Asian Voices in Europe

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EUROPE IN THE WORLD PROGRAMME

Table of Contents

Foreword by Shada Islam		**6**
I.	**Building democracy in Pakistan: a role for the EU and the US**	
	Event report	**7**
	Keynote speech	**9**
II.	**Asian regional deals: spur or obstacle to free trade?**	
	Event report	**14**
	Keynote speech	**16**
III.	**Injecting new momentum into ASEM: an uphill struggle?**	
	Event report	**26**
	Keynote speech	**28**
IV.	**The impact of the global financial crisis on the world's poorest**	
	Event report	**32**
	Keynote speech	**34**
V.	**Asia and the financial crisis: how deep, how long?**	
	Event report	**38**
	Keynote speech	**40**
VI.	**India-Pakistan relations: from tension to cooperation?**	
	Event report	**46**
	Keynote speech (I)	**48**
	Keynote speech (II)	**51**

Keynote speeches

Dipankar Banerjee, retired Major General, Director, Institute of Peace and Conflict Studies, New Delhi, India

Masahiro Kawai, Dean, Asian Development Bank Institute, Tokyo, Japan

Khalid Mahmood, Director of the Institute of Public Policy, Beaconhouse National University, Lahore, and former Pakistan Ambassador

Talat Masood, retired Lieutenant-General, independent military and political analyst, Islamabad, Pakistan

Razeen Sally, Co-Director of the European Centre for International Political Economy (ECIPE)

Isagani Serrano, Acting President of the Philippine Rural Reconstruction Movement, the Philippines

Lay Hwee Yeo, Senior Research Fellow at the Singapore Institute of International Relations (SIIA) and Associate Director of the EU Centre in Singapore (EUC)

Foreword

By Shada Islam

The European Policy Centre and the Tokyo-based Sasakawa Peace Foundation continued to cooperate on their joint 'Asian Voices in Europe' lecture series in 2008-2009 for the third year running.

Under this initiative, six Policy Debates were held in Brussels on key economic, political and security developments in Asia and various aspects of EU-Asia relations. These discussions included presentations by high-profile Asian speakers from Pakistan, India, Singapore, Japan, the Philippines and China. In addition, we also invited experts on Asia based in the United States and in the European Union.

The EPC has been working on EU-Asia relations and Asian affairs since 2004, and the 'Asian Voices in Europe' lecture series is an important and complementary part of this work.

The Sasakawa Peace Foundation (SPF) was established in September 1986 as a private non-profit organisation. Since then, it has launched a wide range of programmes aimed at promoting international understanding, exchange and cooperation between Japan and the rest of the world. The SPF has been organising 'Asian Voices' seminars in Washington, DC, for eight years and decided to extend this to Brussels in 2006, in collaboration with the EPC, to address a European audience.

The series reflects Asia's growing importance in international economic, political and security affairs, increased Asian interest in the Union and steps being taken by both sides to intensify their relationship.

Policy Debates in 2008-2009 focused on some of the key themes, such as fighting poverty, global security and world trade, which were discussed at the Group of Eight Summit of industrialised nations in Japan in July 2008. These included a discussion of the ways in which the international community could bolster democracy in Pakistan, the significance of Asian regional trade agreements and their impact on global trade, and the importance of reinvigorating the EU-Asian relationship. The regional security implications of worsened India-Pakistan relations following the devastating bombing attacks on Mumbai were also studied by independent analysts from both countries.

The impact of the global financial and economic crisis on Asian countries was the theme of two Policy Dialogues: one which looked at the impact of the downturn on Asia's poorest countries and another which focused on Asia's economic powerhouses – China and India.

The series ran from June 2008 to February 2009. The Asian speakers who took part certainly made their voices heard through interesting and thought-provoking presentations. They did not shy away from controversy, stimulating lively and challenging debates with panellists, including European and American analysts and scholars, and EU officials.

This publication includes reports on all these events, plus the transcripts of the keynote speeches given at each of them.

This lecture series has been very successful and the EPC is grateful for the generous support provided by the Sasakawa Peace Foundation.

Shada Islam is a Senior Programme Executive at the European Policy Centre.

I. Building democracy in Pakistan: a role for the EU and the US

June 16 2008: The recent elections in Pakistan could hail a 'new dawn' in Pakistani politics, provided the new government takes immediate steps to strengthen the legal system, develop a new economic model, build state institutions and improve basic services. The EU can play a strong role by offering support in state-building and helping to build a democratic Muslim state that offers an example to the world.

Event report

Khalid Mahmood, Director of the Institute of Public Policy, Beaconhouse National University, Lahore, and former Pakistan Ambassador, underlined the importance of the February elections, which had resulted in a PPP-PML-N governing coalition, even though this has fragmented over disagreements about reinstating suspended members of the judiciary.

Three important events took place during a "traumatic" 2007:

- the country's declaration of a state of emergency;
- the suspension of the 60 judges;
- the assassination of Benazir Bhutto, which was, for the Pakistani people, like the assassination of President Kennedy and 9/11 "rolled into one".

These events exposed the fault lines in Pakistan, and the fact that it has failed to develop into a moderate Islamic state, and has been dominated by a "predatory elite which constitutes less than 1% of the population".

Pakistan's challenge is to address the weak foundations of democracy and rebuild the state. Over the last 60 years, the military has intervened four times and the courts have legalised this – for, as Pakistan military expert Stephen Cohen put it: "The generals can't govern Pakistan, but they will not let anyone else do so."

The country's economy has to be improved, for while there has been over 5% growth *per annum*, this has relied on foreign inflows, leading to a "casino economic model" that neglected domestic savings and exports, did not invest in human capital and failed to protect local industry.

Another challenge is to inject good governance into a currently dysfunctional system, as there has been no investment in basic services, such as education.

One of Pakistan's most over-riding problems is that its politics are geared to fulfilling short-term US interests, which the local Pakistani population deeply resents, and this has created deep structural governance problems. US policy towards Pakistan revolves round giving military support – as a result, of the $12.6 billion in US assistance the country received from 1954 to 2000, only €3.4 billion went to elected governments.

On the security question, the new government has said that it will not hold talks with anyone who refuses to lay down their arms, that its territory will not be used against any other country, and that foreign terrorists will not be allowed to hide out in Pakistan.

It recently condemned the US air strike on the Pakistan/Afghanistan border (in the Federally Administered Tribal Areas – FATA – where Pakistani soldiers were killed), saying the strikes create political instability, and the presence of terrorist groups in Pakistan should be dealt with by putting more human resources on the ground.

Mr Mahmood said the West's interest in Pakistan mainly centres round sorting out Afghanistan, a concern Pakistan shares as it wants a peaceful and stable neighbour, so it is cooperating with the Afghan government, and supporting EU counter-terrorism and reconstruction measures. However, the international community needs to show that it is "winning" in Afghanistan before real progress can be made.

The need for EU support

The EU can help Pakistan to make the structural reforms it needs, and Member States such as Spain, Portugal, Greece and Poland could share their experience of moving from military/authoritarian rule to a democracy, said Mr Mahmood.

The EU needs to recognise that the stakes are high in Pakistan and the rest of the region, and to offer it the support it needs, as it stands at a strategic global crossroads, which could become a seedbed for terrorism and extremism with more and more military intervention.

The Union will gain from increasing its engagement in Pakistan, since a successful Pakistani democracy will demonstrate to the 1.3 billion Muslins worldwide – including 20 million in the EU – that "democracy works and is the best guarantee against terrorism, injustice and hopelessness".

Mr Mahmood agreed with EU High Representative Javier Solana that "the best protection of our security is a world of well-governed democratic states". He believed that this could be the Union's "tryst with destiny", as helping to build Pakistan's institutions and economy is one way to help Islam and the West to coexist harmoniously, enhancing the EU's profile as the world's largest donor, an engine for reform and a soft power.

The US in Pakistan

Karl Inderfurth, John O. Rankin Professor of the Practice of International Affairs, George Washington University, Elliot School of International Affairs, said this was an important democratic moment for Pakistan, as the elections had exceeded expectations by being transparent, free and fair and returned the country to civilian government.

However, there is a danger that the merger of three trends – political uncertainty, the economic downturn and security threats – could create "the perfect storm" in Pakistan.

While the US is slightly less unpopular in Pakistan than before, the way in which it has supported President Pervez Musharraf and given massive military assistance but failed to support a free press and judiciary or a vibrant civil society, has put it "on the wrong side". The US lacks a comprehensive plan to deal with the terrorist threat in the FATA, and must realign its priorities, replacing military assistance with support for services like schools and health clinics.

Mr Inderfurth suggested that the US should:

- stop micro-managing Pakistan's affairs;
- triple non-security aid, including education assistance, and let Pakistan define what military aid it needs;
- give a "democracy dividend" of $1 billion to help the return to democracy, institution-building, supporting political parties and civil society;
- engage with Pakistan on its important issues, and accept that the US is there "for the long-haul";
- take a regional approach to security issues, and cross-border infiltration between Pakistan and Afghanistan; and encourage Pakistan to return to the trilateral NATO-Afghanistan-Pakistan military effort;
- work with Pakistan on joint terrorist operations, with EU assistance, in the tribal areas.

Mr Inderfurth stressed the need for a multi-pronged, regional approach towards Pakistan, Afghanistan and Iran, because this would give Afghanistan stable borders and enable it to develop its economic potential.

James Moran, Director for Asia, Directorate-General for External Relations (Relex), European Commission, said the EU observer mission gave a positive assessment of the election, and the Union is working to strengthen Pakistan's institutions: it has tripled development aid, reactivated the Framework Agreement and reinvigorated trade flows.

The elections had opened windows of opportunity which will close if steps are not taken to sort out outstanding issues. President Musharraf's role must be clarified, as he has declared that "he is not prepared to become a useless vegetable", said Mr Moran.

The country must face up to its economic challenges, focusing on growth, cutting inflation and its deficit, and not letting itself be sidelined by trivial issues. It must move to democratic rule, and the new civil government must seek to fulfil the high expectations people have of it. There is a need to build confidence in the parliamentary system, build respect for the Prime Minister, and help the political parties to turn from fiefdoms into democratic parties.

As to the role of external actors, Mr Moran said the US has a lot to offer in terms of practical cooperation, while, over the next three years, the EU is giving €200 million to help develop natural resources, education and human resources in the border area. This complements its activities in Afghanistan, which is the biggest focus of EU aid and where the EU is helping to support trade and reconstruction along the border, using a multi-track approach to political reform, development and security.

Overall EU involvement has increased substantially over the last few years, as the Union has come to appreciate Pakistan's importance.

Discussion

Asked about a regional strategy for Afghanistan, Mr Mahmood said there was a coalition support fund which is reimbursing Pakistan's expenditure on the war on terror, and the EU is giving €2.5 billion in economic assistance.

Questioned about the new government's priorities. Mr Mahmood said it was dealing with the threats in the FATA, an area that has been the theatre of war for the last 30 years. Pakistan feels that it has taken casualties for someone else's war, as it has sacrificed more troops in the FATA than the US. Mr Moran agreed that the new government needs to give people in FATA more opportunities to develop economically.

On the question of Afghanistan, Mr Mahmood said the Kabul government needs to solve the problems of narcotics and security, and the Pakistan government is trying to use economic incentives in the border areas and a multi-pronged approach that includes political, social and economic elements, while retaining the threat of force. Iran is a key player, but the US refuses to acknowledge its contribution.

Mr Inderfurth said other countries had noted the failure of President Karzai's government to achieve any breakthrough and were concerned about its inability to establish legitimacy. Iran had to be engaged, and he hoped that the new United Nations Special Envoy on Afghanistan might be effective in pursuing a regional approach. He added that India needs to be part of this, and this is more likely given the normalisation of relations between Islamabad and New Delhi.

Asked whether the new government was "a false dawn", Mr Mahmood said that for the first time, senior military officials are calling for President Musharraf to be held accountable. He also welcomed the growth of civil society and a free press, which, he said, the President had encouraged.

Keynote speech: Towards a democratic and prosperous Pakistan – a case for strategic partnership with the EU

By Khalid Mahmood, Director of the Institute of Public Policy, Beaconhouse National University, Lahore, and former Pakistan Ambassador

Pakistan and its people are living through a moment of reconciliation at home and goodwill abroad. Following the 18 February elections, which represented people's commitment to democracy, a coalition of the main parties i.e. PPP and PML-N worked together in the government for a few weeks. However, on 12 May, there was a split in that coalition over the issue of the restoration of judges who were sacked for not taking oath under the Emergency. This raised doubts about a return to the polarisation that Pakistan has seen in the 1990s. However, the commitment of the two coalition partners to work together remains intact.

The election of 2008 was preceded by a traumatic year during which the suspension of the chief justice on 9 March, 2007 led to public mobilisation. This mobilisation was insufficient to bring the regime down but sufficient to bring into the open the alienation of the people from the government.

The imposition of the Emergency on 3 November was described by Mohtarma Benazir Bhutto as the blackest day in the history of Pakistan. She said that "while it is dangerous to stand up to a military dictatorship, it is more dangerous not to do so". In the memory of the Pakistani public, three events stand out in 2007. These are the Emergency, the sacking of the 60 Judges who refused to take oath under the Provisional Constitutional Order and the tragic killing of Benazir Bhutto, which has been equated with the assassination of John F. Kennedy and 9/11 rolled into one.

The year brought out the fault lines that Pakistan has been living through in its history. One of which, in the words of Professor Stephen Cohen is that the "generals can't govern Pakistan but they will not let anyone else govern it either" since the military has no capacity to develop a national consensus. Also, in its troubled history, Pakistan has missed many opportunities due to the absence of a consensus over many issues. These include the role of Islam, whether Pakistan could fulfil its promise of being a moderate Islamic state, ambiguity towards radical Islamic groups and ethnic and provincial differences. A corollary of this has been that a predatory elite which constitutes less than 1% of the population has dominated the state and has rigged the market to obtain the benefits of economic growth over the years.

The various challenges that Pakistan faces today are grave and the people expect early action by the new government on the following:

1. **Address the weak foundations of democracy** as seen in the constitutional and judicial crisis since 3 November over the restoration of the sacked judges and establishing the rule of law.
2. **The economy is at a critical juncture once again** and the government needs to develop a strategy for accelerating sustainable development through addressing fiscal and trade imbalances, inflation which is at an all-time high, food and fuel crisis, poverty reduction, diversification of exports and expanding education at all levels.
3. **Spreading good governance in the system** by efficiency, accountability, delivery of basic services to the people and the larger issues of policy formation and its execution, since over the years because of corruption and politicisation, the standard of civil services have been eroded and they have become dysfunctional.

The new government's policy of tackling terrorism effectively and marginalising the terrorists in the Federally Administrative Tribal Areas (FATA) has begun well. This is being done using a multi-faceted approach in which the government has decided not to negotiate with the terrorists while not refraining from talking to insurgent tribesmen who have renounced violence.

Before assessing the performance of the government in its response to these challenges, it may be useful to step back to determine the context in which all this is happening in Pakistan. In the last 60 years in Pakistan, the military has intervened four times over 32 years and the superior courts have legalised the usurpation of power under the Doctrine of Necessity over the years. They have thus influenced the structure of the state and practice of politics in Pakistan.

These governments have relied on external resources and powers to prop them up. While the economy in the first 50 years of Pakistan has grown by an average rate of 5.5%, it has relied heavily on foreign inflows; and in the Pakistani model of economic development, there has been neglect of domestic savings, exports, investment in human capital and protection to industry. During the last eight years Pakistan has grown faster at an average of 5.7% but the current economic crisis has brought into focus disturbing trends in the Pakistani economy. While it has grown, the structure of the economy has not changed as seen in the current challenges it faces.

As a result, there has been a decay of the institutions and a lack of adequate allocations on health and education. Pakistan compares poorly even with other South Asian countries in some of its social indicators, which are alarming including the neglect of the primary education. This is seen in the proliferations of Madrassas whose number can be estimated at 15,000 while the number of students studying there may be about 1.5 million. The under-investment in education is one of the most alarming indicators of the economic development experience of Pakistan.

One of the achievements that the people of Pakistan talk about with a sense of great satisfaction is that Pakistan has taken seriously its responsibilities as a Nuclear weapon state and acted with restrain and responsibility since 28 May 1998 when it conducted the nuclear tests. This has restored strategic balance to South Asia.

Apart from the misplaced priorities in Pakistan's economy and history, US relations are also a critical element in understanding how Pakistan became a part of the Free World during the Cold War, played a critical role in bringing about the Sino-America *détente* in 1971, how after 1979 it worked together to roll back the Soviet invasion of Afghanistan and then, of course, after 9/11, joined the war against terrorism. According to its critics, this relationship is based on short-term American interests and fears. Therefore, Pakistani people have a sense of being used by the Americans.

It is interesting to note that from 1954 to 2000, out of over $12.6 billion of US assistance only $3.4 billion was given to the elected governments. Since 2002, the assistance has amounted to $10.8 billion which has included Coalition Support Funds totalling $5.5 billion, while economic assistance has been only $2.76 billion. It is clear that military cooperation has been the hallmark of US policy to Pakistan over the years.

