Beyond the Golden Era:
Asia Pacific Cooperation after 2007

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I. Introduction

Forty-five years after Professor Kiyoshi Kojima's vision of a Pacific Free Trade Area gave birth to PAFTAD, this conference, like many of its 32 predecessors, addresses the challenge of regional integration in the Asia-Pacific (Patrick 1996, Terada 1999). *Plus ça change, plus c'est la même chose?* Not really. Barriers to integration remain, including in the Asia Pacific, but enormous progress has been made. The region has become highly integrated and most of its economies are embarked on robust, market-based development. As a result, living standards have risen well beyond expectations. One imagines that even the PAFTAD optimists of 1968 would not have predicted that Asia's emerging economies would today lead the recovery from a deep and embarrassing crisis that started in the United States, serve as principal investors in the US dollar, and assume—gradually to be sure—a central role in managing the world economy.

But the question of integration remains important because the framework that helped to drive this stunning transformation is breaking down. Even before the crisis of 2008-09, the international trading system had gotten stuck. The crisis has uncovered large gaps in cooperation, especially in macroeconomic management and financial regulation. Another important global process, the Copenhagen climate summit, seems headed for a stalemate. In short, existing institutions of international cooperation appear to be unprepared to manage urgent contemporary challenges. The G-20 is a bold new answer to this dilemma, but will it work? What explains the chaos in global institutions, in an era of rapid globalization? What would a more effective structure look like?

These issues will be central to this year's PAFTAD conference. To set the stage, we have been asked to trace the evolution of the global economy and its institutions over the last 60 years, with emphasis on the Asia Pacific. The paper begins with the achievements of the era and the policy approaches (especially market-oriented liberalization) and institutions (especially the GATT/WTO) that helped to bring them about. It next considers signs of age in this system, including the fraying political economy of liberalization, the rising challenge of regionalism, and recent crises—in Japan, emerging Asia and now the United States—that highlight risks. It then turns to implications for future cooperation and the institutions that will manage it.

The paper will argue that the key economic and political foundations of the post-war system of cooperation are weakening. Cooperation in the future will need to be based on new foundations. One possibility is that strong global leadership and reform revive global institutions such as the IMF, with the help of the dynamic, emerging economies. Another possibility is that international decisions will shift to more *ad hoc* forms of cooperation—to pairs or small groups of countries, regions and other "clubs." This doesn't necessarily mean an end to global cooperation, which could be more informally but perhaps still effectively guided by the G-20.

But unless the G-20 manages to build a strong centralized model, countries will continue to adopt policies that they can implement independently or in small groups. For example, they will rely on self insurance or regional insurance against macroeconomic shocks until a strong, credible and politically acceptable IMF emerges. Thus, the expectation of a fragmented or ineffective global system becomes self-fulfilling. Will such a system dampen future world growth? Perhaps yes, but not necessarily by much. There are reasons to expect future growth to remain robust, but to be driven more by national and regional policies than by further leaps in global integration. Such distributed growth, in turn, could be adequately served by less formal and centralized cooperation.

In any case, cooperation is becoming messier. The world is creating more and more varied institutions (bilateral, regional, global) that overlap and diverge in interests. The emerging system may have more in common with governance in a large, heterogeneous country (with many provinces and multiple layers of government) than with the hierarchy of the post-war order.

The challenge for analysis is to find innovative ways to make this complex, centrifugal system work.

These are large and speculative topics and the goal of this paper is to stimulate discussion rather than to provide answers. These problems need to be analyzed from a truly international perspective. One hopes that the challenge of proposing good solutions will provide ammunition for this and another 33 successful PAFTAD conferences.

II. The (latest) golden era

The period before the current global economic crisis was the best half century ever in world economic history (as told by Angus Maddison).[1] In the 60 years between World War II and 2007 the world economy left behind the legacy of the Great Depression and the state-led models that followed it, and became a market-oriented, integrated, lightly regulated, and enormously successful engine of growth. This latest golden era has surpassed the achievements of previous golden ages (e.g. 1870-1913) by a healthy margin. Globalization is the defining feature of the new era; economic interdependence around the world rose to unprecedented levels. This transformation was the result of, and helped to justify, a sustained liberal swing in economic perceptions, including sweeping changes in theory, policy and "facts on the ground."

Yet the forces that made this era successful are weakening. Liberalization is partly a victim of its own success; for example, in many countries the reduction of trade barriers has diminished business and policy interest in further cuts. In other areas of policy, liberalization has gone beyond reasonable limits, as in the regulation of US financial markets before the global crisis. And in still others—for example, the environment—different kinds of policies are needed to cope with global challenges and a more complex world economy.

What comes beyond this new golden era is of course uncertain, but there is reason to expect that the deep sources of success—technology and market-friendly economic policy—will continue to drive economic progress. It is more difficult to imagine that further *increases* in liberalization and trade intensities will match those of the past 60 years, at least in wealthy countries. The next

[1] Maddison (2001) provides a global overview, Maddison (2003) provides detail for the Asia Pacific.

60 years start from an already high level of interdependence and low barriers to trade. They also face other political and economic circumstances that make cooperation more difficult. But communications and the exchange of ideas have become much more ubiquitous. A reasonable guess, therefore, is that future growth will be driven more by the diffusion of technology and economic best practices (and perhaps factor movements) than by new global rules that generate additional leaps in specialization and cross-border trade.

Antecedents of contemporary growth

The 1950-2007 era was remarkably productive. World GDP appears to have grown at an annual rate of 4% during this period, faster than in any other period of comparable length in recorded history (Figure 1). Growth was almost twice as fast as in the 1870-1913 previous "golden age," the best era before the post-war period (Maddison 2001). And that era was exceptional too; the growth rate had doubled from the half century before then (1820-1870), when growth averaged less than one percent. Before 1820, growth was slower still—it was not consistently positive, and when it was, it fluctuated around a small fraction of one percent.

Figure 1. The golden age in historical perspective

Output growth accelerated in 1870-1913 due to technical advances in health (leading to population growth) and production, including revolutions in power generation and transportation, which led to productivity gains economy-wide. These were also communicated through the world economy by a wave of globalization, including immigration, trade and capital flows (see Figures 4 and 5 below). But acceleration was not smooth then or since; growth rates fluctuated substantially after 1870, including within the post-World War II era. To some extent, output fluctuations may have been caused by lumpy advances in technology, but more likely, they were the result of other variations, including especially in the policy environment. Maddison emphasizes these latter variables, and singles out especially those that affect the international division of labor. He argues that the engines of 1870-1913 economic growth were set into motion in Britain and elsewhere by policies and treaties that established a relatively liberal trade and financial regime for Europe and its colonies (at least in terms of access to the colonies' markets).

The next forty years from 1913 to 1950, dominated by wars and the Great Depression, were a "complex and dismal" era (Maddison 2001, p. 101). The problem was not that technology stopped advancing; many important new products and services were introduced and/or widely adopted, including electric power, automobiles, airplanes and the telephone. Rather, the world's economic "software" collapsed; monetary and financial systems and international economic linkages reverted to conditions experienced many decades earlier. The downward spiral in trade, as will be reported in Figure 4, reduced interdependence to levels not experienced since the 19th century. Arguably, the depression contributed to the rise of national political movements and collapse of world order that led to World War II.

What followed after the war was—remarkably—sustained, unprecedented growth. Advances in technology and productivity probably accelerated (partly endogenously), providing even stronger foundations for growth than before. But most importantly, social conditions became favorable to economic progress. A relatively peaceful and cooperative setting allowed the benefits of new technologies to be realized on an astonishing scale, within countries and across the world. The strategies to exploit these opportunities began with state-led efforts to rebuild economies and to jump-start development, but were later driven by liberal, market-friendly policy.

The last sixty years have been an especially golden for Asia. Since the 1600s, Asia had consistently lagged world growth, and by an especially large margin during the early stages of the industrial revolution in the 19th century (Figure 1). But since World War II, Asian growth accelerated sharply and has exceeded high global averages. Behind this resurgence are the serial miracles that started in Japan and spread to the NIEs, Southeast Asia, China and India. The first wave of globalization in 1870-1913 largely bypassed Asia, but the wave in this half century moved Asia to the center of the global division of labor and growth process. The full implications of this truly remarkable development are just beginning to be felt.

