was the famous clenched fist reference: "If you unclench it, Syria and Iran, I will meet you halfway." The third message, a very important one for a relatively young foreign policy president, was to Al Qaeda: "We will defeat you." He followed with the commitment to close Guantanamo, the commitment that we would not torture, and the commitment that the United States would now put itself at the center of the climate change negotiations, not at the periphery where we had been since 1999 over the last two administrations. Finally, he had the guts to go down to North Carolina to meet the marines and say, "You have done

an admirable job in Iraq but it is time to get out, and here is an 18-month timeline during which I want to draw down the level of forces.” Those four steps were all designed to restore a sense of American leadership, American credibility, and American influence.

There is another step that many observers have noticed, and that is a restoration of making strategic choices about where we must be involved on a priority basis. We are a global country and to defend our interests we have to be active in every continent of the world. But certainly one has to make choices and President Obama started signaling his priorities on his second full day in office. He did something unusual. He made his first visit to a cabinet agency and it was not to the Defense Department, or to Treasury, which would have been understandable during the economic crisis. The first cabinet office he visited was the State Department, and he and Secretary Clinton announced the appointment of two subcabinet officials. They were not even officials who were going to be confirmed by the US Senate, so it was rather unusual that he and she would announce them together, but it gave us insight into where the strategic direction lies.

Both the appointment of George Mitchell to be the emissary and the negotiator between the Israelis and the Palestinians and the appointment of Dick Holbrooke to be our envoy to South Asia indicate that those two regions have become, without any question, the strategic focal point of American foreign policy. This is not new and it has been that way for a number of years. Over the last 100 years, Europe was that focal point, mainly because that is where the vital national security interests of the United States were presumed to be. I think that the Middle East and South Asia are now those two regions. It is very clear that he chose two of the most experienced and most successful American negotiators in the Democratic Party for those two positions. This was the restoration not just of our influence and credibility but of making strategic choices. We have profound challenges. Ten to 15 years ago none of us would have said that South Asia was the central arena for the pursuit of my country’s national interest, but it certainly is now. If we could poll the Obama administration at this moment, they would likely say that Pakistan is the single greatest concern right now. Strategic challenges in the Afghanistan-Pakistan theater are more serious even than those in the Middle East in the short term.

Lest we be too consumed by the difficult, there is one very bright strategic opportunity for the United States in South Asia, and that is to continue the creation of a true strategic partnership with India. We have the advantage that it has been a bipartisan initiative in the United States, begun by President Clinton, continued by President Bush, and, I am sure,

to be continued by President Obama. We see a strategic opportunity in the development of a closer economic, military, and political relationship with India.

In the Middle East there are three urgent priorities. The first is to find a way out of Iraq that will not destabilize the country and that will honor the commitment that we have made as a country and that particularly our soldiers have made. It is going to be extremely difficult to do. The plan that President Obama has put forward makes a lot of sense, but it is going to be a great challenge.

The second challenge in the Middle East is to try to resume some forward movement on the Israeli-Palestinian talks, which is going to be difficult because both the Palestinians and the Israelis find themselves fundamentally disunited within their own communities. It is also a time when the United States, Europe, the United Nations, and Russia want them to move toward a two-state solution. It seems, however, that a one-state solution might become the more rational prediction. It is difficult to see how the Palestinians in particular, with Fatah facing elections, can put together a joint delegation of Palestinians and how we can motivate a government in Israel whose foreign minister does not even recognize the need for a two-state solution. Moving both of them toward peace is going to be extraordinarily difficult.

The third challenge, which might be the most difficult of all, is how to engage Iran after thirty years of frozen relations. We have had no embassy in Iran, no government-to-government relations, no business presence, and no journalistic presence for three decades. We have the most unique relationship possible with Iran—we do not know each other. President Obama has said, in my judgment quite rightly, that we need to unfreeze these relations. We need to take steps, both government-to-government and people-to-people, to get to know the Iranians. The goal is to lead with diplomacy and yet to be tough-minded enough and hard-nosed enough to stop their obvious and transparent drive toward a nuclear weapons capability. That would put at a disadvantage not just the United States and Europe but the Sunni Arab states as well as Israel and the moderate Palestinians. It is right to suggest that the talks should begin next month, but my own rather pessimistic outlook is that the likeliest scenario, even following an Iranian election that could possibly unseat President Ahmadinejad, is that the Iranians will be disunited in Tehran. Getting decisions from them will be highly problematic. We may have to go through a period of negotiations followed by a return to very tough economic sanctions and then perhaps followed by another round of negotiations.

There are two caveats here. It would be advisable for President Obama and his advisors to insist to Russia and China, in particular, that the United States will not go to the negotiating table if they continue to undercut the UN sanctions. As the European countries have receded from economic involvement in Iran, China has rushed in to fill the void and has become the leading trade partner with Iran. Russia continues to be the major arms supplier, including of missile technology, to Iran. If we do not have a united front among the five permanent members of the Security Council (the P-5 countries), it is hard to see how a policy of negotiation and sanctions is going to work in Iran. This leads me to the very pessimistic conclusion that if the negotiation track does not work, President Obama may be faced at a certain point two or three years down the road with a really difficult and forbidding choice. Should he elect to use military force to try to arrest in some fashion the nuclear weapons development in Iran? Or, should he devise some longer-term containment strategy that would not involve the use of military force but would seek to contain Iranian power in the Middle East itself? There is no good news here. This is going to be a very tough problem for the Obama administration.