The hot and cold wars that Pakistan has fought with and for US have extracted a political, psychological and social price from the people of Pakistan.

There is a public perception in Pakistan that the relationship with US over the years has dealt with the US' short-term interests and left in its wake deep structural problems of the Pakistani state including increasing costs of cooperation with the USA.

According to some commentators, Pakistan's history and geography have produced the special character of its domestic and foreign policy. There is a perception that the military, judiciary and the USA have manipulated power in Pakistan to their advantage. All this may be changing, which I will talk about in some detail. One point I will argue strongly is that Pakistan's government should be able to act independently while cooperating with Washington.

As regards the new government's policy on counter-terrorism, it is based on the premise that it will not hold talks with anyone refusing to lay down arms nor allow the use of our territory against any other country, nor help foreign terrorists find hideouts in our territory, while not ruling out the option of using force in the event of a failure. This policy has components of political reform, economic assistance and military elements.

There has been growing unease in Washington over Pakistan's efforts to negotiate with the Taliban in the border areas. The Pakistan government condemned the US Strike on 10 June 2008 on the Pakistan-Afghanistan border. Eleven paramilitary soldiers were killed. This was the third time in as many months since the formation of the new government that the attacks have taken place. This was the most damaging by far. The Prime Minister also denounced the attack in the parliament. This is a manifestation of the American pressure on Pakistan and its concerns about the situation in FATA. However, such bombing fuels anti-American sentiments.

The American Intelligence Estimates suggest that in the area of FATA, Al-Qaeda and Taliban have regained capacity to spawn a major attack against the US. This is contested in Pakistan and even in a recent statement CIA Director, Michael Hayden told the *Washington Post* that "on balance we are doing pretty well" in this area. Pakistani authorities are of the view that instead of such air strikes smart intelligence on the ground with augmentation of human resources will be a better way of dealing with the situation. Unfortunately, these attacks have been taking place since 2006 and invariably suicide attacks have followed in the cities of Pakistan to punish Pakistan's soldiers. These attacks also feed suspicions about American military operations inside Pakistan.

Once again the Afghanistan issue has largely come to define Pakistan's relations with the West. Pakistan's commitment to a peaceful and stable Afghanistan remains undiminished as does its cooperation with Afghanistan in counter-terrorism and supporting various measures for implementing EU policy providing security, reform and the reconstruction of Afghanistan. As the *Financial Times* of 13 June pointed out, the war in Afghanistan is in need of a definition of its victory. That is a point well-made and the article goes on to assert that the hope of a settlement in Afghanistan also depends upon its neighbours, particularly, Pakistan and Iran.

While the score-card of the new government on the response to the three challenges is yet to be drawn, it is clear that Pakistan is in need of structural reforms in the nature of its state, politics and economy. The only way this can be done is through the assertion of the rule of law, education, health and access to information and technology.

The experience of the success of many countries in moving from military rule to democracy is instructive for Pakistan. Spain, Portugal, Greece and Poland and a number of new members have moved in recent times from authoritarian and military rule to being a democracy, and in some cases being young democracies with strong institutions enabled them to become EU members. The Union can share its wealth of experience in this regard with Pakistan.

Pakistan's democratic government deserves international support besides that of the USA, which will remain indispensable as the biggest bilateral donor with more assistance in economic and social sectors, of a type which will address the problems of the state, its institutions and economy. As mentioned above, perhaps the EU can meet these requirements more meaningfully, as it needs to recognise that the stakes in this for Pakistan, the region and the world are huge since being located at the strategic crossroads of the world and possessing strategic weapons, the country evokes global concerns about extremism, terrorism, and the rise of militancy.

EU has expertise in developing know-how in reforming economic and political infrastructure in different countries. It has acquired this through its programmes of cooperation with the new EU Member States and North African countries, particularly in developing techniques and modalities for job training, skill formation, delivery of basic services to the people and governance-related issues. These are precisely the requirements for Pakistan at the moment and this type of assistance will prove most helpful, through sustained EU action, while ensuring a level playing field for Pakistan in trade with the EU by providing GSP-Plus for a number of years.

EU should maintain high-level attention on Pakistan with sensitive and smart diplomacy, and should develop a stake in long-term ties with its people, providing massive assistance and resources in education, health and infrastructure development, making education the focus of its assistance packages with high priority projects in less developed parts of the country. The EU would therefore need to increase assistance tenfold from its current €50 million a year to over €500 million and sign an Agreement to signify this relationship.

The EU is Pakistan's largest trading partner as well as the biggest source of direct foreign investment and foreign assistance. Pakistan's interest in the EU includes political support on critical issues of interest and concern to the two sides, market access and transfer of technology.

What will be the gain in it for the EU? Pakistani success in running democracy will demonstrate to the 1.3 billion Muslims in this world including 20 million Muslims in the EU that "democracy works and is the best guarantee against terrorism, injustice and hopelessness". As Benezir Bhutto said, "democracy is morally right", and "it is the only way to contain the growth of extremism, militancy and fanaticism that threatens the world".

I would like to quote the EU's High Representative Javier Solana in this regard who has said that "the best protection of our security is a world of well governed democratic states. Trade and development policies can be powerful tools for promoting reform in the world". In addition, the EU's commitment to strengthening institutions and governance is a part of its mandate to promote security beyond its borders. EU has the right tools, policies and institutions to build capacity and to win the hearts and minds of the people to promote the infrastructure of moderation.

The restructuring that is needed in Pakistan in its institutions and nation-building and economy, can be assisted through such programmes. This will be the EU's tryst with destiny. Thus Pakistan will set an example for the Muslim world and help serve the long term objective of allowing Islam and the West to co-exist harmoniously. It will be a test of the EU's profile as the world's biggest donor and an engine for reforms and a 'soft power' making hard choices with growing stakes in the peace and security of the world.

We hope that the EU will match its words of support with early action on consolidating Pakistan's democracy. We have great expectations from the EU. We hope that the Union will not disappoint the people of Pakistan in strengthening the foundations of democracy and prosperity in Pakistan.

II. Asian regional deals: spur or obstacle to free trade?

October 6 2008: Many of the free trade agreements negotiated or being negotiated by Asian countries and the EU are "trade light" because they reflect foreign policy and political imperatives rather than economic goals. The current impasse in the World Trade Organization's Doha Round is encouraging many nations to clinch bilateral free trade agreements, leading to a "noodle bowl" of more than 100 intra-regional deals.

Event report

Dr Razeen Sally, Co-Director of the European Centre for International Political Economy (ECIPE), pointed out that the EU is the world's largest trading entity, accounting for 19% of world trade, with China the leading exporter (16.2%) of manufactured goods to the Union.

He said that while the EU has several free trade agreements (FTAs) with Asia, most of these are "trade-light", prompted more by foreign policy and political issues than trade *per se*. In contrast, the US, which has also negotiated many free trade pacts, is a more serious 'trade' negotiator. The EU compromises its free market agenda by insisting on linking trade to non-trade issues in the FTAs, and appears to be more concerned about exporting its regulation model than about gaining access to Asian markets.

There has been a "a noodle bar" of preferential intra-regional trade deals – nearly 40 FTAs in just ten years, and a total 103 trade deals in East and South Asia altogether, said Dr Sally. One of the main reasons has been the stalling of the World Trade Organization Doha Round, leaving the FTAs to constitute the building blocks in regional market liberalisation.

Most Asian countries prefer their intra-regional FTAs to be "trade-light," focused on "gimmicky" goals, including foreign policy objectives and not accompanied by hard cost-benefit analysis. As such, these accords often do not involve genuine and tangible trade and economic liberalisation. China and India have been the lead players, with the latter particularly keen on "very trade-light and dirty" FTAs.

While Asia is experiencing increasing inter-regional trade and foreign direct investment (FDI), this operates in a different format than in other regions in that Asian national companies are already linked into global trade as they are often part of the manufacturing global supply chain.

EU-Asia relations

Given that China is the EU's most important Asian trading partner by far, more needs to be done at EU and Member State level to strengthen bilateral institutions, and to develop high-level trade and economic dialogue. But these platforms should not become mere talking shops, said Dr Sally, adding that this was particularly important because both sides faced "protectionist pressures."

Of the other EU-Asia trade relationships, the most promising is with South Korea – the most commercially-minded country in Asia – which is currently negotiating an FTA with the EU.

The Union has tried to set up an EU-ASEAN FTA, but this is mired in difficulties as ASEAN is not a single economic entity, and does not have any credible negotiating machinery. An EU-ASEAN FTA only made sense if it focused on removing regulatory barriers and "WTO-plus" issues such as services, investment and public procurement.

As to a possible EU-India FTA, Dr Sally said this would only benefit the EU if it tackled India's non-tariff regulatory barriers. As internal unilateral reforms on trade and investment have stalled, making it unlikely that India's government would be interested in an FTA, a more useful alternative might be to draw up a framework for better regulations.

Given the different needs of each country in the region, the EU might be advised to take a more plurilateral approach, and needs to:

- think about constructing better regulation frameworks, instead of negotiating FTAs, possibly within the WTO framework;
- "think out of the box" about its bilateral regulations with Asian countries, improving the climate for countries like China and India, and for ASEAN; and
- think of linkages and strengthening WTO rules post-Doha, to address the serious issues of commerce.

Mauro Petriccione, Director, Services and Investment, Bilateral Trade Relations, Directorate-General for Trade, European Commission, pointed out that the EU had been negotiating FTAs for 30 years, and these had never simply been about trade, as they touched on relations with neighbours or accession prospectives. "What's wrong with merging trade negotiations with other political objectives, provided it's not hidden?", he asked.

He agreed that most FTAs outside Europe are "dirty" or "trade light", and provide the political illusion that they replace multilateral liberalisation. However, the serious FTAs are complementary to the WTO, tackling the so-called "Singapore issues" – trade and investment, competition policy, and transparency in government procurement – which are not currently part of the Doha Round. While the EU is still attached to the Doha Round, it also believes that negotiation of FTAs serves its economic interests.

Mr Petriccione described the three main strands of the EU's "Global Europe" trade framework, launched last year.

Global Europe: the EU is currently negotiating an FTA with South Korea and a deal is expected shortly. With ASEAN, the EU is looking for a region-to-region free trade agreement. In India, negotiations began "on the tail of reforms" being undertaken by the Indian government and conclusion of the agreement will be difficult unless the reform process regains momentum.

Japan: the EU and Japan could in theory clinch a comprehensive FTA in a very short time, but trade relations are "out of step with what one would expect" given the two sides' economic strength. For example, FDI in Japan still stands at just 3%. However there is a resurgence of Japanese and European interest in closer economic relations.

China: an FTA with China is "not politically feasible", said Mr Petriccione. Foreign investors in China are mainly concerned about the rule of law and a good investment climate. The EU's growing trade deficit with China is not so much an economic issue but more a political problem. The EU and China have a "dialogue-mechanism", he said, which has to be at a sufficiently high level to make an impact in Beijing. In China, building personal relations is very important, he added.

Discussion

In response to a remark about the need for good political relations to push through an FTA, Dr Sally said there are limits to what trade negotiations in either the WTO or through FTAs can achieve. He felt that little could be achieved in the WTO setting, because negotiations on the Doha Round had little connection to the real business environment.

Mr Petriccione added that while the WTO is valuable, it does not completely fulfil European economic interests as most regulations are outside the WTO's remit. The value of FTAs for the EU is that they create a framework which obliges regulators to get together if there is a problem, creating a mandate to explore compatible regulations.

Asked about the effects of the global financial crisis, Dr Sally said the implications were not good. While he did not foresee a reversal of the 1980s and 1990s reforms, these were likely to slow down, with an increase in economic nationalism and perhaps creeping protectionism. The financial turmoil could, however, also focus peoples' minds on the need for trade liberalisation. Financial services like banking, security and insurance would be most affected, but there was a danger that this might spill over into other sectors.

Mr Petriccione felt that while there would be no short-term impact on negotiations, governments might be more cautious in future about setting up FTAs.

On EU-Chinese relations, Mr Petriccione said the EU Chamber of Commerce in China was very effective, but European companies could learn a lot from their US counterparts about lobbying more effectively.

Challenged on why India was not a "sincere negotiator", Dr Sally felt that India was defensive and its FTAs (with South Africa or Brazil) only reduce tariffs on goods that are of little value, as India prefers to "lock in" existing agreements.

Mr Petriccione added that EU negotiations with India were proving more difficult than both sides had anticipated, in spite of the intensive preparations. Neither side can afford, legally nor politically, to conclude an agreement that does not meet WTO conditions. The Global Europe framework specifies that the EU cannot present deals that are not WTO-compatible.

Asked whether the Doha Round was dead, Mr Petriccione said that "for a corpse, it twitches violently." The EU believes a deal is do-able, but it is a question of finding the necessary political will among the WTO's 150 members to create a "coalition of the willing".

Questioned about whether India was a "developing" country or "one in transition" he said that Indians still prefer to describe themselves as living in a "developing" country. It is a lively economy that the EU wants to be part of.

Asked about the scope for FTAs in the Asia-Pacific region, Dr Sally said that while 53% of overall East Asian trade is intra-regional trade, this is misleading, as much of the production is linked to final markets in the West.

Keynote speech: Asian Trade Deals and the Prospects for Regional Integration in Asia

By Dr Razeen Sally, Co-Director of the European Centre for International Political Economy (ECIPE)

Introduction

In late 2006, Peter Mandelson, the EU trade commissioner, announced a new EU policy on free trade agreements (FTAs), contained in the European Commission's Global Europe Communication. The core of this new chapter in EU trade policy are FTAs with three Asian partners, India, ASEAN and South Korea.

Negotiations have already started and the EU has joined the bandwagon of FTAs in Asia. It is not new to FTAs and has more preferential trade agreements (PTAs) than any other leading power, but it put new FTAs in deep-freeze from the late 1990s, prioritising the WTO and the Doha Round, while others launched FTAs. Before its change of heart, the EU was the only leading power not engaged in FTAs in Asia.

EU-Asia trade relations: facts and figures

The EU dwarfs its Asian trading partners in terms of GDP, GDP *per capita*, trade in goods and services, and inflows of foreign direct investment (FDI). Japan, Hong Kong and Singapore are close to or above EU levels of *per capita* GDP, but are some way behind on other headline economic indicators. The EU is the world's largest trading entity, accounting for 19% of total world trade (excluding intra-EU trade), followed by the USA. China, ASEAN and Japan each account for 7%-9% of world trade. Korea and India have just above 3% and under 2% respectively.

Rankings and shares of world trade in merchandise goods are similar – though China accounts for 10% of goods exports, while India's share is just above 1%. The EU has an even bigger share of world trade in commercial services, accounting for over 25% of the total. China has a much lower share; Japan, ASEAN and Korea moderately lower shares, but India a bigger share of world trade in services than in goods. The EU's lead in FDI is even greater than in world trade, accounting for almost 50% of outward FDI and over 40% of inward FDI. Japan, Korea, China, India and ASEAN all have very low global shares of accumulated FDI in comparison. China accounts for nearly 9% of recent FDI inflows.

Turning to EU bilateral trade-and-investment relations with third countries: the USA is by far its leading trading partner, China its second largest trading partner, followed by Japan and ASEAN, and even farther behind by Korea and India. In 2005, China accounted for almost 14% of EU goods imports, and by 2006 had displaced the USA as the EU's biggest trading partner in goods. The EU is China's biggest trading partner, and EU-China trade has been increasing by over 20% annually.

Japan and ASEAN have similar shares of EU trade in goods. The EU is ASEAN's third biggest trading partner, with Korea and India farther behind in their shares of EU goods trade. The EU is Korea's second largest export market and India's premier trading partner; with EU-India trade growing at 14% *per annum* since 2002.

EU services trade with Asian countries is very low compared with goods trade, and minuscule compared with EU-USA services trade, and the EU, USA, China, Taiwan and Japan have bound all (or almost all) tariffs in their WTO tariff schedules. Korea and Indonesia have bound over 90% of their tariffs. Other Asian countries have lower levels of tariff bindings, with big differences across the continent.

EU-Asia FTAs in EU trade-policy context

In Global Europe, the Commission stresses commercial criteria for its new FTAs, which are all about "stronger engagement with major emerging economies and regions; and a sharper focus on barriers to trade behind the border," and strengthening EU competitiveness. The commitment to the WTO and a successful Doha Round is restated, but priority is given to bilateral and region-to-region negotiations to achieve market-access objectives.

Before Global Europe, the EU focused on the WTO at the expense of new FTAs. It does not take rocket science to understand the EU's change of heart: the Doha Round has gone nowhere; other leading players have left the EU behind in the scramble for FTAs; and the EU's "footprint" in Asia is less visible than the USA and others.

In terms of content, Global Europe's stated aim is to have strong, comprehensive, "WTO-plus" FTAs. Tariffs and quantitative restrictions should be eliminated and there should be a "far-reaching" liberalisation of services and investment. Services provisions should presumably be compatible with the "substantial sectoral-coverage" criterion in Article V of GATS. A model EU investment agreement, developed in coordination with EU member-states, is envisaged.