Triumph of the market

The post-World War II policy framework did not set out in an especially liberal direction. The architects of Bretton Woods wanted to reverse the protectionist excesses of the inter-war era, but they also tightly circumscribed international economic activity with fixed exchange rates, capital controls, and barriers to trade, in part because they eschewed the *laissez faire* environment associated with the disaster of the 1930s. Most policy makers and leading scholars (not only John Maynard Keynes, but also more conservative economists like Gottfried Haberler and Sir John Hicks) felt that macroeconomic stability was paramount and warranted sacrifices in efficiency that might result from barriers to trade and financial transactions (Irwin 1996, p. 202).

The state was also prominent in development strategy. The expanding socialist bloc based its economic system squarely on state ownership and central control, and Western countries like France pursued extensive experiments in nationalization, planning and regulation. Exchange controls continued for many years after the Bretton Woods; the yen become convertible for current account purposes only in 1972, and the British pound only in 1979. In Latin America, import-substitution supported by overvalued exchange rates and exchange controls became the centerpiece of policy. Initially, these approaches appeared to work; up through the early 1970s, economies in Europe, Latin America and Asia achieved impressive results with state-led models of growth. An analytical rationale for these approaches was provided by coordination problems that gave rise to the "big bang" development theories of Rosenstein-Rodan (1943), Leibenstein (1957) and Hirschman (1958).

As the global economy prospered and became more competitive, the "commanding heights" of government came under challenge. In some areas of policy, governments could no longer defend interventions against markets that had become large enough to overwhelm them (for example, in maintaining disequilibrium exchange rates among currencies and between the dollar and gold). In other areas, broad dissatisfaction arose with rules that blocked profitable transactions within and among countries. Rent seeking and government failure were identified as important drags on efficiency (Krueger 1974). Firms and individuals and lower levels of government became more adapt at circumventing regulations (say, through off-shore investments, or special economic zones). The case for liberalization became stronger and began to dominate professional economics, including especially the views of the World Bank and the IMF. These perspectives were confirmed by the "miracles" of Asian and other countries (World Bank 1993), although more nuanced debates also emerged about the role of government and institutions in facilitating market-oriented growth (Rodrik 2003).

It is not possible to demarcate sharply the state-led strategies of the early postwar era from the market-oriented strategies that followed, but 1973 offers a useful milestone. This year marked the end of the Bretton Woods fixed exchange rate system and an upsurge in new patterns of international capital flows, fueled by petrodollars. As in the late 19th century, capital flows resumed a central role in connecting economies around the world. Money center banks on-lent petrodollars to developing countries, leading to the first major post-Bretton Woods financial crisis, the developing country debt crisis of 1982. Markets increasingly set the terms of development policy; governments came to see their role as facilitating investment and competitiveness.

The timing may be fuzzy, but it's difficult to overstate the breadth and scale of market-oriented reforms. The most dramatic transformations occurred in the former socialist economies, which abandoned central planning in wrenching transitions in the late 1980s. But economies everywhere liberalized markets, with strong models emerging on every continent, including Latin America (Chile), Africa (Botswana), Europe (United Kingdom) and Asia (many). Even in continental Europe, state enterprises were extensively privatized and the bounds of competition were vastly enlarged by the common market and the gradual transfer of authority to the European Commission. The United States eliminated a wide range of market regulations, including those in the financial sector adopted during the Great Depression.

By the mid 1990s, the triumph of the market was complete. Socialist countries had abandoned central planning and were transitioning to market economies; the principles of economic management summarized in the "Washington Consensus" (Williamson 1989) were defining the agenda of leading international policy institutions; economies with export-oriented strategies, mainly but not only in Asia, were booming; and the United States was ascendant among advanced countries with a vibrant economy riding the investments of the dot-com boom.

In a lively, accessible argument for the consensus, Thomas Friedman (1999) wrote that the "driving idea behind globalization is free-market capitalism. The more you let market forces rule and the more you open your economy to free trade and competition, the more efficient and flourishing your economy will be. Globalization means the spread of free-market capitalism to virtually every country in the world." Befitting the times, he also argued forcefully for self-regulation: "...the market on its own is brutally disciplining itself. …major banks have restricted leverage, cutting off reckless fund managers, demanding more documentation from those to whom they are still lending and scrutinizing more seriously not just the balance-of-payments figures of emerging markets but also their operating systems, legal systems and overall software." The post-2007 world faces more complex realities.

The institutional framework of trade

The framework for post-war international economic cooperation, which led to many of these achievements, is well known. The Bretton Woods conference of 1944 established the World Bank and IMF,[2] and initiated plans for an International Trade Organization, eventually endorsed by 53 countries in the Havana Charter of 1948. But concerns in US politics (about the opportunities the Charter gave to other countries to impose trade restrictions and the limits it placed on the ability of the US to do so) caused President Truman to withdraw the Charter from congressional consideration (Cohn 2002). But 23 countries also signed a General Agreement on Tariffs and Trade (GATT) in 1947, representing the first of eight rounds of negotiations that have dramatically lowered tariffs and other barriers to international trade (Figure 2).

Figure 2. Declining rates of protection.

Uruguay Round, completed in 1994, represents the crowning achievement of the system. In addition to lowering tariffs, it brought agriculture and services into the international framework, addressed many other trade-related interventions, and established the World Trade Organization (WTO). The WTO institutionalized the enforcement of global rules through a beefed-up dispute settlement mechanism and provided for a framework of additional negotiations. Hoekman and Mavroidis (2007) describe the core operating principles of the WTO, many of which it inherited from GATT, as these:

- Single undertaking
- Tariffs are the only permissible form of protection

[2] Since this study focuses on trade relations, it does not attempt to follow the evolution of the roles of the World Bank and IMF.

- Non-discrimination
- Reciprocity
- Enforcement of obligations
- Transparency
- Safety valves

The “single undertaking” concept was new; it obligates all WTO members to accept all provisions of the agreement, although with varying transition periods and some exceptions for developing countries. It made the system truly global—and harder to administer. The early focus of the world trading system was liberalization, typically limited to relations among a relatively small number of advanced economies. But over time and especially with the formalization of the WTO, the system shifted from liberalization to the design and enforcement of rules (Baton et al. 2008). This put trade issues into the middle of complicated national regulatory debates. Moreover, countries uninterested in or unwilling to adopt international rules could no longer opt out; they now had to resist the adoption of rules they did not wish to accept. Coupled with the near universal expansion of GATT/WTO membership, these developments vastly complicated the task of reaching further agreements.

Has the GATT/WTO contributed to the growth of international commerce? Not long ago a positive answer to this question might have been considered self-evident, but Rose (2007) concluded from an empirical study that membership in GATT/WTO did not increase trade. Subsequent analyses have generated more supportive conclusions. It appears to be especially important to control for non-GATT/WTO economic relations among countries, such as colonial ties, free trade areas, and currency unions. In some recent studies (Tomz et al. 2007) these variables are introduced by redefining GATT membership to include colonies of members (they received GATT privileges corresponding to those of members, but were not considered members in Rose’s study). In other studies they are directly controlled (Gowa 2008). In both approaches, such controls make the GATT/WTO variables significant and positive; Gowa (2008) concludes that members trade 42 percent more with each other than non-members.[3]

The history of GATT/WTO provides insight into the structural obstacles that now face the negotiating framework. Agreements need to have consensus, but negotiations face the increasingly diverging interests of a growing membership. One indicator of the complexity is the sheer number of participants; the size of successive GATT/WTO rounds increased from 23 original contracting parties in 1947 to 126 participants in the Uruguay Round (1986-1993), and to more than 150 countries in the current Doha Round (Figure 3). All along, innovative efforts were mounted to make the negotiations manageable, but none has proved sustainable. In 1975 a "Consultative Group of Eighteen" was established, but it succumbed in 1987 to the criticism that it lacked transparency. A less formal approach involved gathering key delegations (ranging from 8 to 20 countries depending on the issue) in "Green room" meetings (originally in a room with that color scheme adjoining the Director-General's offices), but this format too was heavily criticized by countries that were excluded. Many proposals have been made to create a steering committee with a small number of representative members, akin to the boards of the World Bank and the IMF, but these efforts have not been supported by the smaller economies that might be excluded, or by the larger ones that have their say anyway (Schott 2000).

Figure 3. Relationship between rounds and countries.