We also see in President Obama's first 100 days a return to multilateral engagement: 1) the appointment of a very skilled, very energetic ambassador to the United Nations and the signaling from President Obama and Secretary Clinton that they want to take the United Nations seriously and seek to rebuild it; 2) the announcement on climate change; 3) the announcements on nonproliferation and the need to rebuild the Nuclear Nonproliferation Treaty (NPT) regime, including the important speech that President Obama gave on nonproliferation and disarmament in Prague, and the announcement of the US-Russia intention to draw down further the level of our nuclear armaments; and 4) President Obama's announcement that he would encourage the Senate of the United States to finally ratify the Comprehensive Test Ban Treaty (CTBT). This return to multilateral engagement, though not at the expense of American flexibility and freedom to operate in the world, is also a hallmark of the first 100 days.

I see a last sign of restoration and that is of diplomacy at the frontlines of America's national strategy. In his second term, President Bush, and especially Secretary Rice, tried very hard to position diplomacy as a first resort in American dealings with the world. But, the fact is that our diplomatic establishment is underfunded. While since September 11, 2001, we have tended to lead with the military and intelligence and fully fund them, we have a diplomatic corps that needs rebuilding and refinancing. I hope

we will see from President Obama and Secretary Clinton some proposals for Congress to do that.

If that is, in a broad sense, an outline of where the president is heading, what are the greatest challenges that he will have to overcome to try to meet some of these very ambitious aspirations? I was impressed by Henry Kissinger's op-ed in the *International Herald Tribune*. He suggests that it is one of the tasks of the great powers to make sure that we are all acting for international stability but that it is the specific task of the United States to translate these aspirations into grand strategy and into a coherent plan for how we will fulfill all of these ambitions. It is appropriate to pose that as the central question for the Obama administration. It may be, as some commentators have written—and it seems odd to say this given all the weight that President Obama has on his shoulders—that he has had the easiest 100 days of his first term in office. He has had the luxury of doing what all presidents and secretaries of state can do, which is to lay out the ambitions and policy objectives. Now he has to translate them into concrete reality.

What will be the barriers to progress? The first I see is the Democratic-led Congress. Will the president be able to convince the Congress that we should resist this historic lure of isolationism—which I thought after September 11, 2001, might have been extinguished in America but we still see too many signs of during the economic crisis—and the lure of protectionism? We must have the will to lead. We will see now how the Congress reacts to the budget proposals. We need the financial weight to lead in the world and it is unclear to me if Congress will fully fund all of the president's foreign policy priorities.

The second barrier many observers see also has to do with Congress. How many proposals can Congress consider and approve, on both the domestic and foreign policy agendas? On the foreign policy front, Congress will have to make the key decisions on climate change and carbon levels and will have to decide whether to ratify the CTBT. Congress will have to decide on the assault weapons ban, which was the major issue when President Obama visited Mexico two weeks ago. What is the capacity of Congress to translate some of these foreign policy initiatives into American law?

The third barrier I see has to do with Europe. I have been struck and really gratified to see the way that Europeans have responded to President Obama. As someone who lived in Europe between 1997 and 2005 and experienced some of the worst years of US-European relations since World War II, it has been gratifying to see the way that President Obama has been received. But President Obama is going to need more than pleasant sentiments from Europe. On Afghanistan, there is a great deal of bitterness within the US

government that many of our major NATO allies are essentially sitting out the war. They are refusing to send troops to the eastern and southern parts of the country, where most of the fighting and casualties are occurring. Germany refuses to send troops to the battlefield, as do Italy, Spain, and Belgium, while we have Allies such as Canada, the Netherlands, Denmark, Estonia, Bulgaria, Romania, and especially the United Kingdom that have made this difficult decision to send troops.

I was the US ambassador to NATO on the day we decided to go into Afghanistan. It was not for a gentle peacekeeping mission; it was for a combat mission. We assumed that all the countries would be ready to undertake their responsibilities. However, that assumption was wrong and that is a challenge for the US-European relationship.

I am not an expert on the economy, but I know that one of the major points of difference is the size of the stimulus packages between the United States and Europe. I fear, on Iran, that our ability to be successful might be based on our ability to keep the military option on the table at the same time as we negotiate. Will European leaders support this publicly in order to make the impression on Iranian leaders that needs to be made? I have my doubts. So I would say as a third barrier that the US-European relationship needs to be more about deeds and less about nice sentiments concerning President Obama.

Fourth, should we look again at our North Korea strategy as we look at the Iran strategy? North Korea is thwarting the wishes of the other five parties in the Six-Party Talks. All of the commitments North Korea has made have now been violated for a second time in the last decade. Is the framework correct? Or, should we step back and reassess where we are going to find a more fruitful way forward? We may end up in this position on Iran in a couple of years. Do we have the power and ingenuity to stop North Korea and Iran from doing what the entire international community does not want them to do?

I have two final thoughts on the challenges that President Obama is going to face. The first is that many of the major international institutions—the backbone of the international system—seem to be much better suited for the 20th century than the 21st. There has been talk about how to modernize the IMF, the World Bank, and NATO—which has been in the process of modernization and reform for at least the last 20 years. I will just pick one to think about: the United Nations Security Council. It may seem contradictory coming from someone from a country that enjoys the veto, but I think the Security Council will have vastly decreased legitimacy in most parts of the world unless we enlarge it and invite in new permanent

members. It is hard to imagine that in the 21st century the Security Council will be effective if Japan, the second largest contributor to the UN system, remains off the council on a permanent basis. If India is to become the largest country in the world by population, how can India remain off the council? How can Brazil remain off the council? How can it be that not a single African country is represented on the council? If one looks at it, the Security Council's central structure was decided by Chiang Kai-shek's China, Stalin's Soviet Union, de Gaulle's France, Churchill's Britain, and Roosevelt and Truman's America. That is the Security Council in 2009. It is absolutely necessary to consider ambitious and aggressive institutional reform to consolidate continual support for the council.