This should contain provisions that go beyond WTO disciplines on competition, government procurement, intellectual property rights (IPR) and trade facilitation, plus provisions on labour and environmental standards. Rules of origin (ROO) should be simplified and there should be strong regulatory disciplines and regulatory cooperation.

With the economic criteria of "market potential (economic size and growth) and the level of protection against EU export interests (tariffs and non-tariff barriers)" in mind, the EU has selected India, ASEAN and Korea as partners for new FTAs in Asia. Russia is of "direct interest", but not yet a priority for an FTA, and neither is China, which "meets many of these criteria, but requires special attention because of the opportunities and risks it presents."

In terms of what Asian partners can expect from the EU: tariffs and quotas will be eliminated on 90% or more of goods' trade, but that will still allow for carve-outs for swathes of agricultural trade. Market access and rule discipline in services, investment, government procurement, competition and trade facilitation will not be as strong as in US FTAs.

The EU approach to IPR will sit more comfortably than the US approach with developing-country partners. There will be little or nothing on anti-dumping and agricultural subsidies. Finally, negotiating partners should be alert to EU stratagems to sneak in non-trade provisions on climate change, human rights and other issues into FTAs. That is the EU Trojan Horse to watch out for.

Sceptical economists ask why has the EU decided to negotiate FTAs with India, ASEAN and Korea but not with Japan and China? The latter two comprise 55% of the EU's potential Asian market. An FTA with Korea could be considered a stepping stone to one with Japan. But excluding China from the FTA calculus is even less convincing, and diminishes the EU's "economic criteria" for new FTAs. Fear of Chinese competition is clearly the main reason why China is not on the list.

According to Professor Messerlin of Sciences Po in his ECIPE Policy Essay, the EU's Asian FTAs can only add to the existing noodle bowl of market preferences and ROO complications – an unholy mess of arbitrary, tailor-made regulations for politically-influential companies. Companies increasingly depend on governments to do deals for them rather than relying on a simple level playing field. This makes business more costly and uncertain, with competition and efficiency the losers.

The EU policy elite's mercantilist outlook leads it to believe that the lack of EU competitiveness in Asian markets can be fixed by opening them through FTAs. That would benefit some EU firms in some sectors but is not the same thing as EU competitiveness, and EU firms' market share in expanding Asian markets has not fallen due to lack of market access.

Policies to improve competition and efficiency in the Internal Market are far more likely than FTA quick fixes to boost the competitiveness of EU firms in Asia. EU non-discriminatory unilateral liberalisation and improved offers in the Doha Round would be the external complement to competition-friendly internal-market reforms. But that is not how mercantilist politicians, bureaucrats and CEOs see the world.

The EU is more serious about commercially-relevant FTAs than most other players, but its "economic criteria" for new FTAs are compromised by non-trade goals and onerous regulations the EU tries to export via FTAs. These include a weaker stance on market access and related rules compared with the USA; the absence of Japan and China from its FTA wish list; potential trade-diversion and noodle-bowl effects; and a general mercantilist outlook that neglects unilateral liberalisation and internal-market reforms. The last two features are, of course, not confined to the EU.

FTAs in Asia

Turning to the state-of-play of FTAs in Asia, is the noodle bowl of Preferential Trade Agreements (PTA) in danger of being replicated in Asia? Or are the new Asian FTAs more serious? Do they hold out the prospect of strengthening regional and global integration?

Unlike other regions, East Asia used to rely on non-discriminatory unilateral and multilateral liberalisation rather than discriminatory FTAs. Now it is playing catch-up, with FTA initiatives spreading like wildfire in the past six years. The major Asian powers – China, India and Japan – are involved, as are Korea, Australia, New Zealand, Hong Kong, the South-east Asian countries, as well as other South Asian countries. There are about 20 FTAs in force and 60 more in the pipeline in China, India and Southeast Asia.

China is the driving force for FTAs in Asia. It is considering or negotiating FTAs left, right and centre – in East and South Asia, the Middle East, Latin America, Africa, Australia and New Zealand. By 2006, it had 9 FTAs on the books and was considering negotiations with up to 30 other countries. The China-ASEAN set of negotiations, more than any other FTA initiative, is the one to watch in the region. The aim is to have an FTA in place by 2010. It would be the largest FTA ever negotiated, covering 11 diverse economies with a population of 1.7 billion and a GDP of US$2 trillion.

Beijing is also negotiating or thinking of negotiating rather weak FTAs elsewhere in the developing world, e.g. Pakistan, MERCOSUR, the South African Customs Union (SACU) and perhaps India. China's approach to FTAs is pragmatic and eclectic, ranging from strong (Hong Kong and Macau) to middling-to-weak (probably ASEAN) to very weak (probably India, SACU and other countries in Africa, the Middle East and elsewhere).

Even the China-ASEAN FTA is unlikely to create much extra trade and investment if it does not go substantially beyond tariff elimination in goods. Trading interests are placed in the context of foreign-policy "soft power", i.e. diplomacy and relationship building and its FTAs are driven more by "high politics" (competition with Japan to establish leadership credentials in East Asia; securing privileged influence in other regions) than economic strategy. The danger is that this will deliver weak, partial FTAs that create little trade but a lot more political and economic complications. And that would send powerful signals to other countries to do the same.

In South-east Asia, Singapore blazed the FTA trail, with Thailand next to follow, and now Malaysia, Indonesia, the Philippines and Vietnam trying to catch up. Of the ASEAN countries, only Singapore has reasonably strong FTAs, and an especially strong FTA with the USA, but is a misleading indicator for the region. Thus far most signs point to other ASEAN countries becoming entangled in a web of weak and partial FTAs, with many product areas, especially in agriculture, excluded from goods liberalisation.

Regulatory barriers are unlikely to be tackled with disciplines that go much deeper than existing WTO commitments. Services commitments are unlikely to advance much beyond the WTO's GATS agreement, let alone deliver meaningful net liberalisation or regulatory cooperation (e.g. on mutual recognition of standards and professional qualifications). Provisions on investment and the temporary movement of workers are also likely to be weak, with perhaps even weaker commitments on government procurement, competition rules and customs administration.

It is already apparent that agreements in force and those being negotiated are creating a noodle bowl of complex and restrictive rules of origin and differ between bilateral FTAs. Collective ASEAN FTAs with third countries will compound the problem, if they end up with yet another layer of differing ROO criteria. If this is indeed what emerges, administrative and other compliance costs could be too onerous for most exporters in the region. Many will find it cheaper to pay the MFN-tariff duty.

India is also newly active with FTAs, in its South Asian backyard and in other developing-country regions. In South Asia it has several bilateral FTAs. Hitherto loose regional cooperation is supposed to be transformed into the South Asian FTA (SAFTA) by 2010, leading to a customs union by 2015 and economic union by 2020.

India's approach to FTAs outside South Asia is mostly about foreign policy and is "trade light", with little economic sense or strategy. An FTA with ASEAN is planned for completion by 2011; and bilateral FTAs are also in place with Thailand and Singapore. ASEAN-India and India-Thailand negotiations have been bedevilled by India's insistence on exempting swathes of products and on very restrictive rules of origin for products covered. In addition, India is part of the BIMSTEC group (the other members being Bangladesh, Sri Lanka, Nepal, Bhutan, Thailand and Myanmar) that plans an FTA by 2017. It has mini-FTAs – basically limited tariff-concession schemes – in force or planned with several countries and regions and negotiations have started with Russia, Japan and South Korea.

Japan was the last major trading nation to hold out against discriminatory trade agreements, preferring the non-discriminatory WTO track instead, but has changed decisively in the past six years. Japan's biggest FTA initiative is the Japan-ASEAN Economic Partnership Agreement, which is supposed to be completed by 2012. It is comprehensive on paper, but progress has been slow because of Japanese reluctance to reduce and then phase out agricultural tariffs, and its insistence on restrictive and often product-specific rules of origin, especially for agricultural products.

Another complicating factor is that Japan has given greater priority to bilateral FTA negotiations with individual ASEAN countries, which is going to make it very hard to achieve a clean, comprehensive Japan-ASEAN FTA. The latter risks ending up as a loose umbrella for a series of bilateral FTAs.

Japan has several other FTA initiatives in train, which it calls "economic partnership agreements" (EPAs) – to indicate that they go beyond traditional FTAs in goods, with comprehensive coverage of trade and investment-related issues in goods and services. These are really just euphemisms for weak and partial FTAs, as in essence, Japan seems to be reacting to China's FTA advance, but without a real strategy.

South Korea is also in the thick of FTA activity. Like Japan, it is defensive on agriculture, but unlike Japan, it seems to be more serious on other negotiating issues. It has made more progress than Japan in FTA negotiations; standing trade tensions and conflict in a contained, businesslike, problem-solving setting.

- Regular high-level contacts need to be strengthened significantly and better focused. The EU needs its equivalent of the 2006 US-China Strategic Economic Dialogue. This involves intensive bilateral exchanges focused on the most contentious trade issues and draws in government agencies across the economic-policy spectrum, culminating in twice-yearly ministerial-level meetings. This will be more difficult for the EU to organise, given that Member States, especially the Big Three, will have to be involved. Nevertheless, it is worth pursuing.
- The EU should give China market-economy status (MES) as soon as possible. Its argument that China does not yet meet four out of five set criteria is specious. China is more marketised than Russia and most other developing countries. Yet the EU recognises Russia but not China as a market economy. Giving China MES would impose more limits on arbitrary EU protectionist measures, especially anti-dumping procedures and would, at a stroke, greatly improve bilateral relations. Sadly, the EU lacks the internal consensus to go down this route. It is incumbent on a range of actors: producers and retailers who import from China, market-friendly governments in the EU Council, freer trade elements in the Commission and the European Parliament, and think tanks such as ECIPE, to make a powerful case and assemble the votes within the EU to get the policy changed.

These are all measures that would help contain protectionism and reinforce China's engagement as a "responsible stakeholder" in the WTO and other international institutions – a stated EU goal. They would create extra political space for the Beijing leadership to better implement China's WTO obligations and go forward with unilateral, WTO-plus structural reforms to further open up the economy. Parallel moves by the USA are at least as important. Hence both the USA and the EU have a vital role to play in smoothing China's integration into the global economy.

The EU-Korea FTA

The EU trades at lower levels with Korea than it does with China, Japan and ASEAN. This is also true of EU FDI to and from Korea. An EU-commissioned study on the potential impact of an EU-Korea FTA estimates that a full FTA would deliver appreciable gains for Korea, but the net effect on the EU would be rather modest. A limited FTA would drastically reduce Korean gains and have an even more modest effect on the EU. Significant liberalisation of services is crucial in order to deliver meaningful gains.

Korea is by far the EU's best FTA prospect in Asia. First, Korea, next to Singapore, is the most credible FTA player in Asia. It has very high levels of agricultural protection and correspondingly defensive negotiating positions. But it has been more serious and forthcoming than Japan, China, ASEAN countries and India on non-agricultural issues in FTA negotiations.

Second, the US-Korea FTA sets the floor for EU-Korea negotiations: the EU can and does expect at least parity with Korean concessions made to the USA. While it remains to be seen whether the US-Korea FTA will be ratified by one or both countries, the chances of successfully concluding EU-Korea negotiations in reasonably quick time are good. The result might be a relatively strong, WTO-plus FTA, though with significant gaps.

During the second round of negotiations, the EU offered to abolish all its tariff duties on bilateral goods trade, with no exemptions or extra-long transition periods for agriculture – a major departure for the EU. In return the EU wants 100% removal of Korean tariffs, major services liberalisation, the removal of restrictions on EU investors, and a strong focus on tackling non-tariff and domestic regulatory barriers.

It is probable that an EU-Korea FTA will leave significant gaps. Both sides might well agree to zero duties on all trade in manufactures and a special safeguards' mechanism for agriculture. It remains to be seen what devils will lie in the detail of agreed ROOs. Mutual defensiveness and GATS-style positive listing might result in several services sectors being exempted from liberalisation or covered by weak disciplines.

The EU wants to exempt audiovisual, air and maritime cabotage services and both sides may agree to soft, barely WTO-plus disciplines on government procurement and competition rules. Finally, the depth and bite of the FTA depends crucially on strong disciplines on domestic regulatory barriers.

The EU-ASEAN FTA

EU-ASEAN trade is lower than EU bilateral trade with China and Japan, but is higher than EU bilateral trade with Korea and India. EU FDI stock in ASEAN is higher than it is elsewhere in Asia except Japan.

Relatively big numbers for EU trade and FDI with ASEAN should not be taken at face value: ASEAN is neither a country nor an integrated economic region and its members have very different historical legacies, political systems, levels of economic development and institutional capacity. Trade barriers between ASEAN countries, especially non-tariff and regulatory measures, are quite high. Regional economic integration exists more in ASEAN blueprints and 'visions' than it does on the ground.

An EU-commissioned study on the potential impact of an EU-ASEAN FTA estimates that an ambitious FTA (with zero tariffs on all goods trade and a 50% reduction in barriers to services trade) would increase EU GDP by 0.1% and ASEAN GDP by 2.2%. A less ambitious FTA (with carve-outs for sensitive agricultural products) would hardly change these figures.

A third scenario (taking into account other existing FTAs) would increase the ASEAN gain to 2.6% of GDP. A much more modest FTA (limited to goods liberalisation) would increase EU GDP by 0.03% and ASEAN GDP by 0.5%. Hence a substantial FTA would deliver appreciable gains for ASEAN but have a modest effect on the EU. These forecasts are similar to those for the EU-Korea FTA.

In addition to tariffs, other ASEAN countries have much higher non-tariff and regulatory barriers, which vary considerably between countries. The EU and ASEAN have a Cooperation Agreement that dates back to 1980. Since 2004, they have the Trans Regional EU-ASEAN Trade Initiative (TREATI), which is the framework for region-to-region regulatory cooperation on trade, investment and trade-facilitation issues. The EU is also negotiating Partnership and Cooperation Agreements with Singapore and Thailand, and will start PCA negotiations with Malaysia, Indonesia, the Philippines and Brunei. There are plans for a PCA with Vietnam as well.

More broadly, the Asia-Europe Meeting (ASEM) is an annual summit involving the EU Commission, EU Member States and the ten ASEAN members. It has an "economic pillar" for meetings of economic and finance ministers and senior officials, as well as an Asia-Europe Business Forum. The EU has expressed a wish to accede to the ASEAN Treaty of Amity and Cooperation.

The EU Commission's mandate is to negotiate a collective FTA with the ASEAN members with which it has started or plans to start PCA negotiations. This leaves out Cambodia, Laos and Myanmar. The EU already gives Cambodia and Laos duty-free access to its market as part of its ‘Everything But Arms’ package for Least Developed Countries. It will not include Myanmar on principle, given its human-rights record and EU sanctions. Some ASEAN leaders, on the other hand, insist that the FTA must include all ASEAN members, in line with other ASEAN FTAs with third countries. These issues remain to be resolved. But compromise is likely: these should not be big negotiating road-blocks.

As for negotiating content: the EU wants a ten-year transition period for tariff elimination and commitments in services and investment, perhaps with longer transition periods for some sensitive agricultural products. It is willing to give Special and Differential Treatment (SDT) to less-developed ASEAN countries in the form of longer transition periods, while no SDT is envisaged for Korea and India.

The EU’s draft mandate for the ASEAN FTA negotiations contains softer language on government procurement and competition rules than in the draft mandate for the negotiations with Korea. With ASEAN, the EU wants compatibility with the WTO’s GPA and regulatory cooperation on competition issues. Finally, the EU aims to complete negotiations by mid 2009, with the bottom line that an EU-ASEAN FTA only makes economic sense if it goes deep into non-tariff and regulatory barriers in ASEAN countries other than Singapore.

This is highly unlikely. First, the record of existing ASEAN FTAs shows that they hardly go beyond tariff elimination on 90% or more of goods trade and Singapore’s FTAs are exceptional. The USA is the only player that has attempted strong FTAs with ASEAN countries: it succeeded with Singapore, has failed so far with Thailand and Malaysia, and considers Indonesia and the Philippines unlikely prospects. A US-ASEAN FTA is not on the cards.

Second, given intra-ASEAN differences and the lack of an adequate common negotiating machinery, the EU will find it exceedingly difficult to negotiate with ASEAN collectively. ASEAN is big on summits, other meetings, Visions, Charters and sundry blueprints, but when it comes to concrete measures, ASEAN decision-making is very unwieldy and dilatory, and eventually-agreed positions tend to be low common denominators.

The easy way out for the EU and its ASEAN counterparts is to negotiate a relatively “trade-light” FTA that does not seriously tackle non-tariff and regulatory barriers – akin to other ASEAN FTAs. This would be politically symbolic but commercially nonsensical. If this is indeed what transpires with ASEAN, the EU should change strategy, and the sooner the better, so what should it do?

