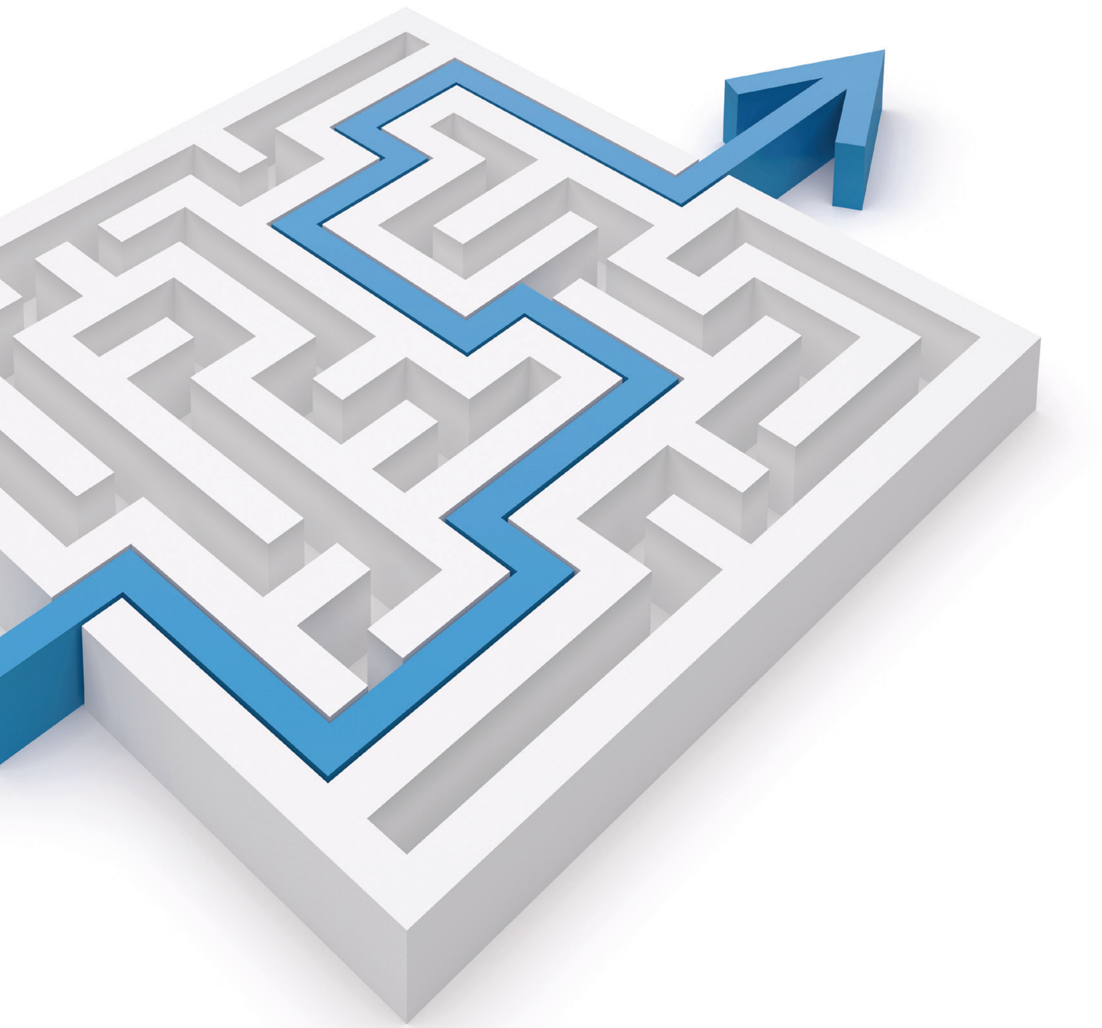
ECONOMY AND SOCIETY

Learning from the crisis:
How can Asia and Europe respond to future financial and economic crises?



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Learning from crises: How can Asia and Europe respond to future financial and economic crises? [1]

INTRODUCTION

The 2008/09 global financial and economic crisis, and more recently the European sovereign debt crisis represent an unprecedented challenge to members of the Asia-Europe Meeting (ASEM)[2] process, an inter-regional dialogue on economic, political and socio-cultural issues between the 27 EU and 19 Asian governments. Crises create instabilities, eroding the confidence in the architecture of the global economy and shaking its institutions. Asia-Europe co-operation remains of utmost importance not only to facilitate greater global financial integration but also to regain confidence in the international monetary and financial system.