The Quad—consisting of the trade ministers of Canada, the European Union, Japan and the United States, countries that together controlled more than half of world trade—came into existence in 1982; it was instrumental in initiating the Uruguay Round and in the compromises that led to its conclusion. The Quad was a major step forward from a process that was previously dominated by the United States and the United Kingdom. But some difficult issues still had to be solved more narrowly; for example, the EU and US achieved the key agricultural compromise required for the Uruguay round in the bilateral "Blair House Accords" of 1992. In effect, throughout its history GATT worked best when a small number of large countries wanted to agree, and had sufficient influence to bring along other contracting parties. Disagreements in

[3] This is a large increase for an institutional contribution, which is of course difficult to measure. Somewhat puzzlingly, Gowa herself minimizes the importance of the contribution, noting that trade increased manifold during this period.

the Quad resulted, for example, in the cancellation of crucial meetings just prior to the 1999 Seattle ministerial, and contributed to the debacle of that meeting. The Quad itself became a victim of Seattle, although from time to time ministers continue to meet quietly on the sidelines of other events.

The contributions of the GATT/WTO are all the more remarkable because of the though context of global liberalization. The organization repeatedly achieved breakthroughs that seemed unlikely. Today it effectively manages a complicated system of rules that provide some discipline to the routine processes of trade. Even during the extraordinary global recession, these disciplines and the WTO's technical oversight function have helped to contain the protectionist pressures that arise in downturns. The WTO has amply demonstrated that it adds value to the global trading system and needs to remain an integral part of it.

But the outlook on negotiations is more discouraging. The WTO lacks mechanisms for resolving divisions that separate the diverse interests of countries, especially developed and developing countries. Even with vigorous leadership—say, a group of visionary G-20 heads of state—it would be difficult to imagine the WTO achieving a meaningful bargain across its enormous portfolio. (Some modest deal may be still necessary, if only to clear the stage for other, more decentralized approach to negotiation in the future.) More complications will come with environmental rules. There is wide agreement that procedural innovations are needed in the WTO—for example, in creating some representative leadership—but they face much political resistance (Barton et al. 2006). Even with a more effective decision making process, it is simply not clear that there exist comprehensive global deals that satisfy so many constraints.

Deepening interdependence

Scholars have noted that the post-war period is not the first to witness sustained globalization, and indeed started from a relatively closed point in the wake of the Great Depression (Bordo 1998, Irwin 1996). But the recent expansion of international linkages has set records in most areas of commerce (except labor flows, which were higher under the immigration regimes of the pre-World War I era).

The ratio of trade to GDP is one measure of these trends (Figure 4). As Feenstra (1998) noted, this indicator understates volume increases because the prices of tradeables have declined relative to non-tradeables. Research also suggests that economic connections became more diverse; trade shifted from primary materials to a wide range of manufactures, and now encompasses a widening range of services, facilitated by advances in communications (Findlay and O'Rourke 2001). Capital flows also picked following the collapse of Bretton Woods (Dobson et al. 2001) and then accelerated with astonishing force in recent years (Figure 5); between 1990 and 2007 the share of cross-border investments in world GDP roughly quadrupled, growing at an average annual rate of 15%.

Figure 4. Rebounding trade relative to GDP

Figure 5. Explosion of global capital flows

The density of international linkages has transformed the nature of production. As has been widely documented, production now involves fragmented supply chains with relatively narrow processes located in different countries reflecting differences in comparative advantage or economies of agglomeration. This made the production chain very dependent on the predictability of logistics and policy in different countries. It has also made policy more complicated. Firms have varied, overlapping interests in different countries, and the economics of exchange rate adjustments, for example, have substantially changed as countries import large shares of the inputs required for exports.

Interdependence appears to be deepening especially fast among neighboring or otherwise closely related countries (Coe et al. 2002). This is especially true for Asia (Capannelli et al. 2009). There is no reason why falling communications and transport costs should lead to geographically concentrated linkages—but it appears to do so. One hypothesis advanced for this finding is that economies of scale and technology have become more ubiquitous, so that firms no longer have to reach over long distances to obtain specialized products. Another hypothesis focuses on the nature of falling transport costs; these contribute to the decentralization of production, but in the process make coordination costs more important. Coordination costs may be lower in regional setting because they depend on various factors such as cultural similarity and historical ties, ease of personal travel, and differences in time zones.

Achievements

The achievements of this period were enormous. Between 1960 and 2007, the world's[4]:

- population increased by 118%
- real GDP increased by 443%
- per capita GDP increased by 149%
- real trade increased by 1342%
- life expectancy increased by 37%
- death rate declined by 55%

While these gains ultimately depend on the development and diffusion of technology, there is little doubt that the global economic system was central to their realization. Starting with the path-breaking work of Sachs and Warner (1995), many studies have demonstrated a strong relationship between economic openness and the rate of economic growth. In fact, this link between has become one of the most-studied relationships in empirical economic analysis. Although the relationship is overwhelmingly positive in every study, its causal interpretation has been challenged based on claims that the underlying findings were not robust, and that economic institutions rather than actual liberalization were the cause of improved results for open economies (Easterly 2005). The most recent and careful studies, however, continue to demonstrate a direct causal link (Estevadeordal and Taylor 2008).

There is ample evidence that the world benefited from the extraordinary integration of the global economy in the post-war period, and that the GATT/WTO system played a critical role in this process. Of course, the world started from depressed initial conditions—the legacies of World War II and the Great Depression. But nothing like this had happened before—the reach of economic growth, the "convergence club" of empirical growth theory, dramatically widened, embracing many emerging economies, including especially Asia's tigers and giants.

Some have gone still further to claim that business cycles have also moderated in this period. Barro and Ursua (2008) define a crisis as a 10% GDP decline, and find only 3 such episodes in

[4] Calculations are based on World Bank, World Development Indicators, extracted September 25, 2009.

OECD countries after 1950 (all in small countries), compared to 72 between 1870 and 1950 (many associated with war and the Great Depression). They also find fewer crises in non-OECD countries, 23 after 1950 vs. 70 before. But more modest cycles have occurred fairly steadily over time. Lee and Tang (2009) show that relatively constant proportions of Asian and OECD economies suffered from various indicators of recession throughout the post-war period. Liberalization does not appear to have led to a "great moderation" in economic activity, as expected only a few years ago. And we know now that crises are not confined to any group or type of economies, and often spread rapidly among countries.

III. End of an era?

Interdependence has increased the need for cooperation, but support for it has weakened for political and structural reasons. The political challenge is driven, most importantly, by two related trends: the end of global political blocs and the diffusion of economic power. As a result of these trends, political pressure has become ineffective in forcing compliance on economic issues. Countries and interest groups increasingly make decisions based on economic self-interest rather than power politics. Positive coalitions are more difficult to form and no adequate procedural solutions have emerged to resolve the resulting collective action deficit.

The structural challenge to cooperation is posed by the natural decline of benefit/cost ratios along the path of trade liberalization. This is a consequence of success. Liberalization has reduced the most costly and manageable barriers to integration (including a large part of tariffs and obvious quantitative restrictions), leaving behind the more difficult obstacles that are easier to address (or to leave unaddressed) in narrower, regional agreements. For example, deeper integration in service sectors could still offer large benefits, but it is much more complicated to negotiate, especially on a global level.

The rearrangement of political interests and structural payoffs does not mean that cooperation is impossible, but it does mean that established mechanisms in have become less effective. Subsequent sections will explore models of cooperation that might be more compatible with emerging trends.

End of hegemony

The success of the world economy and especially the expansion of the "convergence club" to emerging economies are redistributing international economic power. The United States grew relatively rapidly in the past half century, but Europe, Japan and several smaller economies have essentially caught up, and others are making rapid progress. At the same time, America's military power—its preeminent source of influence in the two-bloc politics of the post-war era—has become less important in forming coalitions for economic issues. These developments have been underway for some time (Keohane 1984), but have gathered momentum with the collapse of the Soviet bloc and the rise of Asia.

Europe moved from rapid recovery in the 1950s and 1960s to eventual consolidation into a single market rivaling the size of the United States. Asia, powered by a series of "miracles" patterned on Japan's experience in industrial development, emerged as the world's manufacturing center in the 1970s. China and India, following this strategy but on a scale that dwarfs previous efforts, are among the most important contributors to world growth today.[5] Figure 6 provides a conservative measure of the shifts in global economic power by plotting the shares of GDP (at market prices) for the United States, Asia and Europe. At the outset of our dataset (1960), the United States had nearly 40% of the share of world output, twice as much as Europe and four times as much as Asia. By the end of the period, however, the shares of all three were nearly equal, in the 20 percent range (Figure 6).

Figure 6. Shifting economic power: shares of output.