My last point is about great power relationships. One of the things that President Bush did very well and has received little credit for was to focus on America's relations with the rising powers of the world. I would say that the improvements in US-China relations have been significant and very important for American national security. The challenge will be to translate all that promise into more effective action because, frankly and respectfully, I do not see China doing what it must for the global good on Iran, on Burma, or on Darfur, just to pick three issues. While China is doing many things that are good for the world and currently playing a key role in the economic crisis, I think there are continued challenges there.

It is a singularly important objective for President Obama to think about reviving the centrality of the US alliances with Japan, South Korea, and Australia as the backbone of our position in Asia and as the backbone and centerpiece of our efforts to keep Asia peaceful and stable in the 21st century as China rises. There are two other relationships that I hope President Obama will emphasize and these are with India and Brazil. Brazil's sense of self-confidence, its increasing prosperity, its central role in Haiti, and its aspiring role in the United Nations should lead us to establish a much better relationship with it. Great power relationships will be a particular challenge for President Obama as they have been for the last few US presidents.

*R. Nicholas Burns is a former US under secretary of state for political affairs and a former US ambassador to NATO. He is currently Professor of the Practice of Diplomacy and International Politics at the John F. Kennedy School of Government, Harvard University.*

## YOICHI FUNABASHI

There are strong expectations and enthusiasm for this new US administration throughout Asia Pacific. In Japan, for instance, more than 70 percent of the public has demonstrated their favorable approval for the Obama administration, while the support level for their prime minister is hovering at 20 percent. Having said that, I think that the legacy costs of the Bush administration are so enormous that I would like to do a reality check. What are the challenges ahead for the new administration? It is important to first recognize that the Bush administration was far from a disaster as far as Asia Pacific policy is concerned. The Bush administration has stabilized the US relationship with China and strengthened its relationship with Japan and has done that while simultaneously forging a very robust relationship and strategic partnership with India. That is not a small feat. The good part of the story is that, judging by my conversations with some high-ranking officials in the Obama administration, they fully understand this. They are not interested in only pursuing anything but Bush's policies, unlike the initial stages of Bush administration policy, which was too enthusiastic about pursuing an "anything but Clinton" policy.

The first legacy cost from the Bush administration is the financial crisis, and it has only just started. We should not underestimate the huge impact of this crisis and the meltdown of the perceived American model, which has discredited the perception of the US standing and leadership as well as its image in Asia Pacific. Gordon Brown said in the press conference at the London G20 that the old-world Washington consensus is over, and many people here in Asia Pacific seem to conclude that "Washington Consensus" is another name for crony capitalism. This perception is now sitting in many people's minds here, and this poses serious policy risks to the Obama administration because this also is likely to bring about more critical views of the American way of life, political system, democracy-promotion diplomacy, and even the strategic military alliance system that the United States has helped build throughout this region. The US model has inspired reform and open-door initiatives in the region in the past 50 or 60 years, but now it has put this reform agenda in a much more difficult position. If this financial Washington Consensus model has been inexorably entwined with the American political system, as well as the security and military underpinnings, the first wheel is now off. This will inevitably complicate American standing and prestige in this region, its political power, and

the capacity for its political system to be a model. I think we should not underestimate this.

There is critical importance in the US-Japan, US-Korea, and US-Australia alliance system as China rises, and the Obama administration seems to be interested in promoting and even revising that alliance system so as to match these new challenges. Yet, this enterprise requires very careful study and critical examination of what should be the objective of alliances under the new circumstances. Inevitably, given this financial crisis, the United States finds its relationship with China as one of the most crucial relationships to stabilize that situation. It wants to keep China engaged in investing in the United States, particularly in purchasing US government bonds. As we see the emergence of the G20 as a major forum, simultaneously we may be witnessing an emergence of a G2: a China-US relationship. This by itself is not a bad thing, because we all need to see the US-China relationship stabilized for the purposes of stabilizing the financial system. But it also complicates the US relationship with the other countries in the region such as Japan, Korea, and India. As far as the US-Japan relationship is concerned, if the US-Japan alliance should be strengthened as a part of efforts to counter China, this would certainly upset the status quo. Equally, strengthening the US-China relationship and shifting away from Japan would threaten Japan's interests as well as the US-Japan relationship. In either scenario, we would see a serious security dilemma emerging in the Asia Pacific region.

The surest way to avoid this pitfall is to create some kind of trilateral policy consultation. As far as I know, there has emerged a keener interest in creating this trilateral policy consultation among all three capitals: Washington, Beijing, and Tokyo. However, at the same time there are also reservations in each capital. With regard to Washington and Tokyo, there are serious reservations particularly in the Pentagon as well as in the Ministry of Defense.