The ASEM community now boasts twelve members in the G20 and represents over 60% of global population and over 55% of global GDP. This ensures that the decisions made within and between Asia and Europe have major effects on the global economy, with an impact on economic stability and growth. The declaration by heads of state at the 8th ASEM Summit in Brussels in October 2010 called for a push "towards more effective global economic governance". It is evident that major opportunities exist in the current climate to create greater economic and financial co-operation, while improving existing coping mechanisms.

The leaders of the G20 reiterated this push towards greater co-operation at the Cannes Summit Meeting in November 2011. In the final declaration, they jointly stated, "we reaffirm our commitment to work together and we have taken decisions to reinvigorate economic growth, create jobs, ensure financial stability, promote social inclusion and make globalization serve the needs of our people"[3]. In this era of considerable uncertainty, uncoordinated policy actions will only act to deter investor confidence and will lead to a further slide in the health of the global economy.

Asia and Europe are both facing serious challenges to deepen their regional integration. The EU provides the frontier for deepened regional economic and financial integration and the challenges and vulnerabilities that come with that. Asia, though not as deeply integrated, has experienced growth despite two major financial and economic crises (1997/98 and 2008/2009) in just over a decade, thus illustrating the level of resilience of its economies and their important role in supporting global recovery. Both regions have a strong impetus to integrate further, one to meet the needs of sustained growth, the other to safeguard the health of the EU. The EU is struggling to create the mechanisms and political will to overcome the current crisis that is threatening to drag the Eurozone economies deeper into the mire. Emerging economies in Asia see the advantages arising from integration as further allowing regional investment flows to meet the rising domestic demand, a key driver for sustained economic growth.

It is this effort to rebalance Asian economies that is contributing to global growth. However for this to take shape, Asia and Europe need deep structural reforms and enhanced exchange rate flexibility must be introduced and integrated across the region. According to the President of the Asian Development Bank, Haruhiko Kuroda, "the region [Asia] will make increasingly valuable contributions to global stability and global prosperity".[4] At the same time, a common understanding of opportunities, risk potentials and co-operative initiatives for building more resilience and prosperity in Asia and Europe seems to be lacking. Europe is facing challenges that call for greater and more structured collaboration in solving the Eurozone's crisis.

[1] Special thanks to Dr. Giovanni Capannelli, Dr. Sun Lixing, Dr. Manuel "Butch" Montes, and Prof. Marjan Svetličič for their contributions to this report.

[2] The Asia-Europe Meeting (ASEM) was initiated in 1996 when the ASEM leaders met in Bangkok, Thailand. ASEM is an informal trans-regional platform for dialogue and co-operation between the two regions and has arisen out of a mutual recognition that the relationship between Asia and Europe needed to be strengthened in light of the challenges and opportunities of the 21st century. ASEM now brings together 46 member states (Australia, Austria, Belgium, Brunei Darussalam, Bulgaria, Cambodia, China, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Indonesia, India, Ireland, Italy, Japan, Korea, Laos, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Mongolia, Myanmar, the Netherlands, New Zealand, Pakistan, the Philippines, Poland, Portugal, Romania, Russia, Singapore, Slovakia, Slovenia, Spain, Sweden, Thailand, United Kingdom, Vietnam) plus the European Commission and the ASEAN Secretariat (www.aseminfoboard.org).

[3] Cannes Summit Final Declaration, G20 Leaders Summit, Cannes, France, 4 November 2011, http://www.g20.org/index.aspx (accessed 15/11/2011)

[4] Kuroda, H. 2010, 'The role of the Asian Development Bank', The G20 Seoul Summit 2010: Shared Growth Beyond Crisis, last updated November 08, 2010, http://www.g8.utoronto.ca/newsdesk/seoul/seoul-kuroda-en.htm (*accessed 24/10/2011*).

SECTION I: WORKSHOP—THE IMPACT OF THE CRISIS ON REGIONAL ECONOMIC AND FINANCIAL INTEGRATION IN ASIA AND EUROPE

In response to calls for effective global economic and financial governance, the Asia Europe Foundation (ASEF), the Asian Development Bank Institute (ADBI), the University of Ljubljana (UL), the Europe-Asia Policy Forum (EUforAsia) and Prospex jointly organized a workshop in Ljubljana, Slovenia, from the 14th to the 16th of September 2011. Involving high-level experts from both regions, the workshop aimed at generating innovative ideas and informed recommendations on how to assess vulnerabilities, prepare for future crises, and identify activities for more extensive cooperation among the two regions.