New regional economic institutions typically accompany growth poles. Europe's transformation into the European Union is well known—indeed, the European experience contributed to Professor Kojima's vision for Asia. While the diversity of Asia has not permitted so formal a development, there has been progress on deepening regional ties (ADB 2008). Proposals for the East Asian Economic Group (EAEG) by Malaysia were first deflected into APEC (the Trans-

[5] This paper is focused on the Asia Pacific, but growth poles have also emerged in Latin America, based on similar policy strategies. Latin American economic integration through MERCOSUR, a trade zone initially criticized for diverting more trade than it creates, has become more open by including the Andean Community countries and by gradually reducing extra-MERCOSUR barriers.

Pacific alliance survives, but has been too diverse to achieve formal cooperation), but the structure has reemerged through ASEAN's relations with its "plus three" partners, China, Japan and Korea. Economic cooperation within ASEAN has intensified, first through the ASEAN Free Trade Area, and in 2007 with a comprehensive blueprint for an ASEAN Economic Community. ASEAN has also become a hub for range of trade initiatives with Australia and New Zealand, and India. A broader East Asian Summit includes these countries and envisions a free trade area in 15 years.

Given the dispersion of economic power, many countries have called for the revisions in the governance of the IMF and the World Bank. These institutions have been managed by European and US presidents, respectively, and their voting shares have been slow to adjust to the changing distribution of world economic activity. As in all clubs (as discussed further below), charters make it difficult to shift voting rights away from the status quo. These issues have proved especially controversial in the IMF, which has been widely criticized for its interventions in developing countries, and particularly in the Asian financial crisis of 1997-98. IMF lending fell to near zero in 2007, and has revived since mainly through lending to Eastern European countries indebted to Western European banks. The IMF has been identified by the G-20 as the most likely venue for macroeconomic surveillance and cooperation—based on its mandate to conduct Article IV consultations on macroeconomic conditions with member countries—but its effectiveness remains to be established. For example, when the IMF extended its overview to exchange rate policy, China discontinued its consultations. The IMF also failed to persuade major economies to control rising imbalances in 2006. At a minimum, a big G-20 push would be required to make the IMF effective in its surveillance role.

The international role of the US dollar is still a powerful symbol of US economic strength, but it too is under pressure. Approximately one-quarter of world foreign exchange reserves are now held in Euros. The SDR,[6] initially envisioned by the architects of the IMF as a synthetic reserve currency, but dormant for many years, has been revived by the 2008 London Summit, which triggered a $283 billion new SDR issue by the IMF. In the meantime, the Chinese government

[6] An SDR is a basket of the US dollar, Euro, British pound and Japanese yen. An IMF member has the right to exchange its holdings of SDRs for currencies in the reserves of other member countries.

has been experimenting with the liberalization of the Chinese yuan by issuing bonds, arranging swaps with other central banks, and permitting the yuan to be used in settling some external trade. A significant shift from the dollar is unlikely in the short run, but gradual steps to find alternatives are of interest to investor countries and would be even welcomed in the United States. And the role of the dollar could erode rapidly if concerns grow that the US will use inflation to reduce its real international debt.

Fraying politics

An unusual combination of factors generated political support for trade cooperation in the early postwar period. Since liberalization tends to benefit workers in countries with wages below the world average, it is usually popular in poor countries and less so in wealthy countries (Rodrik 2008). All else equal, this should have made the United States reluctant to champion of global trade. But as a large, dominant economy, the US could shape global liberalization in ways that benefited its own producers. And the battle with the Soviet bloc meant that the United States wanted to strengthen its allies. These arguments made the politics of trade very favorable in the post-war period in both “poor” Europe and the “rich” United States.

Over the following decades, the politics of free trade became more contentious. The wage gap between the United States and other advanced countries narrowed, reducing incentives for liberalization among them. To be sure, new benefits emerged from trade based on economies of scale (Krugman 1991), but these forms of trade suggested narrower, reciprocal concessions among similar countries. While developing countries would have benefited from additional global liberalization—their products typically face the highest levels of protection—they did not have the economic weight to affect global negotiations. Global support for broad liberalization weakened.

These challenges are reinforced by political developments within countries. Governance across the world became more pluralistic—for example, there are several new, vigorous democracies in Asia today that were not in place during the Uruguay Round. As a result, the transfers involved in economic adjustments have become more visible and politically costly. Regional economic integration has emerged as an attractive alternative to global agreements in part because it gives countries greater control of the agenda as they attempt to minimize political costs.

Yet curiously, the trade agenda became more ambitious. GATT was transformed into the WTO and opened new areas of negotiation. It envisioned opening the scope of negotiations still further, to labor, environment, competition and other issues, although these were thankfully jettisoned at the Singapore ministerial in 1996. It brought in new members and, by adopting the "single undertaking" rule, established a more demanding negotiating framework. And eventually in the Doha Round, it took on the fundamental divisions between the developed and developing countries.

These opposing trends—weakening support and a more ambitious agenda—have halted progress in global negotiations. The Doha Round may come to negotiated end—it should, if only to provide avoid a dead end. But the WTO's agenda is now so complex, and the champions of agreements are so few, that global cooperation is unlikely to resume steady progress without new strategies and institutions.

Rising regionalism

The most dramatic trade policy development in the recent years has been the spread of bilateral and plurilateral trade agreements. In 2000, 33 such agreements had been concluded by the Asian member countries in the ADB, but in the next nine years the number jumped to 216.[7] All world regions have participated in this process, and nearly all of regional trade in Europe and Latin America, and much of Asia, is now covered by bilateral or regional agreements (Figure 7).

Figure 7. Share of regional trade covered by FTAs.

Numerous explanations have been offered for these trends, ranging from disenchantment with the WTO process to providing incentives for investment, or creating blocs large enough to compete with economies such as China and India. Smaller agreements also permit highly interdependent economies to address more complex barriers at the border and beyond it. The Asia-Pacific is a relative late-comer to the regional agreements, but since the 1997-98 crisis

[7] Asian Development Bank, ARIC http://aric.adb.org/5.php accessed September 25, 2009.

virtually all important bilateral relationships, except those among the three major North Asian economies, have come under bilateral or regional agreements.

The Asia Pacific trade agreement network has built up around the ASEAN process. Initially set up as a security forum, ASEAN began to shift its attention to economic issues in 1976. Initial expectations for ASEAN's integration were low due to the region's small intraregional trade (reflecting similar patterns of comparative advantage), but rapid development has led to rising linkages and increasingly ambitious integration objectives. Spurred by large competitors such as China and India, ASEAN has moved the AFTA agreement forward, and in 2007 adopted an ambitious blueprint to build a deeper ASEAN Economic Community.

ASEAN now has agreements now with the "plus three" countries of China, Korea and Japan, as well as with India, Australia and New Zealand, and has negotiations underway with Europe. This ASEAN network offers substantial benefits for ASEAN that have been estimated as high as (Plummer 2009). In the meantime, India, Australia and New Zealand have also created agreements with Japan and Korea, and have negotiations underway with China. Through the inclusion of these countries the trade network of ASEAN has come to resemble the larger grouping of the East Asian Summit.

The debate about whether regional agreements are stepping stones or stumbling blocs toward an integrated global system is unsettled in theoretical terms (Baldwin 1997, Bhagwati et al. 1999), but there is ample evidence that Asia's free trade areas have been trade creating (Plummer). FTAs may provide a route to broader liberalization by setting off a "domino effect" that makes it more advantageous for countries to join expanding blocs (Baldwin 1999), and by chipping away at interests that favor protection (Baldwin 1997, McCulloch and Petri 1997). Regional agreements also break ground by going beyond the conventional boundaries of the WTO to address issues such as investment and facilitation. They sometimes also incorporate assistance that makes countries more willing to undertake market-opening measures that require adjustment. But they have been also criticized both for diverting trade and reducing efficiency, for shifting attention away from the global process, for being ineffective (e.g. excluding sensitive sectors, having long lead times and complicated rules of origin), or for creating large, intransigent blocs..

In any case, while the global process is faltering, regional initiatives are multiplying. Arguably a successful Asia-wide agreement, under the ASEAN+3 or the East Asian Summit, might be the most efficient way to shake up global negotiations enough to renew interest in a global framework. Even if not, large successful regional agreements could integrate substantial chunks of the global economy, achieving many of the key efficiency gains.