How the United States should integrate the bilateral alliance relationships with the emerging multilateral regional mechanism in the Asia Pacific region is the most crucial challenge for the new administration to explore. Perhaps more fundamentally, how will the Obama administration actually develop its policy to firmly commit to multilateral institution building in Asia Pacific? When I interviewed Secretary Clinton when she came here in February, I asked this question to her directly and her answer was very positive and encouraging. She said that she would attend all ASEAN Regional Forum (ARF) meetings, unlike her predecessor who twice skipped attending the ARF. She also suggested that the trilateral dialogue among

China, the United States, and Japan perhaps should start from economic and environmental issues. That may be an option, and the policy planning staff level would be another option to explore.

Finally, let me briefly speak on Pakistan and Afghanistan and how the United States and Japan and the United States and Asia could develop their joint policy toward these challenges. Last week there was an international donors conference here on Pakistan. On top of the US, Japanese, EU, and Korean pledges, we also had Saudi Arabia pledging US\$700 million, Iran US\$300 million, and the United Arab Emirates US\$350 million. This reflects a new direction in Obama policy that is more multilateral based and also regionalizes the effort to address these issues. On top of that they focused more on diplomacy and on development as a crucial instrument of diplomacy. We are still not sure about the ultimate objective and strategy when we provide development assistance, particularly for Pakistan. Is our objective designed to stabilize the regime, to stabilize the Zardari administration, or to fight against terrorism? Or is it to stop the Taliban from intruding in the Punjab beyond the Federally Administered Tribal Areas? We are not certain. Moreover, Japan and the United States have provided substantial economic assistance for Pakistan for the past 20 years. No one knows exactly where that money went and how effective it has been, so I think we should articulate our future objectives and determine the modality of our economic assistance for Pakistan. The key question is not what is to be done—we all came up with US\$5 billion, and the US Congress has already appropriated US\$7.5 billion over the next five years to Pakistan—but the key questions are how, by whom, and for whom?

*Yoichi Funabashi is editor-in-chief of the Asahi Shimbun, Japan's leading daily newspaper.*

## WOLFGANG ISCHINGER

About four years ago, a group of ambassadors was sitting together in Washington and one of them asked his colleagues, “What’s the best way to make sure that my prime minister doesn’t get invited to the ranch?” I was just in Washington and in this matter the situation has changed, not surprisingly but quite dramatically, back to the old game in which each

ambassador wants to outdo his colleagues by making sure that his prime minister will be the first to have his picture taken in the White House. This is a dramatic change and is of course a lot more important than just being about photo opportunities. This is the good news.

From a European point of view, the Obama administration and President Obama himself have so far had an almost perfect track record—great summitry at the NATO, EU-US, and G20 meetings and with the Prague speech. Policy decisions that were announced were seen as being in line with mainstream European thinking and therefore greatly welcomed. I read Dr. Henry Kissinger's article in the *International Herald Tribune* and no one has said it better: "President Obama used the occasion to sketch his specific approach to foreign policy: multilateralism, repeated insistence on distinguishing himself publicly from his predecessor, [and] wide-ranging negotiations on a number of fronts simultaneously ... Not since John Kennedy's visit to Europe in 1961 has an American president evoked comparable demonstrations of public support." The list has already been discussed: rethinking Afghanistan, resisting protectionist temptations, a new approach to Iran, new dialogue and negotiations with Russia, non-proliferation and arms-control initiatives, and a new post-Kyoto approach to energy and climate change and the environment. First and foremost beyond these specific policy initiatives, the one thing that strikes me as key to everything else is that trust has been rebuilt, which is probably the single most important ingredient for the future of America's relationship not just with us Europeans but across the board.

Are we moving toward a transatlantic or for that matter transpacific paradise? I would like to suggest a few words of caution on how to manage what looks increasingly like irrational exuberance. The real challenges, of course, lie ahead. Again quoting Dr. Kissinger in his piece, when speaking about the possibility of comprehensive solutions, he says that "this reality needs to be translated into some operational concept of world order." Let me add that such a concept will only work if it is going to be underpinned by a perception of the legitimacy of US leadership and if US policy initiatives are going to be seen, not only in Europe but around the world, as sustainable and real.

Let me talk about these two issues: sustainability and legitimacy or leadership. There is an obvious need to develop a vigorous commitment to the reform of global institutions. But, will the administration find a way to overcome the obvious hurdles in terms of enlarging the Security Council? The magic formula has not yet been found or, if it has been found, it has not yet been translated into reality.

Second, the president's commitment to such issues as the CTBT, the Fissile Material Cut-off Treaty, and other arms-control and proliferation initiatives are most welcome in Europe, but we do have a serious concern about whether this will actually be supported by a Congress in Washington that has not been overly enthusiastic about such initiatives in the past.

Third, the determination to revive the lagging Israeli-Palestinian talks is most heartily supported throughout Europe. But, how much friction may such an effort cause between various actors in this game, including possibly between Washington and Jerusalem, and to what extent can it be sustainable given the US political environment?

Fourth is the issue of Iran. We love the idea that finally the United States after almost precisely 30 years is at least expressing a willingness to start to talk directly to Tehran, but how far does this go? If Iran were not to respond in the desired way now or in the coming period, is that going to mean that we will be back to square one with the same sanctions mechanism that we have tried to move forward over the last several years? Would it not be preferable to announce that we would be willing to talk to Iran at this moment without any preconditions and see how far that can take us?