Experts also shared their perspectives on regional financial cooperation with the objective of fostering global growth and stability. The workshop specifically discussed issues related to future monetary regimes, regional financial integration mechanisms, regulatory frameworks, fiscal policy implications, as well as priorities for the next ASEM Finance Ministerial Meeting.

Process and Proceedings

From the outset the project aimed to identify the key dynamics that are shaping regional financial integration in Asia and Europe, as well as the broader global financial system in response to the economic crisis. Along with identifying the dynamics, the project intended to highlight the financial vulnerabilities and risks facing Asian and European economies. By bringing together high-level Asian and European experts to identify these risks, the project provided policy recommendations and options to ASEM members. These options will outline areas of regional and inter-regional co-operation to offset the impact of the crisis and aid the creation of coping mechanisms for future crises. In addition, the group provided a list of priorities for the next ASEM Finance Ministers Meeting and urged the Slovenian government to host the meeting in 2012.

One of the key features of the workshop was the use of a foresight strategy methodology to generate and analyse policy options for mitigating future economic and financial crises in Asia and Europe. Under the expert guidance of facilitators Dr. Steven Libbrecht and Mr. Martin Watson from the foresight consulting group, Prospex, the participants looked at the next two decades of economic development and tried to map out the possible factors driving the post-crisis global financial system up to 2030.The reason for using 2030 as a timescale is that it offers a reasonable timeframe for strategic foresight, by allowing for structural change to occur through policy reforms.

Participants discussed the pros and cons of long-term economic analysis and proposed innovative responses for both Asia and Europe to face the emerging challenges and risks moving forward. The produced outcomes can be considered as the result of an intense journey by experts through the dynamics impacting the global economy, the possible future scenarios we face, the questions that remain unanswered, and finally the policy options that need to be taken to realise a resilient and stable future global financial system.

The workshop began with a run through of the process and the uses of strategic foresight methodologies. This was followed by presentations by Prof. Alfred Steinherr, Bolzano University (formerly the Chief Economist at the European Investment Bank) and Prof. Akira Kohsaka, Osaka University, on the respective responses to the global crisis in Asia and Europe and the challenges we are still facing. The aim of these presentations was to provide perspectives on the developments in the financial and economic systems in Asia and Europe following the crisis of 2008/09. The presentations offered a point of departure for the workshop participants to discuss the extent of the current challenges and the effectiveness of the policy solutions adopted in both regions.

This was followed by a plenary session to identify of the key question being addressed, with consensus focusing on: "How can global and regional financial integration contribute to resilient and stable economic and social development?" With this question in mind participants worked on identifying the driving forces affecting financial integration in Asia and Europe. Each participant was asked to choose three driving forces, guided by social, technological, economic, environmental, political factors. The next step saw the driving forces clustered under headings based on their commonalities and linkages, see Fig. 1 for details.

Figure 1: Clusters of Drivers *(including factors)*

Monetary & Fiscal Policy
Rise of Asia *(China, China's development, East Asia strategy in investing its foreign reserves)*
Demographic Factors *(pension funding, uneven demography, migration)*
Sustainability *(Green Growth, scarcity of resources, ecological constraints)*
Political Legitimacy *(leadership, trust, political situation, political integration, rise of neo-nationalism, unemployment, competition for FDI, Islam, National Interests, regional security, human stupidity)*
International Monetary System *(enhanced fiscal and monetary policy co-ordination, develop global and regional capital markets, International Financial Institutions, Global Currencies, USA Factor)*
Economic Paradigm and Regulatory Regime *(privatization, tax cutting/small gov't objectives, more responsibility, de-regulation, financial innovation, financial regulation, Establish stable & resilient domestic financial system)*
Eurozone crisis/resolution *(how the Eurozone evolves to solve current public debt problem, resolution of sovereign debt crises, example of global and regional financial development/ Asian co-operation)*
Trade and Growth *(increase in trade, real economic growth, economic integration, spatially expanding production networks, trade off – security & growth)*

Having identified and evaluated the driving forces and created clusters to identify the major issues affecting "global and regional financial integration", the participants moved into four groups to further reflect and elaborate on the clusters. They charted the factors on a pair of axes based on "Uncertainty" and "Impact" with attributed values of Low, Medium and High. On completing the analysis, the participants were asked to find combinations and linkages (or divergences) between these driving forces, focusing on the medium and high impact ones. Each group was asked to present and discuss their choices with other groups providing a critique.