- The EU should give up negotiating with ASEAN collectively (meaning ASEAN-10 or ASEAN-minus-3), aiming for a stronger TREATI framework for regulatory cooperation with ASEAN, complemented with stronger trade-and-investment regulatory cooperation with individual ASEAN countries, perhaps within a PCA framework.
  Such EU-ASEAN trade cooperation would mirror the EU-China approach proposed earlier – but with an exception. An EU-China framework on a par with the US-China Strategic Economic Dialogue is much needed, but would not make sense for EU-ASEAN, as ASEAN is too diverse and unwieldy. It would quickly degenerate into vague general statements, photo opportunities, golf excursions and karaoke sessions. That is already covered by other forums.
- The EU should go full speed ahead with an FTA with Singapore. This could be done in quick time and be relatively strong and clean. It would be at least as wide and deep as the US-Singapore FTA. Ideally, it would remedy some of the latter’s faults, notably on complicated, product-specific rules of origin.
- The EU should not go full speed ahead for bilateral FTAs with other ASEAN countries, even though serious FTAs with them are presently not deliverable. Malaysia and Thailand are the strongest candidates after Singapore, but Malaysia’s interests are intimately bound up with its policies that discriminate in favour of the Malay majority.
  This precludes sufficient opening of services markets and government procurement. Thailand has gone backwards after the military coup in 2006: economic-nationalist rhetoric has increased; anti-market NGOs are more influential and protectionist interests are more powerful. Indonesia, the Philippines and other ASEAN countries present even greater obstacles. Stronger regulatory cooperation with ASEAN and an EU-

Singapore FTA would of course deliver paltry welfare gains compared with a serious EU-ASEAN FTA. But the latter is politically not feasible; and the former economically more sensible than a dirty EU-ASEAN FTA.

The EU-India FTA

India is the smallest of the EU's Asian trading partners considered here and receives less EU FDI than the others. But the relationship looks very different from the Indian end: the EU is India's biggest trading partner and biggest source of FDI.

A revealing EU-commissioned qualitative analysis, conducted by the Centre for the Analysis of Regional Integration at Sussex (CARIS) and CUTS International, argues that a "shallow" FTA, i.e. one with tariff liberalisation but little else, would result in limited welfare gains and risk strong trade diversion. That is because India has relatively high tariffs and the EU low tariffs, with little overlap in their production structures. Diversion away from efficient third-country suppliers could happen in services trade and FDI in addition to goods trade.

The study argues that only a "deep-integration" FTA would be worthwhile, but this requires serious tackling of India's non-tariff and regulatory barriers, which are on a much bigger scale than the EU's non-tariff and regulatory barriers. Such an FTA could induce significant productivity gains driven by technological change, economies of scale and other dynamic effects. Growth in FDI is very much related to productivity gains.

The EU-India FTA negotiations follow the formal upgrading of bilateral relations in recent years. A broad EU-India Cooperation Agreement has been in force since 1994, with a 'strategic partnership' from 2004. For the FTA, both sides aim to eliminate duties on 90% of tariff lines and trade volumes within seven years of an agreement being signed. Both sides aim to complete negotiations by 2009.

The EU Commission's mandate for negotiations with India contains softer language on government procurement and competition policy than did its negotiations with Korea. But it implies higher ambition than for negotiations with ASEAN. There is no mention of SDT for India, which is strange, since India's *per capita* income is much lower than the ASEAN average. It seems both sides are happy to leave most agricultural trade out of liberalisation commitments, while still covering 90% or more of total trade. Both sides profess high ambition for liberalising trade in industrial goods, and even higher ambition for liberalising services.

The CARIS/CUTS study has the right diagnosis and prescription – and (without saying so) points to the near impossibility of a serious FTA with India. India has the worst FTA record of all the major Asian players: its FTAs are appalling. Many are gimmicky, commercially nonsensical preferential-tariff agreements on a limited range of goods. Even in the relatively more serious FTA with ASEAN, India insists on carving out much of agricultural trade as well as a range of industrial products, all hedged about with very restrictive rules of origin.

India is not serious about WTO-plus liberalisation of assorted regulatory barriers in services, investment, government procurement and other issues in its FTAs. Moreover, dirty, 'trade-light' FTAs fit the broader pattern of Indian trade policy. The government remains inflexible and defensive in the WTO, which is one of the major obstacles to the conclusion of the Doha Round. More importantly, unilateral trade-and-investment liberalisation, and market reforms more generally, have stalled since the present Congress-led government took power in 2004.

In this context, it would be naïve to expect the Indian government to sign, let alone implement, any kind of deep-integration FTA. If it cannot pursue even a small fraction of these measures unilaterally, it is out of the question to impose them "from above" through an FTA – and least of all in India's boisterous culture of democratic politics. Furthermore, this would imply a wholesale overhaul of Indian regulation, including deep reforms in the states, which is not realistic. The states have entrenched political autonomy, with constitutional guarantees; they cannot be commanded to act by the central government.

This kind of reform agenda can only be pursued unilaterally through a combination of initiatives at central and state levels. Inevitably, it will be long, drawn out and patchy. The EU is on a hiding to nothing if it believes it can get a deep-integration FTA from India. It was a mistake to launch FTA negotiations, just as it was a mistake to launch FTA negotiations with ASEAN collectively. So what should it do?

- If negotiations do not soon show signs of sufficient progress on non-tariff and regulatory barriers, the EU should put them in deep freeze. It could consider restarting FTA negotiations if political conditions change in Delhi and there is a new wave of market reforms, including unilateral trade-and-investment liberalisation, but this is highly unlikely in the short term.
- The EU should focus on much stronger trade-related regulatory cooperation, along the lines advocated here for EU-China and EU-ASEAN. This could be enshrined in a new bilateral agreement, but not in an FTA framework and should encompass regulatory cooperation with the Indian states on trade and FDI-related issues.
- Finally, the EU could envisage a Strategic Economic Dialogue with India along the lines as with China. It is far more urgent to set up an EU-China mechanism, given the EU's much stronger commercial ties – and greater trade tensions – with China. But a parallel EU-India mechanism for the medium-term would be wise.

Conclusion

The EU says its new FTAs with Asian countries will be governed by commercial criteria, and is aiming for strong, comprehensive, WTO-plus FTAs. This is unlikely to materialise. The EU is not as ambitious on market access and rules as the USA in FTA negotiations, and has entrenched protectionist interests in agriculture as well as in some industrial-goods and services sectors. Its commercial criteria are severely compromised by its zeal to export the "EU regulatory model", including a range of non-trade objectives it sneaks into bilateral and regional trade agreements. Its two major Asian trading partners, China and Japan, are not on its FTA wish-list.

Over in Asia, the emerging patchwork of FTAs leaves much to be desired. Some FTAs are preferential-tariff agreements on a limited range of goods. Even the better ones are trade-light and barely WTO-plus: they cover tariff elimination on most goods trade, but do not seriously tackle non-tariff and regulatory barriers. They are unlikely to contribute to regional and global economic integration, but will cause extra complications through a noodle-bowl profusion of complicated and discriminatory deals. This undermines comparatively simple, transparent, predictable and non-discriminatory multilateral trade rules.

The new EU-Asia FTAs risk making the problem worse. The mercantilist outlook of all major FTA players, including the EU and its Asian partners, leads them to neglect unilateral liberalisation and domestic structural reforms. The latter are far more important to building up firm-level competitiveness than crow-baring open export markets through FTA negotiations.

For the new FTA negotiations the EU's best prospect is a relatively strong, WTO-plus FTA with Korea, building on the recently concluded US-Korea FTA, but this will probably leave significant gaps in agriculture and some services sectors.

The EU has little hope of concluding a serious FTA with ASEAN collectively (or even with ASEAN minus Cambodia, Laos and Myanmar), so should focus on stronger EU-ASEAN trade-related regulatory-cooperation, and a strong, WTO-plus FTA with Singapore. Strong FTAs with other ASEAN countries are unlikely. It has little hope of concluding a strong FTA with India, so should focus on stronger bilateral regulatory cooperation, and a deep-integration FTA later if Indian political conditions change and there is a renewed wave of unilateral liberalisation.

Lastly, the EU needs a much stronger framework for trade-related regulatory cooperation with China, focusing on tackling concrete issues where there is trade tension and conflict, without linking them to the EU's non-trade objectives. There should be a coalition within the EU to accord China market-economy status. All these measures would help contain protectionism, strengthen bilateral relations, encourage the

Beijing leadership to go forward with WTO-plus reforms to open up the Chinese economy, and reinforce China as a responsible stakeholder in the multilateral system.

Note: this speech is based on material from an article by Dr Razeen Sally, 'Looking East: The European Union's New FTA Negotiations in Asia', the European Centre for International Political Economy (ECIPE), London 2007. www.ecipe.org/publications/jan-tumlir-policy-essays/looking-east-the-european-union2019s-new-trade-negotiations-in-asia-1/PDF

III. Injecting new momentum into ASEM: an uphill struggle?

October 20 2008: The global financial crisis will dominate the 24-25 October ASEM 7 Summit and the organisation must deliver a coordinated response to demonstrate its relevance and show that it is more than just a useful discussion forum. ASEM, with its 45 members, is large enough to influence international affairs and well-placed to provide a platform to test out ideas, but needs "polishing" to give it more momentum.

Event report

Lay Hwee Yeo, Senior Research Fellow at the Singapore Institute of International Relations and Associate Director of the EU Centre in Singapore, considered whether ASEM has progressed "from a Sexy Summit to a Strong Partnership".

ASEM membership has grown from 26 members in 1996 to 45 today, comprising 27 EU Member States plus a representative from the European Commission and 10 ASEAN members plus China, Japan, Korea, Pakistan, India, Mongolia and a representative of the ASEAN Secretariat.

The ASEM Summit being held in Beijing on October 24-25 2008 (ASEM 7) has to guard against unrealistic expectations about what it can achieve, otherwise we will be disappointed, warned Ms Yeo. It is essentially an inter-governmental forum built on a series of workshops and conferences and, while there have been calls to move to practical cooperation, this has yet to happen. After 12 years as an instrument of dialogue, ASEM needs "polishing" to give it more momentum.

ASEM was launched in 1996 just before the Asian financial crisis in 1997, and in response to the crisis established the ASEM Trust Fund to contribute EU technical assistance and funds to help Asian countries cope with the social consequences, confounding fears that the EU was just a "fair-weather friend".

We have now arrived at a deep global financial crisis, said Ms Yeo, but as the two Chinese characters which make up the word "crisis" imply, it can be both a danger and an opportunity. ASEM has to come up with a coordinated response to the crisis, otherwise it is in danger of seeming irrelevant. The ASEM 7 Summit must issue a clear statement to restore people's confidence, suggesting measures to stimulate the global economy.

It is important to keep protectionist sentiments at bay and avoid the situation in the US and Europe, where the crisis is leading people to question the benefits of globalisation. While there are valid concerns that globalisation weakens social provision, it is vital to revive the World Trade Organization's Doha Development Agenda and keep the global trading regime open.

Within ASEM, leaders agree that the world has moved from a unipolar to a more uncertain, multipolar world, which demands a multilateral approach – only a strong rules-based multilateral system can forestall big-power rivalries.

French President Nicolas Sarkozy has argued that, given the poor performance of the World Bank and International Monetary Fund in the current financial crisis, it is time for Asia, the EU and the US to undertake full-scale reforms of the Bretton Woods Institutions. ASEM is well-placed to provide a platform to test out ideas for new formulations.

With possibly 38 Heads of State and Government, the European Commission President and the ASEAN Secretary-General attending ASEM 7, expectations are high, and Ms Yeo hoped that the Chinese government would use this opportunity to push for European and Asian unity to confront the challenges.

Geoffrey Barret, Senior Advisor for Asia, Directorate-General for External Relations, European Commission, said that along with the Olympic Games, ASEM 7 is China's biggest-ever event in terms of the numbers of

Heads of State and Government expected to attend. It is therefore given high priority by the government and expected to be a superbly-organised meeting. With the acceptance of many new members in Helsinki in 2006, ASEM 6 signalled a change of direction and the strengthening of region-to-region relationships.

ASEM embraces virtually the whole of Asia and Europe, and represents half of the world's GDP, almost 60% of the world's population and 60% of global trade. With the entry of India, Mongolia and Pakistan, ASEM is now large enough to shape the international agenda.

However, as an organisation predicated entirely on political will, ASEM needs to demonstrate its "value-added", said Mr Barret. As the financial crisis will dominate ASEM 7, this gives its political leaders the opportunity to show that it can respond with proposals to solve a global crisis.

As well as the crisis, ASEM will be discussing core themes including climate-change negotiations; development and development cooperation; labour, employment and social cohesion; and human rights.

The Summit is expected to close with a general statement on sustainable development and a second declaration on the international financial situation. As a precursor to the meeting, President Sarkozy and European Commission President José Manuel Barroso met with US President Bush to discuss this.

ASEM also relies on stakeholder interest, so in parallel to the formal ASEM 7 meetings there will be a lively Business Forum, the People's Forum (for civil society organisations) and a Parliamentary Partnership.

In addition to summit meetings, the ASEM process is organised through 'clusters' which bring together officials working in different spheres, such as finance or education. The EU supports this process – for example promoting seminars on themes such as ICT for development, energy, cultural development, and the Trans-Eurasia Information Network – but other countries need to come on board.

The ASEM process is complementary to the bilateral relationships that the EU is building with Asian countries, but the organisation needs to be ambitious in tackling global challenges, raise its visibility and prove its relevance.

Professor Hua Xing, Senior Researcher and Director, Centre for EU Studies, Chinese Institute for International Studies (CIIS), praised the ASEM process in which 45 members from different economic and political backgrounds meet in an atmosphere of mutual respect and equality. He believed the goodwill generated would carry over to other international meetings.

However, a current drawback is that while a joint *communiqué* will help build the consensus between the different parties to ASEM, statements do not have concrete, binding results. Despite this shortcoming, these meetings provide the opportunity for bilateral meetings between different partners and are important for fostering China-EU relations.

The Chinese government is anxious for the meeting to be a success and, given the new spirit of openness in the country, is likely to approach it from the viewpoint that the global community is facing the same financial problems and one should work with one's neighbours to solve these problems.

Discussion

Pressed on what panellists hoped would come out of the Summit, Ms Yeo hoped for a joint statement on the financial crisis and for the People's Forum to be more closely involved in the ASEM process. She also hoped that leaders would emerge on particular issues – for example, those in the EU who are passionate about fighting climate change.

Mr Barret wanted an ambitious outcome, particularly on the issue of climate change, which would provide a good signal in the lead-up to United Nations Climate Change Conference in Copenhagen in

December 2009. He hoped that ASEM would agree that human rights was a legitimate topic to be discussed as, after 12 years of dialogue, no subject should be taboo.

Questioned about possible rivalry between India and China at the Summit, Mr Barret believed it was not about regional balances, but about governments working together. Professor Xing said other Asian countries also play an important role in shepherding developments: for him, a more difficult issue is the imbalance between the number of Asian and EU members.

On the question of Burma/Myanmar, Mr Barret said the EU had concluded that the most constructive way to deal with this issue was to include members of the Burmese junta in discussions. Ms Yeo said Asian countries now recognise there is a problem which needs to be solved, while Professor Xing hoped ASEM could play an important role in helping the Burmese junta to find a fair solution to the country's internal problems.

On the status of the People's Forum, Ms Yeo believed that it had always been part of the process, and Professor Xing said Chinese citizens had participated for the first time and that if one could collect people's ideas, there would be no need for the type of street demonstrations seen at G8 meetings, for example.

Asked whether ASEM's value might be diluted through its increasing membership, Ms Yeo believed Asians were good at managing differing national and political configurations.

Questioned on whether rich Asian countries could mitigate the effects of the financial crisis with their sovereign wealth funds, Ms Yeo said Asians feel they have lost their "crown jewels" by investing in the EU. There should be a Code of Conduct on how these funds are used, and the onus is on the Organisation for Economic Co-operation and Development (OECD) to draw up key principles.

On the issue of whether Russia should be involved in ASEM, Ms Yeo said that when ASEM was set up, its aim had been to engage the dynamic economies in discussion, so it was not relevant to include Russia. ASEM is now concerned about the issue of energy security and, given that Russia is economically strong and a Eurasian country, its membership could be considered.

Keynote speech: Injecting New Momentum into ASEM: An Uphill Struggle?

By Lay Hwee Yeo, Senior Research Fellow at the Singapore Institute of International Relations (SIIA) and Associate Director of the EU Centre in Singapore (EUC)

Introduction

The 7th Asia-Europe Meeting (ASEM) Summit will take place in Beijing on 24-25 October 2008 in the midst of a global financial crisis. This crisis is much larger than the Asian Financial Crisis of 1997/98.

Ten years ago in 1998, the 2nd ASEM summit was held in London in the midst of an Asian financial storm. Many of the Asian countries were then reeling from the impact of the crisis. Despite uncertainties if the 2nd ASEM Summit would take place, EU showed that it was not just a fair weather friend. Not only did the Summit take place as planned, but the leaders came out with a clear statement on the crisis, acknowledging its severity but at the same time reaffirming their strong belief in the fundamentals of the real economies of the Asian countries.