Institutional implications

What do these shifts imply for the institutional framework of cooperation? In a recent paper (Kawai et al. 2009), co-authors and I examine how global institutions evolve over time. We find that international institutions, as other clubs, form because members share an interest in specific public goods. But members are reluctant to give such clubs broad freedom to evolve over time; they set restrictive criteria for the admission of new members (if that is politically feasible) and/or very high hurdles (through supermajority voting) for changing the institution's agenda and especially voting system. As a result, clubs are less adaptable to change than other institutions such as governments and firms.[8] Clubs start out as efficient producers of services because their rules are match the requirements of their members, but become less so over time. And as member preferences diverge, their governance also becomes more contentious.

These considerations add up to what we called a "governance trilemma" of international institutions, illustrated in Figure 8. It shows that it is very difficult to structure clubs to achieve all three objectives that are commonly expected from international organizations. Ideally international institutions will be (a) democratic, by providing voice to all members; (b) effective, by delivering efficient public goods, and (c) universal, by accepting all countries that take on reasonable obligations of membership. While various institutions meet two of these goals, none appear to meet all three. "Universal and democratic" institutions include the United Nations and the WTO, but have trouble implementing decisions. "Democratic and effective" institutions are exemplified by the G7/G8, but fall short of being universal—and are under pressure to expand.

[8] Governments and firms are responsible to broad groups of shareholders or voters and adjust their services to maximize the value of their assets. By contrast, as long as a club exists, it produces services only for its controlling members, even if its assets could be more productively used elsewhere. In theory, inefficient clubs could disband and release assets, but they seldom do.

“Universal and effective” institutions like the IMF and the World Bank (and GATT, before its transformation into the WTO) act, but are criticized for not using open, democratic processes.

Figure 8. The governance trilemma

One solution to the trilemma is a multi-layered institutional architecture for making decisions. In such a structure, smaller “democratic and effective” institutions (say, regional trade groups) take action, but subject to coordination by a “universal” global framework (say, G-20 leadership or rules such as GATT article XXIV). This is akin to functional federalism within larger countries, and to the principle of subsidiarity in Europe (Casella and Frey, 1992). This framework can generate a wider range of public goods than are possible under universal clubs. The entry and exit of smaller clubs can be actively encouraged by the global framework, for example by offering infrastructure services to clubs. The OECD approaches this model by functioning as a platform for plurilateral initiatives, such as efforts to draft disciplines for subsidies and investment policy. Platform capabilities also exist, to an extent, in the IMF and the World Bank.

Layered cooperation needs to be guided by a coordination mechanism to assure coherence. This is especially important, for example, in trade and standards, where inconsistent decentralized decisions would lower global welfare. UN peacekeeping operations provide an interesting model: different groups contribute to and implement peacekeeping missions, but the Security Council has to approve them. This permits new public goods to be developed, subject to system-wide oversight. An alternative is to produce lower-level public goods with similar, complementary regional institutions, such as regional development banks. Although these institutions don’t have explicit coordination rules, their overlapping shareholders and frequent interactions provide a measure of consistency.

Layered institutions are not a panacea, but they allow cooperation to proceed despite constraints that can immobilize larger global institutions. But if the framework is to work in a globally consistent manner, it will also need mechanisms for coordination, through direction from higher-level institutions such as overlapping boards of directors or a G-20 process, or enforced rules.

IV. Managing after the crisis

At sixty years of age, the world's global institutions have become sidelined in managing global cooperation. This should not have come as a surprise; the global economy has changed dramatically, and clubs like the international institutions are structured to resist change. Thus, the world's financial and macroeconomic institutions turned played at most a minor role in managing the crisis of 2007-08. This was not for lack of technical expertise—the IMF, the World Bank and the WTO produced some of the most timely and thorough information and analysis available on the crisis. What they lacked was the ability to convene decision makers and the independence and/or mandate from governments that would have permitted them to respond on a substantial scale. For political reasons, they were not even the venue for hammering out plans for inter-governmental collaboration.

Innovations in the global institutional structure

Crisis is the midwife of institutional innovation, and this one appears to be delivering too. Earlier crises—and the immobility of the global system—had led to a layer of decision-making *below* the global institutions that enable like-minded countries to pursue common goals. These included an eclectic arrangements ranging from bilateral meetings such as the Strategic and Economic Dialogue between China and the United States, to multilateral insurance functions embedded in the Chiang Mai process. In trade, they included numerous bilateral negotiations and several potential regional groupings.

The innovation of the crisis of 2008-09 is a new layer of decision-making *above* the Bretton Woods institutions, with the G-20 designated at its Pittsburgh meeting as the "premier forum for our international economic cooperation" going forward (G-20 2009). This historic development dramatically enlarges the table from the G7/8 processes and attempts to reenergize global economic decision making that had ossified under the aging Bretton Woods institutions. It is an ambitious attempt to address both the "democracy" and "effectiveness" deficits of the global process.

The Pittsburgh meeting developed a very comprehensive list of policies to be implemented over time. The leaders committed to:

- Drafting a framework for sustainable, balanced growth
- Creating a process of mutual assessment of policies to implement the framework
- Agreeing on a framework for financial reform in four specific problem areas
- Reforming the voting shares of the IMF and the World Bank
- Pursuing a long list of other goals on trade, environment, energy conservation and poverty

These projects will require further action from the G-20 Finance Ministers and Central Bank Governors. The IMF plays an especially central role in the communiqué as the institution that will provide analytical support.

But will this approach break through complexities that stalled cooperation in recent years? The engagement of heads of state represents impressive commitment, but can it be sustained as the complicated details emerge? The list of issues addressed is enormously long and raises questions about the ability of the G-20 to follow-up rigorously. The inclusive country composition of the G-20 is a major breakthrough in global economic dialogue, but it will not make it easier to addess divisive issues. The consequences of diffused power and declining hegemony will be felt inside the G-20 as much as in other international institutions.

The G-20 will need to rely on the existing global institutions to get things done. These institutions—for example, the WTO with respect to the Doha negotiations—continue to face structural constraints in making joint decisions and enforcing compliance. The G-20 has singled out the IMF for its macroeconomic surveillance functions, but needs to repair the IMF's credibility gap to make this strategy acceptable. Despite the leaders' commitment to making the new system work, many factors that have impaired the system's ability implement ambitious initiatives remain unchanged.

Institutional layering in practice

The G-20 is a shot in the arm for international cooperation, but will not transform its structure overnight. This includes, below the G-20, the layer of the Bretton Woods institutions, subject to the challenges analyzed above. It includes a further thick and complicated layer below those. In Asia alone, 14 "major economic cooperation groups" have been identified by the ADB (2008, pp.

256-259). The work of these groups often overlaps and there are limited linkages among them. The layering of institutions is already in full bloom.

One strategy for energizing this multi-layered system would rely on strong, top-down leadership. In this model, the G-20 would become visionary and cohesive. It would direct and monitor a handful of international institutions (most likely the Bretton Woods institutions with a few additions) to administer policy. Individual G-20 leaders would make sure that cooperation is pursued diligently by their bureaucracies. The global institutions would be strengthened with resources and consistent top-down support. Along the way, they would assume gravitas for affecting national policies. But this is a tall order. Urgent governance reforms will make the global institutions more democratic, but they could make them still more unwieldy. And global institutions will not find it easy to achieve or sustain legitimacy. They will find themselves in conflict with some governments and many NGOs. As the IMF and the WTO in the past, they will become excellent targets for political criticism in many countries.

An alternative strategy is to rely on "bottom up" cooperation—on a variety of forums and institutions for implementing policy. This approach could yield practical and politically acceptable results, but would require more flexibility. It would work more slowly and carry the risk of fragmenting the global system. In this model, the G-20 would still set a global agenda, but implementation would be left to smaller institutions working on related goals. Thus, for example, a prescription for insurance against crises might result in a large IMF role for some countries (say in Europe) and a parallel Asian system that achieves a similar objective through an expaded Chiang Mai process.

Sub-global cooperation is underway on many fronts. It often involves a few participants in *ad hoc* meetings, for example two or more major powers like China, Japan, the United States and Europe. The Strategic and Economic Dialogue between China and the United States is a prominent example, but corresponding meetings exist in Europe and were recently launched in North Asia by China, Japan and Korea. Larger groups are involved in regional organizations such as ASEAN, the East Asian Summit, and APEC, and in their counterparts in elsewhere, for example MERCOSUR. Each of these organizations generates work programs and follow-up tasks for its national bureaucracies. Since these work programs overlap and are often carried out by the same government offices (for example, similar surveillance efforts are conducted by the IMF, the ADB and ASEAN) they provide coherence to the policy process.