Finally, the new approach to Russia that was announced, including the arms-control negotiations that were just opened, is most welcomed in Europe, but again there are a couple of *dilemmata* visible on the horizon. I find it difficult to imagine, just to give an example, how precisely one can get rid of the ballistic missile defense deployment plans for Poland and the Czech Republic in order to get rid of this irritation between Washington and Moscow without simultaneously humiliating two very important NATO powers, namely Warsaw and Prague. I think that requires very deft diplomacy at the least, and it is not going to be easy. These are a few of the difficult challenges that lie ahead where hopefully we will manage to stay together.

Let me conclude by talking about legitimacy and leadership. The obvious recipe is to lead, if possible, not by the sheer exercise of power but by consensus building and by the exercise of a certain amount self-restraint by the powerful vis-à-vis the less powerful. I was not pleasantly surprised when I saw the kinds of questions President Obama had to face upon his return to Washington after his European trip. Europeans were full of happy thoughts about his conduct, but American journalists kept buzzing him with questions like, "Why didn't you get more out of the Europeans on this and on that?" In other words, his life, even if he is going to be beloved by us Europeans, is not always going to be easy.

More fundamentally, on legitimacy, if the United States desires—and I certainly belong to those who hope that it is the intention of the United States to reacquire its traditional global leadership role—will the United States be able to demonstrate its willingness to lead by example, to allow itself to be measured by higher legal, political, and moral standards than those applied to others? Will circumstances allow the Obama administration to be such a leader? I know that this is a painful question, but when I look at the ongoing debate in Washington about whether it is right or not right to prosecute those accused of being involved with torture, it strikes me that not prosecuting them is not going to be helpful in reestablishing the kind of moral leadership that will be very important.

Finally, to conclude on a more forward-leaning and optimistic note, while it is not entirely clear how important Europe will be in the context of future American foreign policy in its totality, it seems clear that Europeans, and more generally non-Americans, should not just sit back and wait to see how President Obama and his administration will handle these and other challenges. I think it remains true that it always takes two, or at least two, to tango and there are any number of things that non-Americans can do to make sure that this administration will be capable of maintaining the momentum as declared over these first 100 days on initiatives such as Afghanistan and nonproliferation. I believe therefore that there is a historic opportunity here today to move toward a new transatlantic and probably also transpacific consensus and to translate the current economic crisis into an opportunity for a new building process of multilateral institutions and better global governance. There are a huge number of difficulties ahead but also an even greater chance to move forward and to build a better community together.

*Wolfgang Ischinger is the global head of government relations for Allianz SE. He is also chairman of the Munich Conference on Security Policy and served as German ambassador to the United Kingdom and the United States.*

## The Intellectual Underpinnings of the Trilateral Partnership in the 21st Century

HENRY KISSINGER

*Henry Kissinger closed the Trilateral Commission plenary meeting with a sweeping analysis of the changes in world politics over the last several decades, noting how the center of gravity is shifting from the Atlantic to the Pacific and that the authority of the state is eroding around the world. These fundamental changes, he argued, are helping shape the great international challenges of the 21st century and call for different kinds of responses than have been customary in the past.*

WHEN THE TRILATERAL Commission was started in 1974, the world was essentially a bipolar world. The idea of David Rockefeller and his colleagues was to bring Japan into a dialogue with what was then the center of global thinking and power, namely, the North Atlantic area. China had just begun its relationship with the United States—it was not a significant economic factor—and Japan was an outpost in Asia for the concerns that were evolved primarily in the North Atlantic context. Since then, the international system has changed fundamentally.

Let me talk about the nature of the international order and the issues in relation to the international order that I see emerging and which require some global group that addresses them. Since 1974, we have seen the collapse of the Soviet Union, the unification of Germany, the rise of China, and the abandonment by India of its non-alignment and its active participation in global affairs. We have also seen the rise of nongovernmental organizations—some terrorist, some nongovernmental organizations that undertake positive work, but all of them active in a manner that was marginal or nonexistent when we conducted Middle East policy in the administration in which I served. Terrorism was a very marginal

phenomenon. We dealt with governments and we thought we had a difficult time, but those governments were only marginally affected by the groups that avowed terrorism.

We have seen the shift of the center of gravity of international affairs from the Atlantic to the Pacific, and that is one of the major themes of this new period. We have seen the collapse of the financial system that had been believed to be—in the 1980s and 1990s—the pillar of the economic financial order.

About this I will make a few observations. Some of the discussions with respect to the economic system create the impression that their advocates believe that, at the end of the current crisis, we will go back to a slightly improved version of the previous system, with perhaps some more regulation. I do not believe that that is possible. There are a number of reasons why that will not be the case. I do not think it will be possible or desirable to restore the dominant position of the United States, and one of the key issues that needs to be discussed in this group and others is how one can have an international economic system that has various centers of power, not one that is dominated by one country.

In fact, one of the consequences of the financial crisis is a certain loss of confidence in the United States across the board. Many governments and many countries had become used to the proposition that in the political world we have flights of inspiration that prove temporary. But in the economic world it had been assumed that the US model was the one that was correct and that would be permanent. The fact that this has proved not to be the case will affect the American ability to prescribe solutions in a fundamental way.

I also think that the role of government in the next period, for better or worse, will be much larger and that attention will have to be paid to the fundamental flaw of the globalized economic system as it existed before, which was that the economic model and the political model were out of sync with each other. The global economic model assumed that there were principles that could be applied universally and that it was self-regulating. For that reason it was not believed to be necessary to have a political safety net for the economic system. But the fact was that whenever a crisis occurred, or whenever any group felt significantly disadvantaged, they would go to the political institutions that they knew, which were the national governments. Therefore, there was an inherent discontinuity between the way economics was dealt with and the way politics would react. This has been shown by the fact that in the first round of this crisis, the solutions

are attempted on a national basis—which are then coordinated—and not on a global basis.