An ASEM Trust Fund was also set up to help the affected economies re-structure their financial sectors and cope with the social fall out of the crises. EU also pledged to keep its markets open to Asian exports and China not only contributed to the ASEM Trust Fund, but also promised not to devalue the yuan.

Despite these efforts, there were continued doubts about the ASEM process and how far it could strengthen cooperation between Asia and Europe. Over the years, there have also been increasing calls from people outside the official ASEM process, civil society activists, researchers and business community, for bolder measures to move ASEM from an informal inter-governmental dialogue forum to an inter-regional platform for substantive cooperation.

However, until now, the official ASEM remains very much a process driven by meetings and initiatives, and its low visibility in between the summits led to feelings that it was losing its momentum. What then can be done to re-energise ASEM and the 12-year relationship between the Asians and Europeans? As often said, crisis brings out opportunities. With the global financial crisis likely to take centre-stage at the 7th ASEM Summit in Beijing, what can ASEM deliver in response to the crisis? Would these in turn be sufficient to inject a new momentum into the ASEM process?

ASEM: from Bangkok to Beijing

ASEM was launched in 1996 with an inaugural summit meeting of heads of states/governments in Bangkok. It was conceived as an informal dialogue forum to reinforce political, economic and socio-cultural ties between the EU and East Asian nations. With its key principles of informality and multi-dimensionality, ASEM provides an open and inclusive forum for dialogue and for different initiatives to be raised and pursued.

ASEM is now in its 12th year and remains essentially an instrument used for networking and for informal dialogue between the participating EU and Asian member states. ASEM is now a gathering of 45 partners, comprising on the European side the 27 EU Member States plus the Commission, and on the Asian side, the 10 ASEAN member states: China, Japan, South Korea, Mongolia, India and Pakistan plus the ASEAN Secretariat.

ASEM's diversity and informality make it an ideal platform for testing new ideas and a catalyst for joint actions. As ASEM is not meant to replace, but rather to complement other bilateral, subregional or inter-regional frameworks that bring Asia and Europe together, ideas that are tested in the larger forum can be translated into more specific action items to be coordinated within the other bilateral and plurilateral frameworks.

As more than 40 Asian and European leaders gather in Beijing for the 7th ASEM Summit, expectations will be raised as to what ASEM can deliver despite the fact that it is only a dialogue forum.

ASEM's Response to the global financial crisis

It is inevitable that the global financial crisis will be at the top of the agenda of the 7th ASEM Summit in Beijing, and rightly so. To ensure that the ASEM continues to be seen as relevant in the plethora of summits and conferences, the leaders should try to address the following:

Making a clear and coherent statement on the crisis

In recognition of the severity of the crisis, the Summit should come up with a separate statement (besides the Chairman's statement) on the crisis itself. The clear and concise statement should be aimed at restoring the confidence of the people towards the global financial system and not to engage in any blame game for the current crisis.

Drawing on the positive lessons learnt from the 2nd ASEM Summit held in the midst of the Asian financial crisis, the statement must be measured and credible, not over-promising but with some thoughts on some immediate steps that need to be taken jointly by all governments to generate confidence and forestall any knee-jerk protectionist reactions.

Keeping protectionism at bay

There are great concerns that the current global financial crisis would further erode the support for globalisation and internationalism. Populist governments in response to domestic concerns may institute protectionist, 'beggar-thy-neighbour' policies that may have a short-term 'feel good' effect but are catastrophic in the long run. It is therefore all the more important that the ASEM 7 Summit seeks also to revive the WTO's Doha Development Agenda, and acknowledge legitimate social welfare concerns to forestall rising protectionist sentiments.

Reaffirming multilateral approach towards addressing global challenges

Asian and European leaders have consistently used the ASEM platform to reaffirm the principles of multilateralism in addressing global challenges. As we move from a unipolar world to a yet-to-be-defined new world order with its undercurrents and uncertainties, it is all the more important to work and strengthen a rule-based, multilateral system to dampen and forestall big power rivalries that may lead us down the road of 'might is right'.

Revisiting the call for reforms of international institutions

Closely related to building faith and confidence in multilateralism is the need for the reform of international institutions, particularly those established in the immediate aftermath of World War II. The 20th century institutions may not be totally equipped to address the challenges of the 21st century.

When ASEM was launched in 1996, there were discussions on reforming the UN and the international financial architecture, but all these were put on the backburner because of lack of consensus, and not seen as a priority. However, the current global financial crisis has again called into question the role of international financial institutions such as the International Monetary Fund (IMF).

The opportunity to jumpstart serious discussion on the reform of the IFIs is now. Though ASEM may not be the ideal platform without the presence of the US and other emerging markets such as Russia and Brazil, ASEM with its 43 member states has a combined 60% of global GDP and could catalyst the dialogue and inject momentum and urgency to this task. ASEM with its informality and diversity makes it an ideal platform for testing new ideas.

Addressing other global and regional challenges

While recognising the severity of the crisis, the 7th ASEM Summit must also reaffirm its commitment to a long-term partnership between Asia and Europe to work together in confronting the various global and regional challenges. The original agenda of the 7th Summit, which builds on the number of areas identified in earlier summits and meetings, promises to address issues that are closely interlinked from climate change and environmental sustainability, to energy and food security. Indeed the impact of the global financial crisis on these issues would be profound.

In order for ASEM to continue to remain relevant it must engage and galvanise all the sectors of society – from businesses, media to the NGOs – to discuss and debate old and new ideas on the why, how, what and who of these issues. ASEM is not a platform for negotiations but its inclusive dialogue forum can be harnessed to its advantage.

Outside the official ASEM process, since 1996 civil society representatives from Asia and Europe have organised "alternative meetings" known as the Asia-Europe People's Forum (AEPF). The AEPF has provided a space for civil society activists and NGOs to strengthen networking at the national, regional and inter-regional levels in order to work more effectively on cross-border initiatives and campaigns. The AEPF has also taken an interest in formally engaging the official process to have their voices heard. While initially hesitant, the officials of ASEM have become more forthcoming to the engagements and inputs.

The Asia-Europe Business Forum (AEBF) and the business leaders that actively participate in the AEBF should also be engaged in the search for solutions to the global challenges confronting us all.

Conclusion

Over 40 leaders from Asian and European countries will be attending the upcoming ASEM 7 Summit. Although ASEM is only a dialogue forum, expectations will still be raised as so many world leaders gather in Beijing. China as the host and chair of the ASEM Summit must seize the opportunity to strengthen Asia's and Europe's role and responsibility in international affairs by recognising their global interdependence. Leaders need to make the right statements to show unity and resolve in confronting the global financial crisis.

More importantly, the leaders must show that they are committed to long-term partnership and engagement to tackle not only the financial crisis but also the various inter-related global and regional challenges.

IV. The impact of the global financial crisis on the world's poorest

December 16 2008: The world's poorest people and countries will be particularly badly affected by the global economic crisis, coupled with recent increases in fuel and food prices. It will lead to cuts in Overseas Development Assistance (ODA) from richer countries, exacerbating the situation. The EU could help to mitigate the impact of the downturn by strengthening international coordination to resist calls for a reduction in ODA.

Event report

Isagani Serrano, Acting President of the Philippine Rural Reconstruction Movement, said the poor had been particularly badly affected by the convergence of the "three 'fs' crisis": finance, fuel and food.

The global economic crisis will result in cutbacks in Official Development Assistance (ODA), making it more difficult for countries to meet the Millennium Development Goals (MDGs). Furthermore, as all ODA loans and grants have strings attached and part of these funds are "ploughed back to the source", without debt relief and fairer trade terms ODA will continue to have shortcomings.

The economic crisis will herald a sharp decline in poor countries' export earnings and there will also be fewer net inflows. Any trade concessions that do materialise out of a trade round will prioritise Least Developed Countries (LDCs), leaving middle-income countries like Pakistan and the Philippines to "lift themselves by their own bootstraps".

It is now unlikely that the MDGs will be achieved, said Mr Serrano, as Organisation for Economic Co-operation and Development (OECD) countries (with the exception of the Netherlands and Scandinavian countries) have failed to live up to their ODA commitments. Financing the MDGs and measures to mitigate the effects of climate change would cost just €200 billion – nothing compared to the US' $4 trillion bail-out of its banking and insurance giants.

Money sent home by overseas workers (remittances) are now a major source of external financing for many developing countries – totalling €250 billion in 2007, more than ten times average World Bank annual lending. The Philippines is the world's fourth biggest beneficiary of these – €17 billion in 2007, which has allowed its government to defer badly-needed reforms on the domestic economic infrastructure which would prevent people having to leave in the first place.

Unfortunately the global crisis is likely to lead to a sharp decline in remittances, massive unemployment, a reduction in household consumption and cutbacks in public spending.

One major lesson should be that money cannot be allowed to have "a life of its own", but must serve the real economy. Wealth "let loose like a wrecking ball" is the root of why the world is now in such trouble, he said.

However, this recession could be a blessing in forcing us to adjust to living in a different future, showing the limits to growth and the need to reduce our carbon footprint, and shift to sustainable production and consumption. As Mahatma Gandhi said: "There's enough for everyone's need, but not enough for everyone's greed."

Ernesto May, Sector Director of Poverty Reduction, Economic Management, Finance and Private Sector Development in the South Asia Region, World Bank, said that in the early 2000s, Asia experienced the strongest growth in 40 years.

Its difficulties began two years ago when it had to face the twin shocks of escalating food and fuel prices. This led to ballooning inflation – 25% in Pakistan and Sri Lanka and 10% in Bangladesh, which brought between 130 and 155 million more people into poverty.

He dubbed the current crisis a “financial tsunami” that had moved from the housing market to the banking and then the financial sector and then onto the real economy. In the US alone, this had resulted in a €9 trillion loss of wealth.

Asia’s emerging markets, like China, have been badly hit and right across the region there has been a significant increase in corporate bond spreads, a loss of capital for the private sector and a reduction in foreign direct investment (FDI).

World trade is expected to contract for the first time since 1982, with negative growth in 2009. In South Asia this will mean a slowdown, weakening industrial production and a reduction in growth from 6.3% to 4.5% of GDP – which in this region constitutes a recession. However, remittances, which are a critical source of funding (in India they constitute 27% of GDP, and in Nepal 18%), are unlikely to be reduced significantly for the moment.

This grim outlook for South Asia is likely to continue, with a deeper and more prolonged credit crunch, contraction in investment and export growth, a marked fall-off in FDI and weak domestic banking sectors. On the other hand, if recovery is quicker than expected, there is a risk of inflation.

Despite this gloomy economic picture, the numbers of those living in absolute poverty in South Asia are likely to fall from 595.6 million in 2005 to 403.9 million in 2015 (a fall from 17% to 7% of the total population). However, in Sub-Saharan Africa poverty will increase from 356.4 million in 2005 to 388.4 million in 2015, although as a percentage of the total population this will be a fall from 51% to 37%.

Andrea Mogni, Policy Coordinator, Analysis and Coordination Unit, Directorate-General for External Relations (DG Relex), European Commission, said that in the light of general concern about the effects of the economic crisis on the developing world, United Nations Secretary-General Ban Ki-moon has indicated that the UN could introduce a global stimulus package.

Developing countries will be affected as FDI declines and becomes less risk-averse, more concentrated, selective and sheltered; and there will be an erosion of international reserves as they are used to stabilise funds. The crisis will make it more difficult to access international capital markets and borrowing will be more expensive, making it almost impossible for small entrepreneurs in the developing world to borrow money.

There is a risk that many ‘Highly Indebted Poor Countries’ (HICP) which were able to dispense with their debts may fall back into indebtedness, and there could also be competitive devaluations of currencies such as the Chinese yuan.

The role of the state is expected to increase, with a stronger government framework for the economy and the risk of more protectionism.

The new challenge concerns ODA and whether rich countries will still meet the target of 0.7% of GDP by 2015. However, while aid to the poorest countries could increase through the UN package, this must focus on redynamising the economy, supporting employment and SMEs and creating stability in foreign trade.

Mr Mogni said the EU should respond to the crisis by strengthening bilateral partnerships and programming instruments and refocusing its external policies. Financial instruments need to be better coordinated, with more coherence between EU policies.

The EU must contribute to the reform of the International Financial Institutions, and be ready to increase resources to support lending to third countries.

Jan-Willem Blankert, Policy Coordinator, EU-China Relations, Directorate-General for External Relations (DG Relex), European Commission, said that despite all the headlines, we really know very little about the global economic future. Until June, the news was about rising fuel and food prices, but now every economic forecast is worse than the one before.

The World Food Programme warns that $45.2 billion is needed to supply food needs, but record food prices have exhausted all its resources.

The economic downturn will also severely affect China as its growth is predicated on trade, and the country needs 8% annual growth to provide enough employment. With heavy job losses forecast, there is a serious risk of social unrest, with disgruntled migrant labour returning to the countryside and the spectre of crowds of unemployed people destroying public property. The situation will be exacerbated if the US and the EU take a protectionist stance.

Mr Blankert said the EU could help to mitigate the impact of the downturn on the world's poorest by strengthening international coordination to resist calls for a reduction in ODA.

He finished on a note of optimism, asking whether we are being too pessimistic, as we do not know how long or how deep this recession will last.

Discussion

Questioned on whether Asia would bounce back fast from this recession as it had from the one in 1997, Mr Serrano said that as the economic downturn is combined with the food and fuel crises, people are frightened that it will destabilise the region.

Mr Blankert said that in 1997 the Chinese had not been affected, but are now being hit hard as they depend on exports. Mr Mogni added that China is so closely integrated with the US business cycle that it cannot act as an autonomous anchor to support international recovery. In addition, weak regional cooperation organisations make it difficult to build the monetary cooperation needed.

Responding to a remark about the importance of remittances, Mr Serrano said they might be reduced because of job cuts in countries which use migrant labour. However, Mr Mogni noted that they can actually increase when migrants' home countries are in difficulties – for example, they rose substantially after the recent cyclones and floods which hit the region, so are a form of "safety net".

Asked about the reduction in Chinese development investment in Africa, Mr Mogni said the Chinese model had been to provide money for social development, linked with long-term trade agreements, and this has temporarily been put in abeyance.

Pressed on how the crisis could offer an opportunity for people to "live better", Mr Serrano hoped it would force people to rethink their values, and that money would be "cut down to size".

Keynote speech: Can the world's poorest survive this one?

By Isagani R. Serrano, Acting President, Philippine Rural Reconstruction Movement

The poorest of this world have been through crisis after crisis. Indeed their everyday is a miserable life of continuing crisis. So, will the present one be any different?

The one we're now facing is not just a cyclical financial crisis the world has learned to take for granted and assume as coming anyway. Finance, food and fuels crises, when converging like they do now, make for a truly deadly combination. Regardless of what country you come from, you're going to hurt and the poorest among us will be hit the hardest. How deeply only they can tell.

Nothing is really certain about what's awaiting us down the next corner. The current global mess could spell total disaster. Or it could also be a mixed blessing, if we survive and learn the hard lessons.

The future for the world's poorest will be bleak, obviously. Counter-intuitively, though, the global financial collapse could be the greatest social equaliser that can bring about more justice and sustainability on this planet. But that's another big story in itself. For now, in this policy dialogue, we focus on official development assistance (ODA) and what it means for financing development and the chances of meeting the Millennium Development Goals (MDGs).

The global crisis is certain to result in cutbacks in aid commitments and sharp decline in poor countries' exports earnings.

Already at low levels even before the onset of the crisis, ODA cannot be expected to increase significantly. If the Doha Financing for Development Conference is any guide, no substantial net inflows will be forthcoming.

Whatever comes their way the Least Developed Countries (LDCs) will of course get first priority and a proportionately bigger percentage share in concessional ODA flows. Middle income countries or advanced developing countries – like China, India, Pakistan, Sri Lanka, Indonesia, Philippines – will have to settle for less, mostly loans, even if their combined population of $1- or $2-a-day poor is more than half the world's total.

Developing countries will have to lift themselves by their own bootstraps. Meaning, their development is basically their own lookout. They have to finance their development through their own taxpayers' money, as well as other domestic resources. They could of course continue, as they have been doing in every UN conference, to negotiate for more and less stringent ODA and hope to secure real additional net transfers.

ODA is, by and large, tied debt. In the era of structural adjustment, ODA loans and grants come by with heavy policy strings and this has to change. But until then, ODA will continue to add to the recipient's international obligations and much of it will be ploughed back to the source. Whether and how a country can grow out of aid dependence is big wonder. Debates on aid effectiveness that ignore such aid reality will not amount to much.

ODA, if not reformed (as in untying from donor-driven procurements of commodities and consultancies), and accompanied by debt relief and fairer trade terms, will not get very far. Indeed it may be an additional burden, though its terms may be comparatively softer than those attending private commercial loans.