A bottom-up approach will be acceptable if there is no special need to act jointly and quickly. It will be effective when relatively few countries are involved, when political sensitivities are high, and when the participants already have a good understanding of the problem and the solutions available. For example, negotiations to "rebalance" US and Chinese demand are more likely to make headway in the bilateral SED than in a more open and politically sensitive forum such as IMF/G-20 mutual assessment dialogue. (Of course, these approaches need not be mutually exclusive, and if appropriately managed can complement each other.)

Layered decisions in trade: a case study

What kinds of practical steps would make the layered approach work? A case study is provided by regional trade agreements, which have long been a favorite topic in economic analysis. The goal, in this case, is to permit regional trade agreements to go forward if they improve world welfare (generate more welfare from trade creation than is lost through trade diversion) and leave the welfare of excluded countries unchanged. In a famous early contribution, Kemp and Wan (1976) offered a strategy—essentially lowering external tariffs by an appropriate amount—for ensuring that external partners are not hurt by preferential trade agreements. In recent contributions Baldwin ( ) further explores the logic of regional trade agreements and concludes that they are likely to become the main tool for improving the global trading system.

Assuming that the regional layer will be the an important source of future trade agreements, the critical task facing students of this process is to propose practical mechanisms that improve global efficiency and facilitate steps to establish a still more open trading system in the future. Based on his analysis of the dynamics of interactions between regional and multilateral negotiations, Baldwin (2006) proposes three initiatives that the WTO could take to make regional agreements into "building blocks" for world trade:

- providing clearer information [on] and a deeper understanding of the effects of the multilateralisation of regionalism;

- setting up a negotiating forum for the coordination/standardisation/harmonisation of rules of origin and cumulation; and

- convening a forum of 'spokes' that would explore that possibility of mutually advantageous cooperation on hub-spoke FTAs in different regions of the world.

In a recent paper, (Kawai et al. 2009) co-authors and I pursued a similar goal, but explored an even more flexible approach that would more closely resemble the Kemp-Wan strategy. We proposed that the WTO become an actual participant in the negotiation and administration of regional FTAs by offering to contract its trade-related analytical and dispute-resolution services to regional groups that adopt acceptable agreements. This approach would enable the WTO to make sure that trade agreements are openly and fairly administered, and it would engage the WTO in structuring and modifying FTAs, presumably with the ultimate goal of rolling them up into comprehensive agreements. Our proposals envisioned:

- establishing a new function within the WTO to support and integrate limited trade liberalization, e.g. agreements that cover limited sectors and countries;

- developing realistic standards for limited trade liberalization, which would expand and strengthen Article XXIV to permit a broader range of agreements while ensuring that these avoid injuring non-members; and

- creating frameworks to consolidate sectoral and regional agreements into global agreements.

Ideally such mechanisms would support progress in the liberalization of trade by encouraging regional groups to adopt multilateral-friendly approaches, including lower MFN tariffs, simple rules of origin (such as the 40% regional content rule adopted by ASEAN), and regular consultations with non-regional partners on trade and investment issues.

V. Conclusions

The golden era of economic growth and integration that has driven extraordinary global progress in the last 60 years has hit turbulence. Its challenges derive largely from success; diminishing returns to liberalization, the diffusion of global economic power, and growing pluralism in the politics of countries and regions. These trends have virtually immobilized critical institutions of global economic management. The current crisis, for example, has been handled outside existing institutions, in new ones created or modified for that purpose.

This impasse threatens the forward momentum of the world economy. It is now also leading to innovations in the structure of cooperation. An important experiment is underway to revive global cooperation under the more inclusive, but hopefully still manageable institution of the G-20. But the agenda facing these initiatives is long and complicated, and will require a deep institutional framework to be implemented successfully. The viability of the top-down strategy will depend on efforts to restore the credibility and political acceptability of global institutions such as the IMF and the WTO.

In the meantime, cooperation is emerging in other layers, ranging from bilateral to plurilateral, and the challenge of making these efforts coherent is daunting. Steps to strengthen sub-global approaches could complement efforts to revive the global process, and provide another channel for implementing its priorities. Much intellectual and institutional capital has been invested in the idea that a global system needs to be managed by global institutions. Similar intellectual and practical investments in sub-global approaches, and especially their integration, might yield substantial benefits also in the intermediate term.

This is an extraordinary time for global institutions. A thousand flowers are blooming and perhaps withering. It will take time before these processes mature and can be assessed. Hopefully shocks to the global economy will be sufficiently mild and infrequent in the meantime (in contrast, say, to the inter-war period) to allow effective new designs to emerge.

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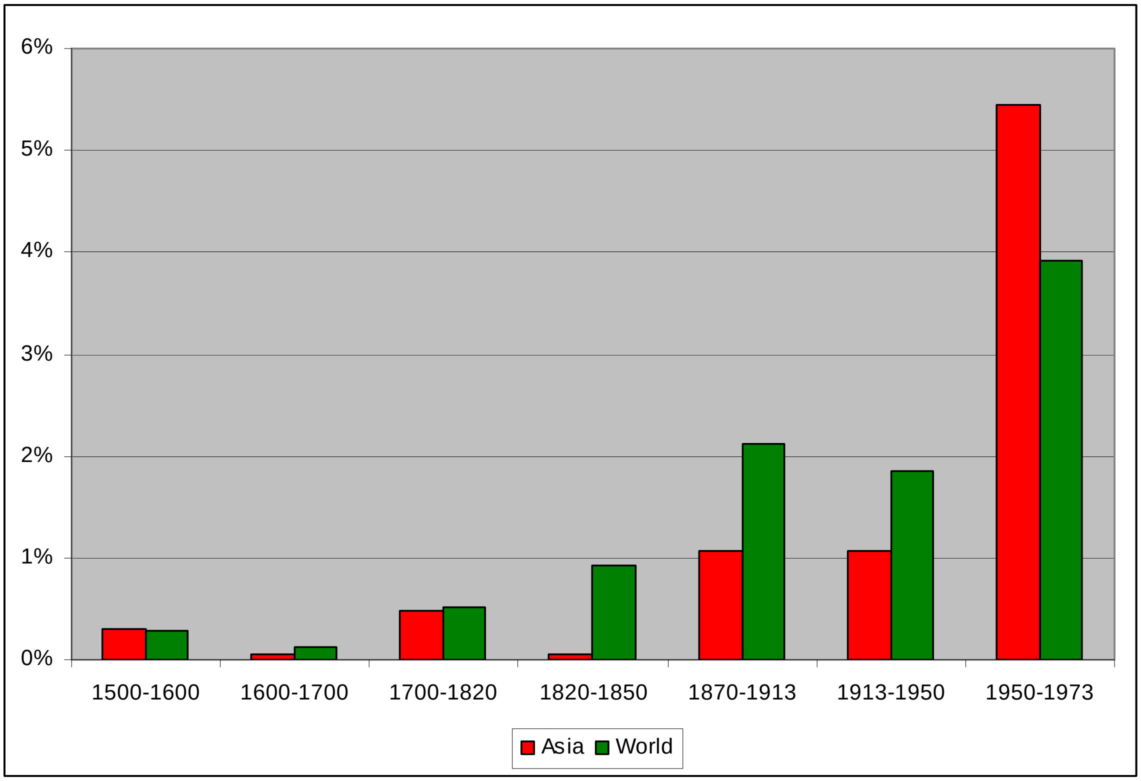
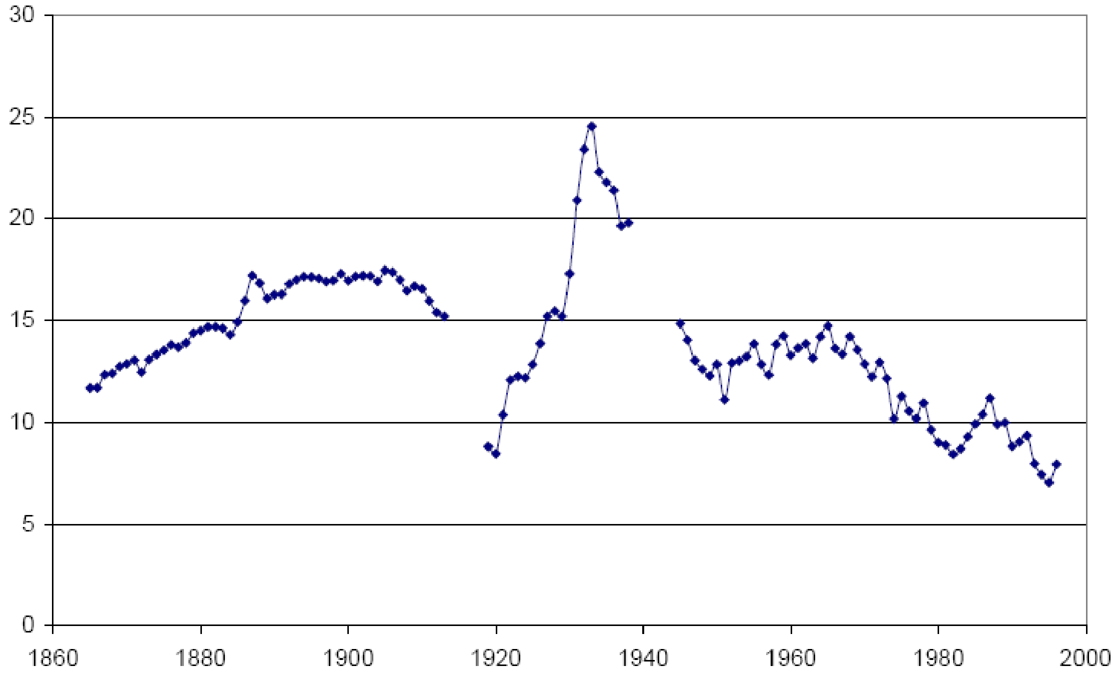
FIGURES