So, all of these matters will need attention and they will need attention in a very special context. Every country that holds the views that I described, which is most of them, has two contradictory motivations. On the one hand, they want to make themselves independent of the forces that produced the crisis and, at the same time, they recognize that the solutions require a global answer. The result will have to be the evolution of some kind of multipolar leadership of the international system. Let me now turn to that issue.

The political world is in a period of fundamental change. When I taught international politics, we dealt with the concept of sovereignty as the organizing principle of the international system, both for foreign policy and for domestic policy. But now the notion of sovereignty is under attack or in the process of change in many parts of the world. Europe, which originated the concept of the nation-state, has voluntarily surrendered part of its sovereignty to the European Union. But the European Union has not been able, up to now, to generate the political loyalties that the nation-state did. Therefore, there is a gap in Europe between the way foreign policy used to be conducted when the nation-state was the repository of all national loyalties and the current situation where on the economic level the European Union becomes stronger but there is no repository for the kind of strategic foreign policy that used to be characteristic of Europe.

Therefore, some of the disagreements that have existed between Europe and the United States are not due primarily to the personality of American leaders, though they were not aided by some of the arguments that the American leaders made. Their fundamental cause is the fact that European public opinion is very reluctant to engage in foreign policy beyond soft power. It is not a lack of loyalty to the alliance; it is not a lack of understanding of what the issues are; it is the fact that in Europe, the nation-state—based on its experience in two world wars—cannot conduct a strategic foreign policy involving significant sacrifices, and the European Union has not yet substituted a political concept. Therefore, a wise policy will keep that in mind, and I believe the Obama administration has acted wisely in Afghanistan in not making an issue of the disparity between the formal NATO commitment and the willingness of the Europeans to support it. I would prefer a different attitude, but I think that if we push that issue, we will weaken our relationship. And in a more fundamental way, as we think of the way

the international order is likely to evolve, we need to understand what Europe can and cannot do and how the North Atlantic alliance needs to be defined to fit the current circumstances.

In other parts of the world, the notion of sovereignty has also collapsed but for quite different reasons. In the Islamic world, particularly in the Middle East, the notion of a sovereign state conducting an autonomous foreign policy was brought in at the end of World War I by the European countries. It, therefore, has not ever, and certainly does not now, attracted the loyalties that the European nation-state had at its fully developed period. What has emerged is a concept of Islamism that challenges the notion of the secular state and, in some cases, the existence of the actual states. The principal country in that area that is conducting a traditional foreign policy in some respects is Iran because it has the tradition of an empire. It has had a national identity, but it is now using it, at least in part, to support the Islamic movements that undermine the secular state.

The principal place where the traditional international system still exists in its more or less pure form is in Asia. The nations of Asia have the kind of national loyalties that were characteristic of the European states. Strategic conflict between the European states is practically inconceivable. In Asia, war is highly unlikely, but there is a tendency to consider each other as potential strategic adversaries. At any rate, a balancing of power of the various states is always in the back of their minds.

So, as the center of gravity of international affairs moves to the Pacific and to the Indian Ocean, there are, in a way, two somewhat contradictory approaches to international affairs that are being conducted, and, if other conditions had not changed, one would predict for Asia some of the kinds of conflicts that existed previously in the evolution of European history. The reason that conflict is not likely is the emergence of global issues that can only be dealt with on a global basis—issues like climate, the environment, energy, trade, weapons of mass destruction—and they impel a global approach. And there is another element. The nations of Europe went to war with each other because they thought the consequences of defeat were worse than the consequences of war. Nobody with modern weapons can have any illusions that the consequences of war will not have the most drastic impact on modern societies. And so, the rise of Asia has to be accommodated in an international system that is based on cooperation and on dialogue without the recourse to military measures that used to dominate international affairs.

But that raises the question of how does one do this? In history, international orders emerged either by consensus or by some application

of a balance of power. Now, ideally, one would like to see order emerge out of consensus. But history teaches, and our own experience teaches us, that in groups based on consensus there is very often an unequal willingness to assume risks and, therefore, leadership groups emerge within the consensus group that assume responsibility, or the whole thing will gradually stagnate and fall apart. But then, the question arises, how does one apply this in the multipolar world that I have described? How can one get either consensus or equilibrium when the various actors are states but they can also be NGOs and they can also be non-state groups. This is the challenge of our time, and this is where a group like this can be of great importance. This group can raise questions that the governments sometimes do not find it possible to address, and it can provide a possible consensus to which governments can repair or which they can use as they make their decisions.

This applies to a number of issues. Let me give one example that was raised by President Obama in Prague, the issue of a world without nuclear weapons. That is a goal every American president has avowed since the beginning of the nuclear age and it has attracted enormous support and been supported by any number of intellectual groups. But the fact is that as a practical matter it is extraordinarily difficult to reach and, in fact, impossible to reach under present circumstances.

At the Munich Security Conference, I quoted Senator Sam Nunn, who is a colleague of mine, on having talked about this project, together with George Shultz and Bill Perry. Senator Nunn puts it this way: "The project is like trying to climb a mountain that is covered in clouds. And you announce that you want to reach the summit but you have no idea what the summit looks like. On the other hand, you will never understand what the summit looks like until you begin the journey and start going into the clouds, and in that process it may become clearer to you. In fact, you cannot do it unless you undertake that journey." Now the reason I and others who have been in my office and who were known as hardliners have cooperated in this project is that we have all had the experience of asking ourselves, "What would we do if we had to make the decision to use nuclear weapons?" Each of us understood that this was a decision of a magnitude that goes beyond anything in previous political experience and probably of a magnitude that can have no moral justification.