The international community can help ease the impact of the financial crisis in developing countries by keeping their end of the global deal, as in Agenda 21, the UN Climate Convention, the Monterrey Consensus, the Paris Declaration, and other international agreements. OECD countries have to unburden debt-burdened poor countries, make aid more effective and trade fairer. They must commit to drastic binding deep cuts on their CO_2 emissions, and shift to sustainable production and consumption as soon as possible.

The MDGs, minimalist as they already are, have been compromised even before this current crisis. The MDG Mid-term Review in July 2007 tells a story that is, at best, worrisome. It is highly unlikely that any developing country will meet all eight goals by 2015. Many are falling behind when they should be on track and most indicators point downwards or upwards but not in the desired direction.

The context then was anything but MDG-friendly. The food crisis was creeping thereby worsening world hunger. Climate change was threatening to spell total disaster that could reverse all gains. With the current financial crisis, the prospects could only be much, much dimmer.

One big reason for the slow progress in MDGs is the failure of OECD countries to live up to their ODA commitments. To finance the MDGs the international community needs to raise at least $100 billion, according to some estimates. Climate change mitigation and adaptation would require another $100 billion initially. That's not much if you compare it to the planned $4 trillion-bailout package for the distressed banking and insurance giants.

Only a number of OECD countries have really made good on their ODA commitments. This includes the Netherlands, Sweden, Norway, and Denmark. Since the Earth Summit and the signing of the UN Framework Convention on Climate Change in 1992 in Rio up till now in the Doha and Poznan negotiations the outstanding issues remain the same – finance and technology transfers.

It seems money is not a problem when it's the banks that have a money problem. Money is hard to come by when it's the poor who's asking.

Ending global poverty and hunger is not only in the interest of the world's poorest. Poverty and hunger anywhere is a threat to security everywhere. It destabilises communities, societies and nations and brings insecurity even to the most secure places. American citizens should know that by now. Humanity, represented by the UN, must summon all it's got – passion, energy, know-how – to eradicate this problem within our lifetime, as promised in the Millennium Declaration of 2000.

At the rate the US and EU and other OECD countries are bailing out their big banks there may not be anything left to fund MDGs and climate change. The $152.5 billion-rescue plan for a single company – AIG – far exceeds the $90.7 billion the US and EU spent on development aid in 2007. The US spent about $23 billion on aid to all developing countries in 2007 while it committed $29 billion to save Bear Stearns.

It's but fair for developing countries to demand substantial and adequate transfers, if not an equivalent bail-out, as rich countries have generously accorded troubled financing institutions.

The big story in the December 2008 Doha Conference on Financing for Development – a follow up to the 2002 Monterrey Consensus – was the global financial meltdown and how it's being addressed by the UN and the richest countries that started it. The issue of fairness and justice took center stage in debates and negotiations on aid commitments.

To begin with, why rescue those who got us into this mess in the first place? Why must big banks be rescued with hard-earned taxpayers' money? Why should they deserve those incredible amounts of public money when developing countries had to literally 'beg' to get a pittance for MDGs? And why would the richest and most powerful countries, which brought us to this situation, be the ones dictating the solutions?

Many in both government and non-government sectors are very critical of the Washington-sponsored G20 summit on the financial crisis last November. They insist that a more democratic summit on the financial crisis should be convened within the framework of the UN, led by the General Assembly.

The prospects for development financing may be dim but there are saving factors. Number one is remittances from overseas workers, or so-called "diaspora money". These remittances have become a major source of external financing for many developing countries. They are the most important source of net foreign exchange flows which help offset trade losses, ease up debt service obligations and finance budget deficits. They increase household spending and investments and boost job opportunities. All told, they help reduce poverty in many ways, perhaps more than ODA does.

In 2007, these remittances totalled more than $200 billion---actually $250 billion in all if remittances of OECD countries like France, Spain, United Kingdom, Belgium, and Germany are included. This is more than 10 times the average annual lending level of the World Bank and about four or five times the historical ODA annual averages. The share of some of the biggest sending countries – India, China, Mexico, Morocco, Philippines, Bangladesh, Indonesia, Pakistan, Vietnam – comes up to more than half the total.

The Philippines, the fourth biggest beneficiary of workers' remittances, recorded over $17 billion in 2007, which could be higher if you allow for undocumented transfers going through informal, personal channels. Philippines' remittances alone are already three or four times the average annual lending volume of the Asian Development Bank.

There is, however, a moral hazard to the positive macro-economic effects of this type of foreign exchange flows. The remittance bonanza in the case of the Philippines, for example, has been a disincentive to badly needed reforms in policies and ways of governing. The relative financial stability provided by huge remittance flows would have been a great opportunity to improve the performance of the domestic economy and eliminate the main reason why the country has to be dependent on overseas employment in the first place.

These 'free flows' have other invisible costs to society. The country 'pays' for the education of overseas workers who then use their knowledge and skills in another country. Breakdown of families because of physical separation affects social cohesion and the consequences bear down on society as a whole.

Poorer countries relying on overseas remittances must put this 'free ODA' to good use while it lasts. This means investing the money in development efforts with long-lasting impact: education, health care, sustainable agriculture and fisheries, renewable energy, reforestation, enterprises and local industry, poverty-reducing infrastructure, and environmental rehabilitation.

The global crisis is expected to cause a sharp decline in remittances. When that happens the immediate consequences would be massive unemployment, reduction in household consumption and cutbacks in government spending on public goods. Icons of prosperity, like the mega shopping malls the Philippines is well known for, would be running on empty.

Perhaps more basic than the positive effects of remittances is education on the crisis. My fear though is that many still don't get it and perhaps will learn the wrong lessons, as usual.

One big lesson in my view is, we cannot allow money to have a life of its own and to make claims on real people, on the real world. As a derivative of the real economy, money exists to serve the real economy.

Money as wealth created out of thin air and let loose like a wrecking ball is at the root of why we're now in such a mess. So much money, leveraged a hundred times over from its original derivative, moves around the global economy as computer bytes with little or nothing at all to do with the production and trade of real goods or doing a service like conservation, community education or spiritual healing.

In a sense, global recession could be a blessing. Money is now cut down to size and comes closer down to where it was derived. And perhaps the deeper this recession gets and the longer it lasts the better for all of us, as there will be more time to learn to adjust and live in a different future.

Our resilience will be tested, surely. We know that security, whether in food or energy, means having the money to buy. As there's less money now to buy us security, people will have to go on an oil and food diet, as it were. How long can they endure before they start clawing at each other or learn to live together with less?

The crisis is telling us that there are limits to growth. It's telling us that we need to drastically reduce our carbon footprint, shift to sustainable production and consumption, and aim for a low-carbon economy. It is telling us to change lifestyles, and most of all, for me anyway, to *slow down*. We need to slow down for our own sake, for our common future.

And finally. The crisis could as well be a test to our common humanity. What if money's no longer the issue, would there still be enough to feed, educate, shelter and care for every soul on this planet? Maybe, maybe not.

But let me end with this borrowed message. "There's enough for everyone's need but not for everyone's greed", so said Gandhi. In communities that are used to sharing, if there's enough food for two there's food for three.

V. Asia and the financial crisis: how deep, how long?

January 19 2009: Initial hopes that the global economic and financial crisis would have a limited impact on Asia, because of its role as "factory to the world", have been dashed, with the region affected more severely than expected by the downturn in US and EU consumer demand. The EU is encouraging Asian countries to work to achieve greater regional integration and stressing the need for global responses to the crisis.

Event report

Masahiro Kawai, Head of the Asian Development Bank Institute, Tokyo, said the global financial and economic crisis was affecting Asia more severely than expected, and that the region's response is crucial for global economic stability and growth.

US consumption is likely to shrink permanently, and Asia's economies – which are closely intertwined with it – will have to adjust. Initially it was hoped that the effect of the US downturn on Asia would be limited, as Asian banks are better managed than those in the West and the supervisory frameworks have recently improved.

However, the liquidity shortage, the credit crunch and the limited access to US dollar funding are affecting all Asian businesses, and the region's domestic markets are declining, with a weakening of consumer and business confidence. All Asian currencies, except the Japanese yen, have depreciated.

The Asian region has also been hit by the decline in the level of exports, particularly the drop in US demand for goods from "factory Asia". In addition, countries such as the Philippines, Vietnam and India, which rely on money sent back to families by overseas workers (remittances) are being hit as these workers are being laid off and sent home, depleting a vital source of income and adding to the pool of unemployed labour.

As a result, Asia's economies are expected to "soften" in 2009, with a projected growth of 5.7%, down from 9% in 2007.

Mr Kawai said Asian governments had taken individual measures to deal with this: some had eased monetary policy, some had supported their banking sector, while others had made international liquidity arrangements. These independent responses had had limited success – for example, investors moved their money to countries with bank deposit guarantees, while some countries "free rode" on others' fiscal stimulus packages.

Instead, Asian economies need a coordinated response, to:

- rebalance sources of growth;
- strengthen sector cooperation for integration;
- improve regional financial cooperation to strengthen financial systems and supervision;
- enhance regional reserve pooling arrangements;
- prepare for exchange rate cooperation;
- raise Asia's voice in international fora;
- increase domestic and regional demand, with less dependence on US-EU demand;
- use short-term fiscal stimuli and invest in infrastructure;
- expand the non-tradable goods (i.e. water or electricity) sector through "real exchange" rate appreciation.

Sustained growth in Asia is crucial for a healthy global economy, so its governments must respond collectively to limit the crisis. Rebalancing sources of growth towards domestic (regional) demand requires closer policy coordination in Asia, linked to more active participation in global fora like the International Monetary Fund (IMF), World Trade Organization (WTO) and the G20.

Jaimini Bhagwati, Indian Ambassador to the European Union, said the financial crisis had begun to impact on India, as GDP growth is forecast to drop from 7% in 2008 to between 5%-6% in 2009, and foreign domestic investment (FDI) and trade credits will be reduced. India will also be hit by the reduction in remittances, as 25 to 30 million Indians work abroad.

Risk has been "re-priced" in G7 countries, with lending frozen and international credit reduced to "a trickle", said Ambassador Bhagwati. While the country's banking sector has not been as badly hit as in developed countries, as 84% of its income comes from individual investors rather than from trading, the boom in construction and real estate has been affected and the garment exporting sector, which employs 4 million people, has shed 1.5 million jobs.

Fortunately for India, its recent growth has not been export-led, and as a gas and oil-importing country it is also benefiting from lower energy prices. As India has quite a high interest rate of 5%, there is room for a further easing of monetary policy, but it has less "space" for a fiscal stimulus package.

Ambassador Bhagwati said that thanks to the National Rural Guarantee Scheme, which provides hours of paid employment in the countryside, consumer demand is still strong among this sector of the population. India's overall household debt is also low, as retail lending is only 10% of GDP and, as few people are exposed to the capital market, they have not yet felt the negative affects of the crisis.

So despite all the problems and declining growth, the Ambassador expected to see capital still coming into India, which will be used to produce goods and services for its domestic consumer market.

Professor Laozu Lu, Director, Centre of Contemporary China, University of Southampton, said China is the only major economy not experiencing a major crisis, but there are question marks over whether its "command capitalism" will work in the long run.

Chinese imports are down by 20% and exports down by 3%, which is partly because domestic consumption is shrinking, but also because the country does not need to import as much to service its export market. Beijing recently admitted that China had overcapacity in almost all industries for 2009. Its economy is shrinking and 33 million urban residents lost their jobs in the second half of 2008, with an additional 140 million migrant workers at risk of losing theirs in 2009. This figure does not include peasant farmers, so the real total will be far higher.

Beijing recently announced a rescue package of €455 billion, with a total of more than €2 trillion with matching funding from local governments. It is also planning tax cuts and has cut Central Bank interest rates. However, the Chinese economy is heavily dependent on industrial manufacturing and as the "workshop for the world", if US and EU consumption declines, so does China's economy.

In China, gross savings are equivalent to 51% of GDP, as compared to the US where they are only equivalent to 13.5%. Currently China's trade surplus is $261.9 billion, although $256.3 billion of this is with the US alone, leaving a trade balance of only $5.6 billion with the rest of the world. So while a decline is inevitable as the Chinese economy is manufacturing-focused, it could take up to 20 months to contract – much longer than the business-focused US.

China must not delay the adjustment process, insisted Professor Lu. It must avoid over-spending in sectors where there is already over-capacity, continue its reforms and provide social security to all its citizens to stimulate consumption.

Vincent Guerend, Deputy Head of Cabinet, Cabinet of Benita Ferroro-Waldner, Directorate-General for External Relations (DG Relex), European Commission, emphasised the EU's strong ties with Asia. Twenty-five percent of EU trade is with Asia, and 18% of EU exports are destined for Asia. The EU is committed to providing significant development support to Asia, but 100 million Asians are living in poverty, and the situation will be exacerbated by the slowdown in economic growth.

Sadly for many Asians, this crisis comes after the soaring energy and food prices in 2007-2008, during which governments such as India's subsidised prices, putting a heavy burden on their fiscal policies. However, although they will suffer from lower investment and exports, the Asian economies are better prepared to face the crisis than in 1998 because of the reforms governments made at that time.

The EU believes it is very important to coordinate global responses to the crisis and has been pushing for the major Asian economies to attend G20 meetings. It is also pushing for greater regional integration through bodies such as South Asia Association for Regional Cooperation (SAARC) and through region-to-region free trade agreements (FTAs). Opening the borders to trade and preventing a slide into protectionism will help Asia ride the crisis, he said. At the same time the EU will continue its programme of development assistance, as giving aid to the most deprived people in Asia is high on its agenda.

Discussion

Asked about the key measures needed for regional integration, Mr Kawai was optimistic that Asian countries would not resort to protectionism as "trade is the lifeline of economic growth". He believed coordination was needed to avoid the "noodle bar" of FTAs, together with a simpler single market which includes poorer Asian countries and contributes to economic growth. Some Asians are concerned about protectionism in developed-country markets, he said.

Ambassador Bhagwati wondered whether all governments would be able to resist protectionist tendencies, but noted that in addition to making trading commitments within the WTO framework, a number of countries have set up FTAs on a "WTO-plus" basis.

Mr Guerend reminded the audience that the EU was built as a "common market", creating wealth from trade, which is the best way to lift people out of poverty.

Asked how to increase employment in China, Professor Lu said the government set a target of 8% growth *per annum* in order to provide jobs for the rural poor pouring into the cities. This growth could be based on infrastructure projects such as bridges, roads and railways, and generating employment for internal services such as health care and schools.

Mr Bhagwati said the India government had announced fiscal measures and infrastructure schemes to generate urban employment.

On the Asian Development Bank's role in mitigating the crisis, Mr Kawai said that developing countries need access to external funding, so require ADB resources, but the situation had become acute because of the foreseen low economic growth. The Bank needs to increase its capital, and is asking European countries for funds.

Keynote speech: The global financial crisis and Asia

By Masahiro Kawai, Dean, Asian Development Bank Institute, Tokyo

Today, I am going to talk about the global financial crisis and its implications for Asia, as it has been affected by the global financial crisis more severely than had been expected previously. However, Asia remains the engine of global economic growth. I am going to argue that Asia's response to the crisis is quite critical because Asia is the only region that still shows strong growth in the global economy. Asia's policy – particularly its collective policy response – will be quite important for the future of the global economy.

We anticipate that the United States' financial system and its economy will undergo significant structural changes, such as consolidation of its financial institutions, de-leveraging of balance sheets, and a semi-permanent decline in personal consumption over the coming years. The US consumption/gross domestic product (GDP) ratio, which was inflated to an unsustainably high level during the housing bubble period, is expected to go down by about 5 percentage points. This means that Asia, with sizable trade surpluses, will have to adjust to the new reality. Asia's policies must facilitate such structural adjustment.

Causes and spread of the global financial and economic crisis

I will not discuss all the factors that led to the financial crisis in the US (including some global contributing factors) and helped spread the US financial crisis to Europe and emerging market economies. I would just like to say that US monetary policy mismanagement and inadequate supervision of the financial sector were important contributors to the creation of the housing price bubble, which eventually collapsed in mid-2006 and led to the US sub-prime and wider financial crisis. One important reason for the spread of the US financial crisis to the global market is the lack of a strong international supervisory/regulatory framework that could check the behaviour of global financial institutions and the cross-border transactions of structured products.

The US Federal Reserve began to reduce the federal funds rate in early 2001 in response to the collapse of the information technology (IT) bubble. The low interest rate helped to create abundant liquidity in the financial system, which allowed housing prices to rise. Although the Fed started to raise the policy rate in mid-2004 due to inflationary concerns, this was not accompanied by a rise in the US long-term interest rate. The US mortgage interest rate remained quite stable, thereby continuing to encourage housing purchases and construction. The US housing price – based on the Standard & Poor's Case-Shiller index – continued to rise until mid-2006 and then started to collapse.

The US financial sector has been neither regulated nor supervised in a way that is conducive to financial stability in a world of rapidly-advancing financial innovation and rapidly-evolving business models. For example, investment banks were not subject to the stringent capital adequacy requirements that commercial banks were subjected to and the over-leveraging of the balance sheets of these financial institutions became the norm. Financial derivatives were not regulated or monitored adequately by any financial authority. Rating agencies were not subject to any authority's supervision.