Figure 1. The golden era in perspective:
Average annual growth rates of GDP



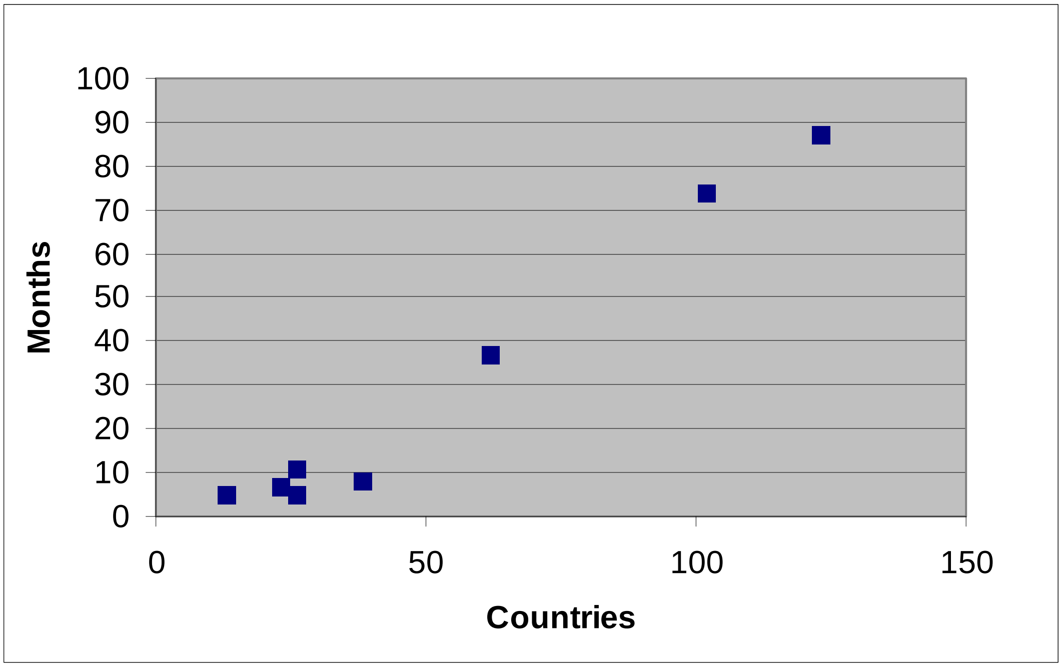
Source: Maddison (2001), p. 261.

Figure 2. Declining world protection:
Unweighted average tariffs for 35 countries



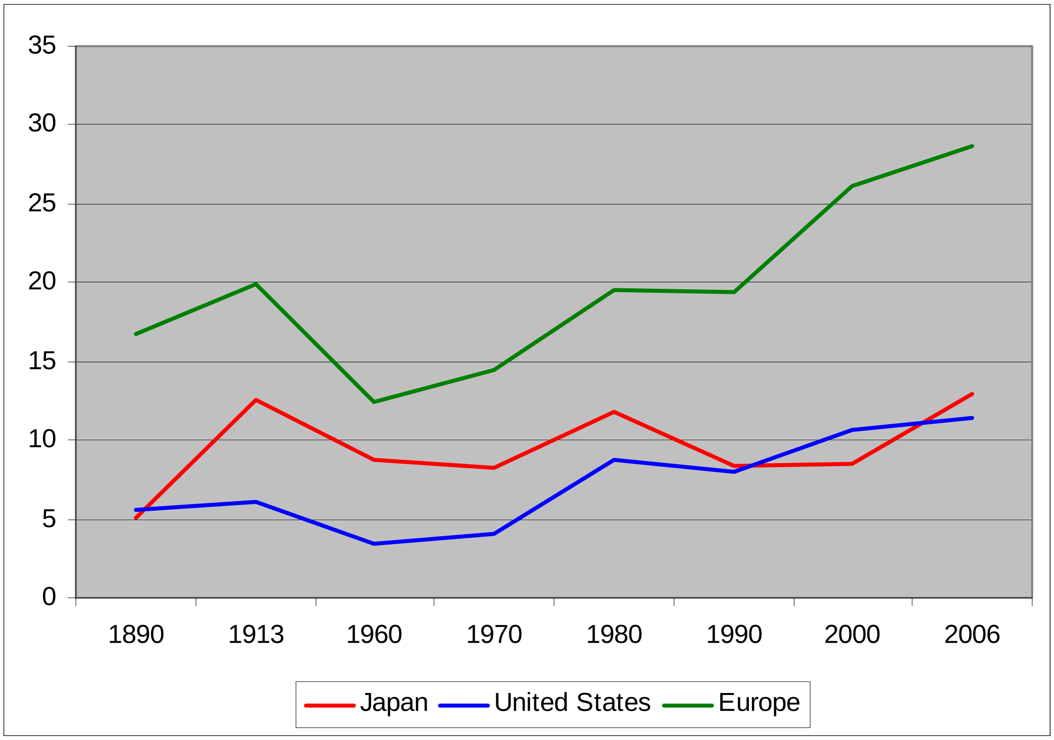
Source: Clemens and Williamson (2001), Figure 1.

Figure 3. Lengthening negotiations:
Months vs. number of participants in successive GATT rounds



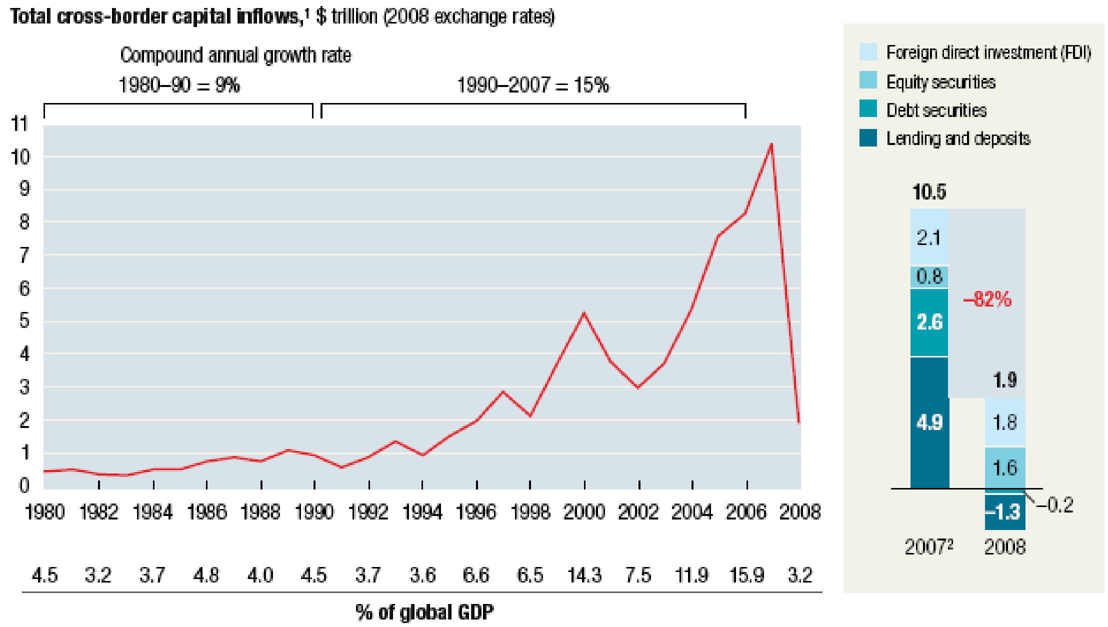
Source: WTO, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm

Figure 4. Rebounding trade:
Share of average of imports and exports in GDP



Source: Feenstra (1996), p. 33. Feenstra's data extended using World Bank, World Development Indicators, extracted on September 25, 2009.
Note: Europe represents a simple average of France, Germany, Italy and the UK. In the data extension it represents the Euro area.