The next step in the process was to select the key dynamics from the analysis and seek to further understand the issues by outlining the: (i) Driving Factors, (ii) Possible Scenarios, (iii) Learning Points, (iv) Research Questions, and (v) Policy Recommendations to deliver these possible developments. Each group was asked to present their findings for critique, allowing for converging factors and scenarios to be consolidated. At the same time, the robustness of the recommendations with respect to all scenarios was discussed.

The final session, looked to draw from group findings and outline the priorities for the next ASEM Finance Ministers meeting, which are outlined in full in Section III of this report.

Conclusion

When applying scenarios and foresight strategies, it is important to point out that these are not predictions of what will actually happen but rather what could happen. The true value of using foresight methodologies lies in the collective learning that occurs as a consequence of the integration of multiple perspectives, allowing for a free exploration of the future. The design of the process allows for the creation of innovative policy recommendations that are robust against a set of wildly diverging yet possible futures. The methodology design allows for expert opinion and discourse to be clearly refined into concrete outcomes, tested and analysed through multiple processes.

The volatility associated with the issue of economic and financial integration represented a number of challenges. Using this type of foresight methodology to investigate an issue with such intense complexities would usually involve a step-by-step approach with numerous workshops to create robust scenarios over time. Faced with the prospect of carrying this out in two and a half days, the workshop organisers chose to take an innovative approach to the process. By focusing the methodology on the key dynamics, the workshop was able to develop robust policy options within the short time frame.

The policy recommendations produced present thoughtful and practical ideas as tangible outcomes to help the governments of Asia and Europe push past the current crisis and develop mechanisms for future crises. It is this aspect of developing mechanisms that is the inherent worth of the process, which aimed to provide leaders in Asia and Europe with the potential future developments and the coping mechanisms needed to avoid future devastating financial shocks.

SECTION II: KEY FACTORS SHAPING REGIONAL FINANCIAL INTEGRATION IN ASIA AND EUROPE

The aim of the workshop was to highlight the latest developments and the central issues shaping the global financial system at present and in the future. As mentioned previously, the participants were split into groups based on their expertise and interests. The groups were brought through the methodology to produce and analyse the major outcomes of the workshop.

Having identified and analysed the key factors, the groups mapped out possible scenarios, learning points, research questions and finally made recommendations based on the outcomes of the process. Based on a review of the commonalities from the individual group reports (see Annex II) and the final policy recommendations, participants agreed that the six issues elaborated in this section will play a major role in contributing to resilient and stable economic and social development in Asia and Europe.

Before analysing each of the key factors, participants discussed what possible scenarios would arise within the 2030 timeframe based on these key factors. The three main themes that arose during discussions were centered on a utopian scenario of global harmony, a more pessimistic scenario of intensified regionalism and finally a worst-case scenario of deepened global depression. Each of these scenarios and their dominant features are described briefly below.

Figure 2: Scenarios

Harmonious Globalisation

This scenario presented a world in which the circuit of capital was truly global and was managed by a reformed and trusted mechanism of global governance. Effective global regulation of the finance sector has resulted in sustainable real sector growth and growing employment. In this scenario, global power was balanced with Asia, EU and US, as well as other emerging economies working together under an efficient and effective G20. The global environmental challenges are being resolved through sustainable green growth, while commodities are not being used at an exhaustive level. Due to global economic stability, political tensions and military conflicts are easier to resolve peacefully. Trust has been restored in the global governance system, resulting in sustained stability and improved living standards.

Regional Isolation

This scenario sees a rise in intra-regional cooperation in the face of stagnant economic growth. With this comes an increase in regional protectionism, leading to intensified inter-regional competition, which results in an ineffective global economic governance system. In this scenario, the global currency system is made up of 3 main currencies, the US dollar, the Euro and an Asian Currency (likely the Yuan but not discounting the Yen). This system intensifies the need for more regional integration and hinders global integration. As the global economy stagnates, unemployment and migration become major social issues and help to deepen distrust in a globally integrated system. The deepening of regional isolationism leads to an increase in inter-regional tensions at various levels.