Eventually, the US sub-prime crisis spread to the rest of the US financial sector and to the global market, and the financial crisis spread to the real economy in the second half of 2008. Lehman Brothers' collapse in mid-September 2008 did a lot of damage to the US and global financial markets and to the real economy. Now, all the developed economies – the US, the European Union and Japan – are in recession, and most emerging economies are being negatively affected.

Developed countries have been responding to the crisis by using monetary, financial sector, and fiscal policies. National policy responses have been the predominant form of response, except for monetary policy in the euro zone where the European Central Bank sets a common short-term interest rate for member economies. Individual country policies have included: liquidity injection, bank deposit guarantees, inter-bank lending guarantees, public capital injection into weak financial institutions, and announcements of fiscal stimulus. Public sector purchases of bad (often called "toxic") assets have not been resorted to yet in the US or Europe.

There has been some international policy response. The International Monetary Fund (IMF) started to support several economies severely affected by the global financial crisis, including Iceland, Hungary, Ukraine, and other Eastern European and Baltic countries. A G20 financial summit was organised in November 2008 to discuss the important issues of the reform of the international financial architecture.

Impact of the global financial and economic crisis on Asia

What has been the impact of the global financial and economic crisis on Asia? The impact was initially considered to be limited, because many Asian banks were judged as fundamentally healthy with limited exposure to US structured assets. Asian banks have made substantial efforts to strengthen capital bases, reduce non-performing loans, and adopt better risk-management systems since after the Asian financial crisis ten years ago. While getting out of the previous crisis, Asian banks and policy makers tried to upgrade the supervisory frameworks of their systems.

As time went on, however, various problems emerged. One is the international liquidity shortage and another is the credit crunch at the international and national levels. The international liquidity shortage was observed most acutely in Republic of Korea (hereafter Korea). From September 2008, the Korean won started to depreciate sharply and the Bank of Korea began to lose sizable amounts of foreign exchange reserves. Indonesia, Thailand, Viet Nam, and other countries have had difficulties raising international funds and are facing high-risk premiums in the international capital market. A credit crunch has affected many Asian firms, particularly small- and medium-sized enterprises, which are finding it difficult to finance their activities. Domestic asset price declines, in particular the collapse of stock prices – which had started even before the current global financial crisis – are now depressing consumer sentiment and business sector confidence.

The impact on the Asian real economy is beginning to be felt, particularly through its impact on exports. Asia's exports were growing relatively handsomely until the summer last year. In the fall, export growth started to decline and has become negative in many Asian economies, including even China. Economies such as Korea; Japan; and Taipei, China are experiencing significant declines in exports. Asia has been known as the world's manufacturer and export powerhouse, the so-called "Factory Asia." Asia as a whole has been producing manufactured products within its production network and supply chains, and exporting to North America and Europe. This model is now being shaken. We are beginning to observe the vicious circle of one country's export declines leading to many others' export declines. In addition, not only is there a decline in exports, but export-related investment is also down.

Countries like the Philippines, India, and Indonesia rely on overseas workers' remittances back home. Remittances are expected to shrink, as overseas workers in advanced or neighbouring economies become increasingly unable to continue to work due to the rapid growth slowdown in these more developed economies. What is worse is that these workers who come home may find it difficult to find jobs at home as the home economy is not doing very well to absorb them as a domestic workforce.

Economic growth is now slowing down rapidly on a global scale. Growth projections have been adjusted downwards continuously by international institutions such as the IMF, the World Bank, and the Asian Development Bank (ADB). According to the most recent projection by the IMF, the growth rate of the advanced economies is projected to be -2.0% in 2009, down from the 2.7% reported in 2007.

The growth rate of emerging and developing economies is projected to be 3.3% in 2009, down from the 8.3% recorded in 2007. This suggests that emerging and developing economies are still expected to provide positive growth for the world economy and that developing Asia, including China, India, and Association of Southeast Asian Nations (ASEAN) economies, which is expected to grow at 5.5% in 2009, will remain the engine of growth globally. In this sense, Asia's stake is high: what will happen to global economic growth will depend heavily on China, India, and ASEAN in the face of a structural decline in US demand. Asia's policy is key to the health of the global economy.

Asia's policy responses

Asian economies have been responding to the impact of the global crisis through monetary policy easing, financial sector policy, international liquidity arrangements, and fiscal expansion. Monetary policy easing is taking place in many economies, such as China, India, Indonesia, Japan, Malaysia, Thailand, and Viet Nam. Banking sector support has also been provided, even in Japan – though the Japanese banking system is basically sound. Hong Kong, Singapore, and Malaysia have adopted blanket deposit guarantee schemes, and Korea has unveiled a $130 billion package to guarantee short-term foreign bank loans in order to ensure that the financial system was stable.

Fiscal policy expansion has been announced by Japan, Korea, China, India, and Singapore. International liquidity arrangements have been made for Korea. The Bank of Korea (BOK), which had problems with international liquidity in the fall of 2008, approached the US Federal Reserve to secure a US$30 billion currency swap in October. In December, the BOK obtained a similar currency arrangement from Japan for US$20 billion and with the People's Bank of China for US$30 billion; so, Korea's international liquidity position is now sound.

I argue that such policy responses are quite useful and necessary but are limited because they have been largely national, independent, and uncoordinated, given that Asian economies are heavily interdependent with each other. This is the case not only in trade and investment, but also finance.

When Hong Kong adopted a deposit guarantee scheme, a deposit flight took place suddenly from neighbouring countries to Hong Kong – just like the deposit flight from the United Kingdom, Germany, and other European countries to Ireland when Ireland adopted a deposit guarantee scheme. So, Singapore was worried about the loss of bank deposits and followed Hong Kong by adopting its own deposit guarantee, which made Malaysia nervous, as its deposits started to leave the country. So Malaysia followed suit.

All of this has made Indonesian bank deposits unstable, as Indonesia maintains only a limited deposit insurance, making it inferior to the recently introduced blanket deposit guarantees in Singapore and Malaysia. This sort of spill-over effect exists in Asia.

In the midst of an economic downturn, many countries have incentives to grow through increasing exports. Some may move to encourage exports through engineering currency devaluation and provision of favourable tax treatment for exports or discourage imports by raising tariffs to protect domestic industries. This type of beggar-thy-neighbour policy can create bad outcomes for many economies. Therefore, Asian economies need to avoid such counterproductive policy through joint efforts.

Fiscal policy stimulus can have a positive spill-over effect on the neighbouring countries through trade, so there is a "free rider" incentive. This incentive leads to a smaller than desirable fiscal stimulus, which needs to be addressed collectively. So even in Asia, there is a case for more coordinated action because of the high economic interdependence in the region.

Simulation study on the impact of a US demand decline on Asia's output

I argue that US demand is expected to be low and that this will be not a temporary but a structural phenomenon. US personal consumption was excessively large until mid-2008 because consumers spent too much behind the inflated housing equity produced by the housing price bubble. The US consumption/GDP ratio historically was something like 66–67%, but gradually rose to 71% over the last ten years. This over-consumption in the US is likely adjusted and Asia has to face it. This is a collective issue for Asia.

From this perspective, my colleague and I have conducted a simulation study to see the magnitude of impact of a US demand decline on Asia. The US current account deficit/GDP ratio was 6% in 2006, and it has been gradually on the decline since then. The basic assumption used in our study was that the US will reduce its current account deficit by 4.5% of GDP and that this deficit reduction will be facilitated by the depreciation of the real effective value of the US dollar vis-à-vis the rest of the world. We then asked what would be its impact on East Asia.

According to our study, many East Asian economies – i.e. China, Japan, Asian Newly Industrialised Economies (NIEs), and key ASEAN members – are going to see their current account surpluses diminish. In terms of sectors, outputs in manufacturing in Asia – in particular, vehicles (in Japan and Korea), machinery (in Japan, Korea, and Taipei, China), electronics (in Taipei, China, Korea, and China), and apparels (in ASEAN countries) – are going to shrink, suggesting a relatively large adjustment in manufacturing sectors.

The output rise in the services sector will compensate this. The services sector expands in all Asian economies because growth driven by domestic demand is expected to take place. This whole adjustment will be facilitated by Asian currency appreciation *vis-à-vis* the US dollar stemming from the US decline in demand. Essentially, Asia is expected to see a semi-permanent decline in external demand and a rise in domestic demand through the development of the region's services sectors. Asian adjustment is going to be substantial, but this is something that Asia has to face.

Recommendations for Asia's collective policy response

Asia needs to adjust to the semi-permanent decline in US consumption, by rebalancing its sources of growth. More specifically, Asia should transform its economy into a "Consumer Asia" rather than simply trying to recreate "Factory Asia," as Asia can no longer rely on external (US and European) demand-driven growth but should move to a domestic or regional (Asian) demand-driven economy. That is, Asia needs to produce more goods and services and consume them within the region. This requires both substantial structural adjustment and regional economic and financial cooperation in Asia. I would like to provide some policy recommendations for this purpose, particularly from a collective perspective.

First, Asia should avoid beggar-thy-neighbour policy reactions – such as competitive currency depreciation, export promotion policy, and import restriction – and should produce policy synergy through concerted action, such as joint fiscal boosting.

Second, Asia's fiscal policy should be geared toward helping promote domestic or regional demand-oriented growth. In China, fiscal spending should be directed to strengthening social sector protection (through introducing comprehensive health, medical, job loss, and pension schemes) and reducing income inequality (through rural sector development) so that personal consumption can be stimulated on a permanent basis.

In India and ASEAN, fiscal resources should be directed to investment stimulus, particularly for infrastructure investment so that more opportunities for future economic growth are created. ADB, with an expanded capital base, together with other multilateral and bilateral development institutions, can provide fiscal support for Asian developing countries. An Asian Infrastructure Investment Fund can also be established with the support of ADB and other development organisations so that Asia's vast savings can be intermediated for infrastructure investment in the region.

Third, Asia needs to accelerate regional market integration in the real sector through the creation of a region-wide free trade area either in the form of an East Asia Free Trade Area (EAFTA), among ASEAN+3 countries, or a Comprehensive Economic Partnership in East Asia (CEPEA, among ASEAN+6 countries). Market integration can create a bigger, more internally-integrated regional market and greater regional business opportunities, thus helping stimulate regional demand.

The focus should be on services' sector development through the sector's structural reforms and liberalisation. This requires progress on ASEAN Economic Community-building as ASEAN is the core of market integration, as well as closer collaboration among China, Japan, and Korea.

Fourth, Asia needs greater regional financial cooperation and integration. The Chiang Mai Initiative (CMI), currently a network of bilateral currency swap arrangements, needs to be enhanced through multilateralisation, size increase (from the currently agreed US$80 billion to more than US$120 billion), delinking from IMF programmes, and greater flexibility in use (no conditionality, comparable to IMF's Short-term Liquidity Facility programme).

Regional economic surveillance needs to be improved by encouraging finance ministers and central bank governors to join forces and establish a professional secretariat that would serve a multilateral CMI and conduct effective economic surveillance. This would eventually lead to the creation of an "Asian Monetary Fund." In addition, an "Asian Financial Stability Forum" should be formed to promote the region's financial sector development, integration, coordination, and monitoring.

Fifth, exchange rate policy coordination is becoming increasingly important. Initially, avoiding competitive exchange rate devaluations and disorderly movements of intra-regional exchange rates would be a useful step. The next step is closer exchange rate policy coordination expecting that capital inflows to Asia will resume.

Once the current global financial crisis is stabilised, one can expect a massive influx of capital flows to Asia as US dollar hoarding will cease. If not managed properly, massive capital inflows can lead to expansion of domestic liquidity, excessive extension of credit by domestic financial institutions, creation of goods' price inflation and asset price bubbles, and macro-economic and financial sector vulnerabilities.

To manage inflows properly, Asian authorities should not resist, but rather accept, currency appreciation – including that of the Chinese yuan – as it allows Asian authorities to ensure macroeconomic and financial sector stability. It will also facilitate Asia's collective move to "Consumer Asia," a regional demand oriented economy.

Finally, Asia, being an increasingly important player in the global economy, needs to unite itself and raise its voice in international forums such as the IMF, World Bank, G20, and the like.

VI: India-Pakistan relations: from tension to cooperation?

February 17 2009: Pakistan and India need to overcome their mutual hostility and differences, and change national borders "from barbed-wire fences into gateways". The epicentre of global conflict is shifting to Afghanistan-Pakistan, so "bold, decisive action" is needed to return this area to normal – and this could be achieved with sensible, forward-looking and dynamic political leadership in India and Pakistan.

Event report

Retired Major-General Dipankar Banerjee, Director, Institute of Peace and Conflict Studies, New Delhi, India, described South Asia as a "single geo-economic identity" that is home to a "bewildering diversity" of ethnic groups, languages, religions and cultures". It consists of independent nations bound together by geography, history and culture, which must learn to cooperate for a common, prosperous future.

Violence must be rooted out in South Asia, because if it is allowed to flourish in one country, it will take root in another and, today, terrorism is one of the biggest threats to this region.

The attacks in Mumbai slaughtered many innocent people, and while the intention may have been partly to protest against India's secularism and rapid economic expansion, the strategic target was Pakistan and its government and it was designed to ignite an India-Pakistan war.

Despite the original aim and terrible results, the attacks could provide an opportunity for hope, he said, since less than a week ago, the Pakistan government arrested a number of Pakistani nationals it believed were responsible. This paves the way for the beginning of genuine cooperation between India and Pakistan, as in addition to this, India's Foreign Secretary Shankar Menon said that India and Pakistan must not continue the hostilities that have lasted over 60 years.

In other positive moves in the region, a secular party won an overwhelming victory in the Bangladeshi elections; in Kashmir, more than 60% of the population ignored the terrorist call for a boycott of the elections; and the Maldives has recently elected a new President, after 30 years.

South Asia must make a new beginning based on a four-fold plan, he said:

- India and Pakistan must continue with the Composite Dialogue they have been holding over the last five years;
- the region's first moves towards cooperation must be based on trade and commerce and the building of a single economic community in South Asia by 2020;
- people-to-people movements and "getting to know each other" schemes must be promoted, changing national borders "from barbed-wire fences into gateways"; and
- regional political cooperation must be strengthened through the South Asian Association for Regional Cooperation (SAARC).

"We are at a very critical period in history," said Retired Major General Banerjee, for as the war in Iraq winds down, the epicentre of global conflict is shifting to Afghanistan-Pakistan, so "bold, decisive action" is needed to return this area to normal. This could be achievable with sensible, forward-looking and dynamic political leadership in India and Pakistan.

Retired Lieutenan- General Talat Masood,independent military and political analyst, Islamabad, Pakistan, said moving from confrontation to cooperation was "a huge task" for both India and Pakistan. The Mumbai attacks had shattered the peace process, undoing all the painstaking efforts of the last two years: while the Pakistani government might want peace, it is too weak to transform hopes into reality, and the India government has been too preoccupied with building its nuclear relationship with the US to concentrate on intra-regional peace.

The Composite Dialogue has focused on confidence-building measures (CBM) such as opening up travel routes between India and Pakistan and bus travel across Kashmir. However, there has been little progress on the substantive political issues confronting Kashmir, Siachen and Sir Creek, and the proposed gas pipeline from Iran to both countries was stopped as a result of US pressure.

There is also a growing military imbalance between India and Pakistan, with Delhi adopting more global ambitions, spurred on by its nuclear cooperation and enhanced security deals with the US.

India's anguish after the Mumbai attacks was understandable, said Retired Lieutenant-General Masood, but it was unfortunate that Delhi accused Islamabad of being behind the attacks, and threatened surgical strikes or the 'Cold Start' doctrine operation against Pakistan. Attempting to isolate Pakistan is a poor strategy, he said, as, given Islamabad's inability to deal with the rising power of militants in the country's Federally Administered Tribal Areas (FATA), destabilising the country would have regional and global repercussions.

Pakistan is no ordinary country, he said. It is the world's second-largest Muslim country, a strategically-placed nuclear power, and a close US and NATO ally in combating terrorism. Besides this, it has close ties to Saudi Arabia, the United Arab Emirates and other Muslim countries, and a strategic partnership with China.

In the long run, India and Pakistan will have to resolve their differences, particularly given the ethnic overlap of Punjabis and Kashmiris in India and Pakistan and, if the problem of Kashmir is allowed to fester, it will encourage militancy. Both India and Pakistan should also stop using "proxies" to fight out their hostilities.

Seeking stability in Afghanistan must be a common vision, as stabilising the country will ultimately stabilise the entire region.

The region can learn lessons from the way France and Germany overcame their differences after the Second World War and joined together in the European Coal and Steel Community, as South Asia's shared geography, history and cultural ethos provide a suitable foundation for a similar economic and political union. A shared vision for the region is needed to optimise its potential.