So, it is an enterprise that must be undertaken, but it is an enterprise also that needs to be looked at or studied in the excruciating detail that it involves. It is not something that you can achieve with placards or in outbursts of pacifism. It is because when you ask yourself of the

impact on the world of the reduction of nuclear weapons, each phase of this has its own aspects and each phase will lead to a very complicated political discussion.

I have been very much engaged in putting Russian-American relations on a new basis. In dealing with Russian strategists one learns that the notion we had in the 1970s of a Russia with unlimited reserves of manpower, threatening Europe militarily with its conventional force, that had to be opposed with nuclear weapons on the ground is totally reversed. It is Russia today that thinks that it is surrounded by countries with unlimited reserves of manpower and unlimited ideological commitment and that it, therefore, had its own necessities for nuclear weapons which cannot be simply analyzed in terms of the overall deterrence of the United States and Russian equation. The issue of nuclear weapons has similarities to the Schleswig-Holstein Question in the 19th century, about which Lord Palmerston said there were only three people who had ever understood it: one was dead, the second was in a lunatic asylum, and he himself was the third and he had forgotten all about it. We have to be the third on this issue and we have to learn about it. This is one of the great challenges before us.

All of us here have been affected by the rise of China, and it has been an explicit and an unspoken aspect of many of our discussions. It has never happened before that a country of such magnitude entered the international system without conflict and yet this is precisely the challenge that our international order faces.

There are two aspects to this. One is, what is Chinese policy? Is it Chinese military policy to dominate the region? This is something one can affect, and must affect, by discussions. The second is the weight of China. Regardless of the intentions of Chinese leaders, the weight of China will increase. It is inevitable; it is a fact of life; and it must, therefore, be considered in any discussions we have about a new international system. This requires, on the side of China, wisdom and restraint, and it requires, on the side of its surrounding countries, comparable wisdom and restraint. Looked at from this point of view, no conversation in the world today is more important than the American and Chinese strategic dialogue. This does not derogate from any of our alliances; it is not a way of governing the world. Quite the contrary, it is a dialogue that makes it possible to create a multipolar world based on the recognition by two of the countries that are the principal carriers of international economic and strategic power of the role that they must play in this. So what we need to think about is this. What matters can only be done, or can best be done, on a global basis? What matters

should be done on a regional basis? What issues require specific, limited groupings to deal with them?

This afternoon, we have heard about the issue of Afghanistan, and that issue and the Pakistan issue involve, really, two problems. One is the traditional military problem of how do you deal with the challenge to order that has presented itself. But secondly, there is the necessity of creating a political system in the region that enables all of the countries that are potentially affected by this to act in a unified manner over an extended period of time. On this we could find that India, China, Russia, Iran, and the United States have parallel objectives, and the challenge will be, first of all, to define these objectives to ourselves in a way that can be translated into action and, secondly, to use the combined pressures that they can exercise to diminish the purely American military aspect of it and merge it into this international system.

In a deep way, this is exactly the problem we face also with respect to North Korea and Iran. Whatever the debate is about the military significance of their weapons, the fact is that we have a situation in which the international community has expressed its determination that there not be nuclear weapons programs in those countries. If they now occur anyway, how can one then still speak of a meaningful international consensus? Of course, there could be a negotiation to achieve this.

Having described all of these complexities, let me leave us with a positive feeling. First, the international financial crisis can help the creation of an international political order for a negative reason. Every country is so preoccupied with its own domestic issues; no country has a great surplus of resources that it can devote to international adventures. So, if political leadership can develop, this is a good objective circumstance. Secondly, we are living in a period in which, for the first time that I know of, no major country is challenging the international system. All of the challenges to the international system come from countries that, in relation to the overall order, are relatively fringe countries or from non-state actors. So, the opportunities that we can see in developing the global patterns that are inherent in this situation are very great despite the fact that the surface knowledge is the opposite.

To all of this I think this Trilateral Commission can make a significant intellectual contribution. It can raise issues; it can define them in a long-range point of view; and it can help with one of the great needs of this period, which is that governments are so preoccupied with the immediate issues that there is sometimes no focal point for a consistent application of long-range visions. So we can raise issues, we can

indicate directions, and in this way we can fulfill the vision that created the Trilateral Commission when it operated in a smaller framework and when one of its primary purposes was to bring Japan into a North Atlantic framework. Now it can help bring Asia and Russia into a coherent global framework.