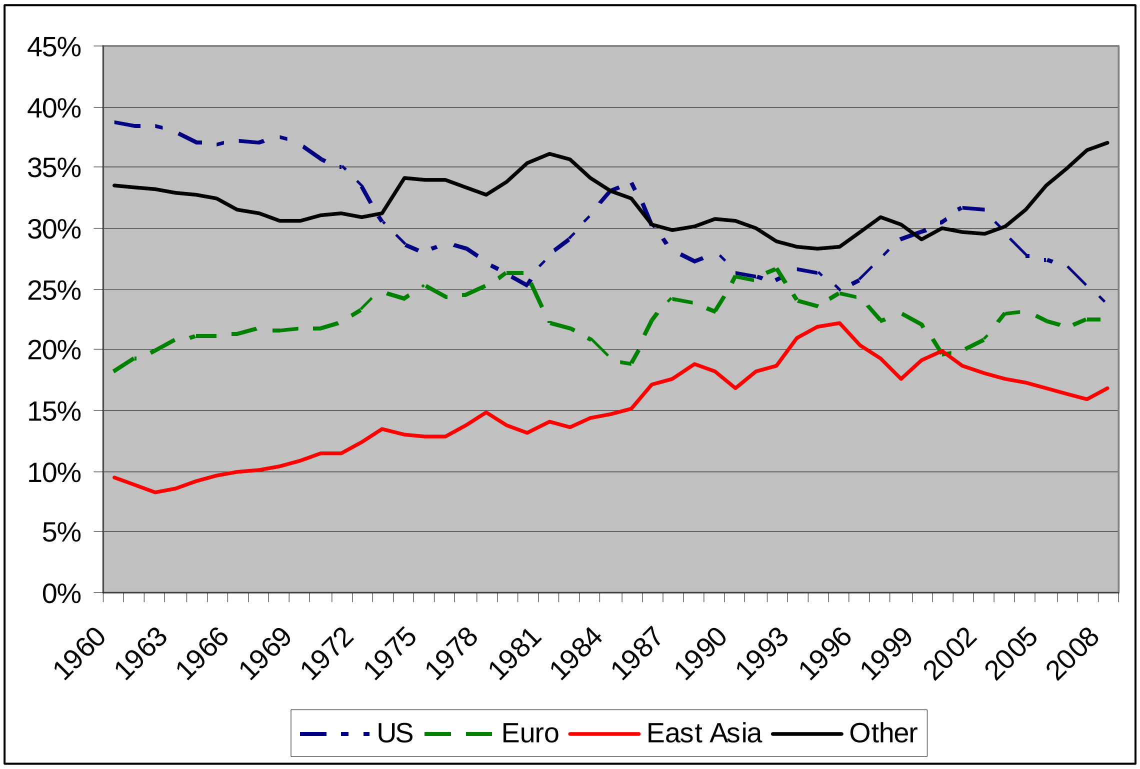
Figure 5. Exploding capital flows



[1]Capital inflows represent net purchases by foreigners of FDI, equity, and debt securities, as well as deposits and loans to local banks.
[2]Figures do not sum to total, because of rounding.

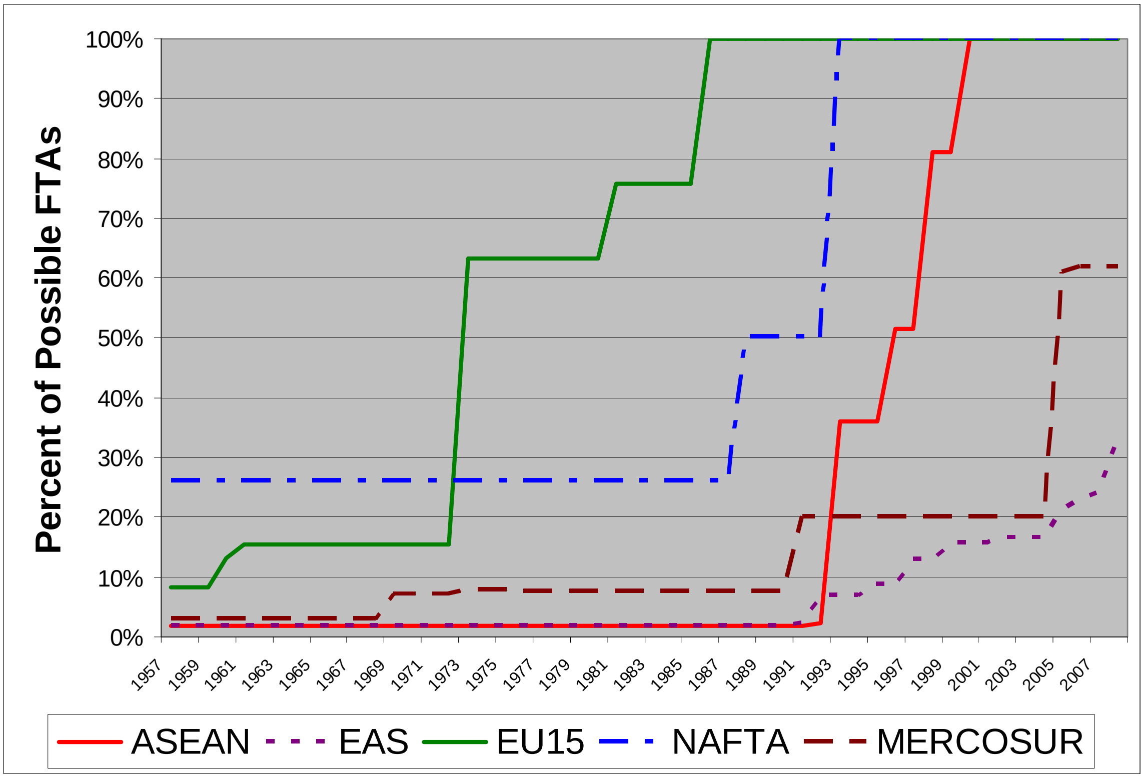
Source: McKinsey Global Institute analysis

Figure 6. Changing weights:
Shares US, Europe and East Asia in world GDP



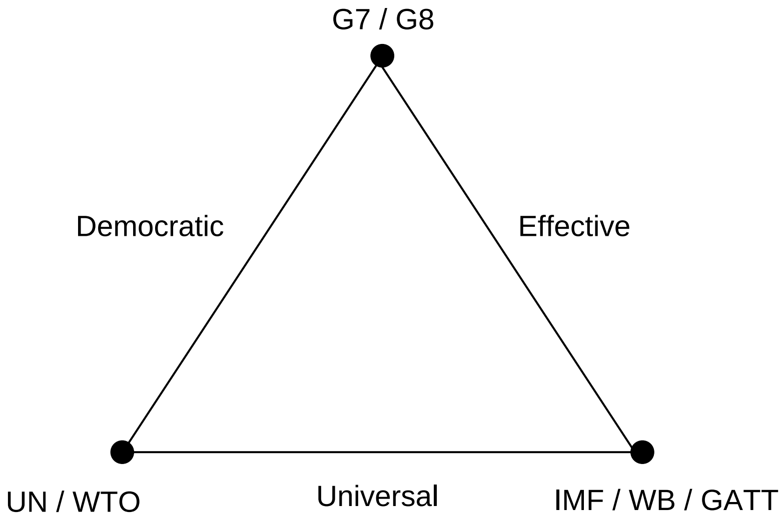
Source: World Bank, World Development Indicators, extracted 25 September 2009.

Figure 7. Rising FTA coverage:
% of possible country pairs covered by an agreement



Source: Capannelli et al. (forthcoming).

Figure 8. The governance trilemma



Source: Kawai et al. (2009).