Sajjad Karim MEP, Parliamentary Rapporteur on the EU-India Free Trade Agreement (FTA), was surprised by both India's and Pakistan's "lack of sincerity and trust" after the Mumbai attacks, with India calling for Pakistan to hand over the suspects, and Pakistan claiming that it was doing everything it could to clamp down on terrorists and training camps. "One must not let terrorists achieve by our reactions what they could not achieve by their actions," he said.

India is the EU's largest trading partner, and shares some similarities with the Union's social and political infrastructure: it is a democracy, a union of states and is based on the rule of law, supported by an independent judiciary.

An EU-India trading partnership could pave the way for closer political links between the two sides, he said, so he hoped that the EU-India FTA would still go ahead, despite growing protectionism in the light of the economic crisis.

As to EU-Pakistan relations, the Union wants to see a secure, stable Pakistan, so it should be more engaged. Turning to India-Pakistan relations, he said Kashmir is one of the main bones of contention between the two countries, and until this is resolved, there is unlikely to be any deepening of relations. In its dealings with both countries, the EU should push for the principle of self-determination for those in Kashmir.

India-Pakistan relations cannot be seen in isolation, said Mr Karim, as the dynamics between the two countries have a global affect. Given the US near foreign-policy vacuum over the last eight years, the EU should step in at a foreign policy level and be more engaged than it was in the past.

Discussion

Asked about resolving the problem in Kashmir, Retired Major-General Banerjee said outside governments, such as the UK, should approach the subject with more humility, as this issue cannot simply be resolved by applying the principle of self-determination – applying this principle could result in hundreds of separate states in South Asia. It has to be done through consensus with all those in Kashmir – Buddhist, Hindu and Muslim – and one cannot force this on people.

Retired Lieutenant-General Masood believed the problems could be resolved with political will and determination, but said none seemed to exist on either side.

Asked whether US-Pakistan relations will change under US President Barack Obama, Retired Lieutenant-General Masood hoped the US administration would put more emphasis on political engagement and economic development than on military support – particularly in the FATA, and was concerned about recent US strikes. He also welcomed the US administration's comments about needing to stabilise the situation in Afghanistan, as "Talibanisation" fills the political vacuum by providing security, governance and employment.

Mr Karim, emphasising that he was speaking in a personal capacity, said the lack of an adequate legal framework in Pakistan has created confusion in the country.

Asked whether the EU should be doing more in South Asia, he said some of the issues facing Pakistan must be resolved internally, but the country is receiving "external oxygen" to maintain the *status quo*, as it is an open secret that the US dictates how Islamabad uses its funds. The country can only deal with its internal challenges when it reduces its defence budget and pumps more money into the social structure. Unfortunately, countries in the region are unaware of the EU and the support it provides.

Asked about India-US relations, Mr Banerjee stressed that it is "a partnership, not an alliance", so India does not have to automatically accept US policies for the country or region if they do not coincide with Indian policies.

Asked about Pakistan's relationship with China, Mr Masood said Beijing takes a long-term view of the region, and has a strategic economic relationship and a very "prudent" international relations policy. Asked about India's relations with China, Mr Banerjee said these are moving in a positive direction, with agreement on issues such as climate change.

Keynote speech (I): India-Pakistan relations: From Confrontation to Cooperation an Agenda for the Future

By Retired Major-General Dipankar Banerjee, Director, Institute of Peace and Conflict Studies, New Delhi, India

I speak to you entirely from my personal perspective with no connections at present with the government of India. As a former combat officer in the Indian military, I do of course have my own personal experiences. But, today it is time to look ahead to the future of the Indian sub-continent and the fate of nearly a quarter of the world's population. I will try and address you more as a concerned citizen of South Asia. As the Executive Director of the only regional South Asian Strategic Studies Institute a few years ago, I had the unique privilege to view issues from a regional and global perspective.

Right at the outset I would ask you to bear in mind three principal realities of South Asia. First, is that it is one single geo-economic identity. The Himalayas define its northern boundaries, the Indian Ocean the south. Low hills separate the sub-continent from Burma and the rest of South-east Asia. In the west, is Afghanistan now a member of the South Asian Association of Regional Cooperation.

The Himalayan river systems provide sustenance to the entire region and their valleys have been centres of great civilisations. Yet, within these boundaries live a bewildering diversity of people of different ethnicity, language, religion and culture, even more than in all of Europe.

The second and equally strong reality is of separate nations formed sixty years ago in South Asia. These independent nation states and their respective nationalisms cannot be wished away. Equally, we need to find new ways of cooperation and collaboration while respecting these national identities. This is precisely the lesson that we need to learn from the European Union.

The final reality is that the destination of South Asia is linked together. Geography, history and culture bind us together irrevocably. The future existence as well as prosperity of all are linked to each other and cannot be separated. But, a common and prosperous future can only be realised through cooperation, accommodation and tolerance accepting this enormous diversity and accommodating their different concerns. It is impossible to build prosperity or form a progressive society based on exclusion and narrow identities or on limited majoritarian principles, for that will exclude far too many and in turn will lead inevitably to greater violence.

Violence of any form and particularly mindless terrorist violence must have no place in South Asia. There is no excuse for terrorism, no alibi of 'root causes' can justify these heinous acts. It is evil pure and simple and must be rooted out from its deepest cores. If we allow one form of terrorism in one country, other forms will grow in the same soil or a neighbouring one. Counter organisations will take roots and violence will never end. Today, the world recognises this to be the biggest threat to planet earth and we can be no different.

The act of horror that was perpetuated in Mumbai in late November last year was perhaps an example of the worst form of this terrorist violence. Its execution was witnessed by the world for three long days. The slaughter of innocent women and children, specific targeting of people of certain foreign countries, and their mindless execution were all observed in real time on television screens around the world. Yet, this was not the only one. Several acts of terrorism were perpetrated on India earlier in 2008. Ten weeks after Mumbai another very similar strike occurred in Kabul killing 30 people.

Let us not forget that terrorism is a tactic, a technique, a weapon that fanatics, dictators, and warriors have resorted to through history. In paraphrasing Prussian soldier, military historian and military theorist Carl von Clausewitz: "If war is the continuation of politics by other means; terrorism is the continuation of war by other means". One thing South Asia cannot afford today is another war between us, because who can guarantee that this may not lead to an even more horrific nuclear catastrophe?

The immediate target of the Mumbai attack was of course India, perhaps because of its secular state and rapid economic emergence, but, let us not forget that the strategic target was Pakistan itself and its government. Pakistan's President recently more or less accepted this recently when he identified the Taliban as the biggest threat to his country. The immediate objective of the terrorists was to set-off an India-Pakistani war as they had attempted to do in December 2001 by attacking the Indian Parliament and by the same terrorist organisation. It does appear as of now that they have been defeated.

There is no catastrophe that does not also provide an opportunity and hope. And, I do see some possibilities as of now. Perhaps a phase of this confrontation has ended. Less than a week ago on 12 February, the Interior Minister of Pakistan, based on the dossier provided by the Indian government and the investigations of the Pakistan Federal Investigating Authority, accepted that the terrorists indeed came from Pakistan and that much of the planning and execution were indeed done by the *Lashkar e Tayyaba* from within its soil and arrested a number of persons associated with this. This bold and courageous statement by the Pakistan Government was a dramatic reversal of its earlier position of complete denial.

India and the international community now expect that Islamabad will now move forward and take the logical follow-up actions. First, to speedily complete the investigations and suitably punish all those found guilty.

Second, to dismantle the terrorist infrastructure and networks so that such attacks are not repeated against India or any other country. These are formidable challenges and the entire international community needs to work together with Pakistan on this. This is also where genuine cooperation can begin between India and Pakistan.

Let me also briefly remind you of two other developments recently in South Asia. Barely a month ago in one of the freest elections in Bangladesh, the fourth largest Muslim country, a secular party came to power with an overwhelming majority. The Islamic Party was reduced to just two seats in 300. Again in Jammu and Kashmir in elections two months ago, over 60% of the people voted in spite of terrorist call to boycott. I wonder which country in Europe sees such participation in elections even under most favourable conditions? They voted for change and good governance, a fundamental demand of every human being. The climate is propitious in South Asia for a new beginning.

Once cross-border terrorism comes to en end, South Asia is indeed ready to make a new beginning. Let me list for you what I consider the immediate steps that both countries could take:-

First, is to pursue and continue with vigour the eight track Composite Dialogue process that is in progress now for some years. Actually much good work has been done and concrete results can be achieved if there is mutual confidence between both countries. A resolution of the Siachen glacier and the Sir Creek issues, both ripe for a solution, can generate the positive impetus that could be carried forward to other issues. Commenting on this recently, Shiv Shankar Menon, the Foreign Secretary of India said in Pakistan, "There would be nothing worse for India and Pakistan than to repeat in the future the sterile pattern of hostility of the last sixty years. Thanks to the peace process, we today have an opportunity to break out of this pattern. I do hope that we will take it."

Second, is the question of trade. The precursor of the EU process was the Coal and Steel Union that enabled a single market for these two critical items and led to this remarkable political endeavour. Commerce and trade in goods and later in services in South Asia can truly provide the same platform. Many have seriously considered the possibility of a single economic community in South Asia in the near future. This in turn will develop dependencies that cannot be easily broken without causing enormous hardships to all countries.

Third, is to increase people-to-people movements and 'getting to know each other' schemes. If there is an assurance that no terrorists will cross borders, the same borders can then become "gateways rather than the barbed wires that they are today". A major measure that facilitated the integration of Europe was the large scale exchange of students and scholars of all variety, even before the borders were fully opened.

Imagine what could be possible in South Asia if there are no fears that Mumbai style terrorists might take advantage of this? Familiarity erodes the enemy image and one can see each other as human beings and not as monsters that many extremists would like to depict the other.

Fourth, is to strengthen regional cooperation through the mechanism of SAARC. Indeed a lot is beginning to happen other than the free trade agreement. Burma may join in the near future, major countries have joined recently as observers and the organisation looks forward to a meaningful cooperative future. This is where the example of the European Union will be enormously beneficial and we look forward to learning from it. I was privileged to lead a delegation of directors of ten South Asian think tanks to the EU only just last year and this was an enriching experience for all of us.

Finally, let us remind ourselves we are today at a very critical period in world history. In a period where world economy is facing the worst crisis in a hundred years, it is also poised in bitter conflict and division. Even as the war in Iraq hopefully winds down, it remains delicately balanced in Afghanistan, with no certainty as to who or what will win.

The epicentre of the current global conflict has shifted according to the US and many world leaders to Afghanistan and Pakistan. It will require many bold and decisive actions at all levels and enormous political will to bring the situation to normality. It will require a major global effort. But the principal work will have to be done in South Asia. I am hopeful, given sensible political leadership this is indeed possible.

Keynote Speech (II): India-Pakistan relations: From Confrontation to Cooperation

By retired Lieutenant-General Talat Masood, independent military and political analyst, Islamabad, Pakistan

The Mumbai terrorist attack once again brought to fore the fragility of India-Pakistan relations, shattered the prospects of peace in the region and has diverted the attention of the two countries from the main challenges facing their people. With the peace process frozen, painstaking efforts of last five years by the two governments and their civil societies to build architecture of peace have fallen apart.

No doubt during the last two years the peace process had already lost momentum as India remained pre-occupied embracing US in a strategic partnership and Pakistan was beset with a host of domestic problems. Although the Composite Dialogue did help in improving the political environment and several useful military, economic and cultural confidence building measures (CBMs) were introduced.

These include advance notification of ballistic missiles flight tests, establishment of a dedicated fiber optic communication link between the foreign secretaries of two countries to serve as a nuclear risk reduction measure. CBMs covering bus travel between both sides of Kashmir and developing air and rail links between India and Pakistan have allowed the people to involve and benefit from the peace process in a limited way.

There has, however, been a lot of bureaucratic inertia and mistrust that did not allow the full benefits of the CBMs. Trade and commerce that has a lot of potential to bring the people together was picking up, but like travel and other positive developments has slowed down. There was no real progress on the concrete issues of Kashmir, Siachen and Sir Creek.

The prospects of a gas pipeline from Iran to meet the growing energy demands of India and Pakistan also were thwarted due to American pressure. Agreement on energy pipelines would have had a positive influence on the strategic thinking and strengthened the cause of bilateral and regional integration.

Another major factor of instability is the growing conventional military imbalance between India and Pakistan that could have a destabilising effect on their relationship. India's military plans and ambitious modernisation programme are gradually acquiring a far wider regional and global dimension, much beyond the India-Pakistan security dynamic. The US-India nuclear deal and enhanced cooperation in defence cooperation, civil space and high technology commerce has altered the power dynamics in the region.

Pakistan, for its part, had shown enormous flexibility on the Kashmir issue and was prepared to go half way on Siachen and even Sir Creek which has to be resolved by 2009, being mandatory due to Law of Sea Conference. India's reticent attitude and absence of political will are largely responsible for the lack of progress. Success on any of these issues would have given a huge impetus to the peace process and pushed back the forces that have vested interest in confrontation rather than cooperation.

India's initial sense of deep anguish after the Mumbai incident is understandable, but making unsubstantiated allegations and whipping up frenzy has been most unfortunate.

New Delhi's earlier implied threats of keeping all options open and launching a massive diplomatic campaign to isolate Pakistan made little sense. Surgical strikes or a 'Cold Start' operation would have invariably escalated into a full fledged war with dire consequences for both countries. The death and destruction caused by war on both sides would have far outweighed the damage and loss of life wrought by the militants in Mumbai.

Similarly, India's design of isolating Pakistan, which still remains to be its primary aim besides being a non-starter, is also poor strategy. Expanding insurgency and the rising power of militants in Pakistan's tribal belt are posing a huge challenge for which maximum support by the international community is imperative. Pakistan's instability will not only have regional but global fall-out. It is therefore surprising to think what India would try to achieve by isolating Pakistan and whether it expects any country to support it.

A few hard facts also need to be remembered: Pakistan is the second largest Muslim country with a population of 170 million people, a nuclear power, strategically located and close ally of US and NATO in combating insurgency and terrorism, notwithstanding the expedient nature of that relationship. Pakistan also has a strategic partnership with China and close ties with Saudi Arabia, UAE and other Muslim countries.

The question then arises about India's motive in launching the diplomatic offensive besides wanting to isolate Pakistan. Was it meant to divert world attention from Kashmir's indigenous uprising and also undermine President Obama's proposal of adopting a more holistic policy that could lead to finding a resolution to the dispute and greater stability in the region?

The world has to be cognisant that besides the religious, cultural and political bonds there is also an ethnic overlap of people of Kashmir, similar to the Pashtun one on the Afghan border. The Punjabis of Kashmiri origin, apart from people from Azad Kashmir, have close affiliation with the Kashmiris on the other side. It is true that Pakistan in the past has been supportive of militant organisations like Lashkar-e-Tayaba and Jamaat-u-Dawa, but has abandoned the policy in the changed geo-political scenario.

Some of these organisations or their splinter groups have now acquired an autonomous character and are creating serious security problems for Pakistan and in the region. It is more the reason that India should take a long term view and try to move toward resolution of Kashmir dispute. Kashmir being a live and dynamic problem is not going to go away and if allowed to fester it would continue to promote militancy.

Now that the Pakistan government has partly owned that perpetrators of the crime were mostly Pakistani and detained leaders of *Lashkar-e-Tayaba* and *Jamaat-ud-Daawa* and demonstrated its sincerity and commitment to prosecute them, there is no reason why the Indian government and media should not calm down. India should get past the 'blame game' as only a credible investigation to determine the facts will bring the perpetrators of crime to justice.

It is important to establish a mechanism that can jointly put in place more creative thinking about responses to terror. There also has to be an institutional mechanism for crisis management between India and Pakistan. With increasing radicalism in both countries it is not possible to rule out future attacks. The current practice of using terrorist incidents for whipping up nationalist sentiment or gaining domestic political advantage is highly counter productive.

The role of the intelligence agencies of India and Pakistan in each others countries has to change from confrontation to cooperation if a qualitative improvement in their relationship is desired.

With India's elections due in April or May of 2009, relations with Pakistan will be a major issue and it would be unfortunate if Congress and BJP use the narrative of hate and conflict for short term political gains. This will exacerbate tensions and give a further impetus to religious bigotry and nationalist jingoism. Keeping forces of the two countries in a semi-mobilised state fuels militancy and religious extremism and will push the two countries further into a narrow lane.

Irrespective of whichever party comes to power in India it should resume the Composite Dialogue with Pakistan. India and Pakistan have to get back to the negotiating table and resume the peace process. The great tragedy of Mumbai should be turned into an opportunity.

There are also lessons to be learnt from the experience of France and Germany for the people and leaders of South Asia. Geography, history and shared cultural ethos provide a suitable foundation for the South Asian togetherness on the lines of the European Union.

What is needed is a genuine shared vision for the stability and progress of the region. The pace of globalisation, dangers emanating from spread of religious radicalism and the global economic crisis demand that India and Pakistan move toward resolving disputes, find maximum areas for economic cooperation, develop political linkages and opportunities for cultural exchange.