*Henry A. Kissinger is chairman of Kissinger Associates, former US secretary of state, former US assistant to the president for national security affairs, and a lifetime trustee of the Trilateral Commission.*

## APPENDIX



# Program

## Saturday, April 25

- 9:00 Chairmen's Opening Statements  
Yotaro Kobayashi, *Pacific Asia Chairman*  
Peter Sutherland, *European Chairman*  
Joseph S. Nye, Jr. *North American Chairman*
- 9:15–10:30 **Session I: The Global Financial Crisis: The Road Forward**  
*Chair:*  
Yotaro Kobayashi, *former Chairman of the Board, Fuji Xerox Co., Ltd., Tokyo*  
*Panelists:*  
Toyoo Gyohten, *Special Advisor to the Cabinet; Special Envoy of the Japanese Prime Minister; President, Institute for International Monetary Affairs, Tokyo; Senior Advisor, The Bank of Tokyo-Mitsubishi UFJ, Ltd.*  
E. Gerald Corrigan, *Chairman, Goldman Sachs Bank USA, New York, NY; former President, Federal Reserve Bank of New York*  
Rudi Bogni, *Director of Old Mutual and of Prospect Publishing; Member of the International Advisory Board of Oxford Analytica; former Chief Executive of Private Banking, UBS, London*
- 10:45–12:00 **Session II: Future Directions for Global Economic Recovery**  
*Chair:*  
Sir Deryck Maughan, *Member, Kohlberg Kravis Roberts & Company, New York, NY; Chairman of KKR Japan*  
*Panelists:*  
Luis Téllez, *former Mexican Secretary of Communications and Transportation; Chairman, Bolsa Mexicana, Mexico City, DF*  
Edmund Alphandéry, *Chairman, CNP Assurances, Paris; former French Minister of the Economy and Finance*  
Zhang Yunling, *Professor and Director, Academic Division of International Studies, Chinese Academy of Social Sciences (CASS), Beijing*
- 12:10–14:00 Luncheon panel: **The Japanese Economy**  
*Chair:*  
Bill Emmott, *former Editor, The Economist, London*

*Panelists:*

Yoshimasa Hayashi, *Member, Japanese House of Councillors; former Japanese Minister of Defense*

Sachio Semmoto, *Chairman and CEO, EMOBILE, Ltd., Tokyo*

Naoki Tanaka, *President, Center for International Public Policy Studies, Tokyo*

14:30–14:45 Remarks by Hon. Taro Aso, Prime Minister of Japan

15:00–17:30 **Session III: Prospects for Regional Development in East Asia**

*Chair:*

Joseph S. Nye, Jr., *University Distinguished Service Professor and former Dean, John F. Kennedy School of Government, Harvard University, Cambridge, MA*

*Panelists:*

Jusuf Wanandi, *Vice Chairman, Board of Trustees, Centre for Strategic and International Studies, Jakarta*

John Hewson, *Chairman, GlobalDC, Sydney*

Yang Jiemian, *President, Shanghai Institutes for International Studies*

Rajiv Sikri, *former Secretary, Indian Ministry of External Affairs; former Indian Ambassador to Kazakhstan*

Hitoshi Tanaka, *former Japanese Deputy Minister for Foreign Affairs; Senior Fellow, Japan Center for International Exchange, Tokyo*

Kim Sung-han, *Director, Iimin International Relations Institute, Korea University; Professor, Graduate School of International Studies, Korea University, Seoul*

19:00 Reception hosted by Hon. Hirofumi Nakasone, Minister for Foreign Affairs of Japan, and Mrs. Nakasone at Iikura Guest House

## **Sunday, April 26**

9:00–12:15 **Session IV: The Threat of Protectionism to Global Recovery**

*Moderator:*

Barry Desker, *former CEO, Singapore Trade Development Board; Dean, S. Rajaratnam School of International Studies, Nanyang Technological University (NTU)*

*Panelists:*

Narongchai Akrasanee, *Chairman of the Board of Directors, Export-Import Bank of Thailand, Bangkok; former Minister of Commerce of Thailand*

Susan Schwab, *former US Trade Representative; Professor, School of Public Policy, University of Maryland, College Park, MD*

Peter Sutherland, *former Director General, General Agreement on Tariffs and Trade (GATT) and World Trade Organization (WTO)*

**Comments:**

Chandrajit Banerjee, *Director General, Confederation of Indian Industry (CII), New Delhi*

12:30–14:15 Luncheon panel: **Afghanistan-Pakistan: Implications for the Trilateral Partnership**

**Chair:**

John D. Negroponte, *former US Deputy Secretary of State; Vice Chair, McLarty Associates, Washington, DC*

**Panelists:**

Gordon Smith, *Director, Centre for Global Studies, University of Victoria, Victoria, BC*

Masashi Nishihara, *President, Research Institute for Peace and Security, Tokyo*

Stefano Silvestri, *President, Institute of International Affairs (IAI), Rome; former Italian Under Secretary of State for Defence*

14:30–17:30 Session V: **The New US Administration: Meeting Challenges, Managing Expectations**

**Chair:**

Lord Kerr of Kinlochard, *Deputy Chairman, Royal Dutch Shell plc; Member of the House of Lords, London; former British Ambassador to the United States; former Secretary General, European Convention*

**US speaker:**

R. Nicholas Burns, *former US Under Secretary of State for Political Affairs; former US Ambassador to NATO; Professor of the Practice of Diplomacy and International Politics, John F. Kennedy School of Government, Harvard University, Cambridge, MA*

**Pacific Asia response:**

Yoichi Funabashi, *Editor-in-Chief, The Asahi Shimbun*

**European response:**

Wolfgang Ischinger, *Global Head of Government Relations, Allianz SE, Munich; Chairman, the Munich Security Conference on Security Policy*

18:30 Closing dinner: **The Intellectual Underpinnings of the Trilateral Partnership in the 21st Century**

**Chair:**

Yotaro Kobayashi, *Pacific Asia Chairman*

**Speaker:**

Henry Kissinger, *Chairman, Kissinger Associates, Inc., New York, NY; former US Secretary of State; former US Assistant to the President for National Security Affairs*