Global Meltdown

This scenario presents the prospect of global depression and intense instability caused by a prolonged period of negative growth and the breakdown of global and regional systems, including their governance mechanisms. The G20 and other international groupings breakdown, leading to a severely weakened global financial system. High unemployment, especially among the younger generations results in the erosion of trust in the global system, while national governments implement short-term protectionist policies to alleviate immediate concerns. In this scenario, political tensions escalate and conflicts are commonplace in this era of instability.

Solving the Eurozone crisis

Arguably the most pressing issue facing global economic stability at the moment is the ongoing Eurozone crisis. The issue was a central point of discussion throughout the workshop with the general consensus being a swift resolution of the Eurozone crisis through initiatives such as the issuing of Eurobonds to alleviate the pressures from the sovereign debt crisis. Discussions on the use of Eurobonds centred on the potential stabilizing factors such as pooling risk to support weaker member states, lowering interest rates, and facilitating lending. Concerns over the risk of moral hazard and political and public objections were considered as major factors hindering the issuing of Eurobonds.[5]

In addition, discussions included the need to review the feasibility of a European specific Sovereign Debt Restructuring Mechanism (SDRM) to improve fiscal policy discipline. This is especially prevalent given the inefficiency of existing formal mechanisms within the Eurozone.[6] A further issue that was highlighted was the need for adequate and equitable private sector burden sharing for sovereign debt restructuring. Participants believed that a failure to do so will ensure that debt burdens cannot be lowered to solvency-consistent levels.[7]

One matter participants agreed upon was the need for greater political will and trust among the key actors (governments, EU institutions, financial institutions) in order to solve the crisis. Effective regional financial cooperation is required to overcome the current crisis but many questions still remain. Firstly, are key Eurozone countries willing to continue to bear the burden of the bailouts to prop up ailing economies (Greece, Portugal, Ireland)? The Dutch and Finns threatened to "not participate"[8] in further Greek bailouts in September and the initial Slovakian Parliamentary "No" vote attest to the strain and frustration felt by the Eurozone members footing the bill for their profligate partners.

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[5] Ian Begg. The Eurozone crisis, demands for fiscal union and hard political realities. http://www.asef.org/index.php/projects/themes/economy/2225-learning-from-the-crisis

[6] Weder di Mauro, B. & Zettelmeyer, J. European debt restructuring mechanism as a tool for crisis prevention, Vox, Available at http://www.voxeu.org/index.php?q=node/5845 [accessed on 14/10/2011]

[7] John Ryan. Policy options to strengthen regional and global financial integration from a European Perspective. [Available on request]

[8] Jan Kees de Jager, Dutch Finance Minister, quoted in: Evans-Prichard, A. Germany pushes Greece to the brink in dangerous brinkmanship. The Telegraph, last updated 10:15PM BST 08 Sep 2011 Available at: http://www.telegraph.co.uk/finance/financialcrisis/8751180/Germany-pushes-Greece-to-the-brink-in-dangerous-brinkmanship.html [last accessed 31/10/2011]

In contrast to this, another question remains: Can European countries continue with the austerity measures laid out by EU institutions and the International Monetary Fund (IMF) ? This is especially pertinent with Greece's inability to meet targets. On top of this, have they the capacity to be "German" (i.e. fiscally austere) and is a Eurozone made up of German-style fiscal management a feasible or desirable prospect? What would be the impact of this development?

In terms of the linkages to the scenarios, discussions on the Eurozone crisis focused on various issues from 'Harmonious Globalisation' to 'Regional Isolation' and to 'Global Meltdown' with depression and instability. Under the 'Harmonious Globalisation' scenario, sovereign debt issues are resolved and a comprehensive and effective global economic governance system is created. In contrast, the 'Global Meltdown' scenario offered the prospect of the EU slipping into a deep depression, while regional and global governance structures are ineffective causing continued unemployment, protectionism and overall instability. The Eurozone crisis did feature under the 'Regional Isolation' scenario that considered the development of a new global currency system with shared influence by the Dollar, Euro and an Asian Currency (most likely the Yuan).

A wildcard social issue linked to the Eurozone crisis was highlighted for its potential impact. Falling under both the 'Global Meltdown' and 'Regional Isolation' scenarios, continued unemployment was discussed as a major future issue for the health of the Eurozone. With the rapid explosion of social unrest seen during the Arab Spring, triggered in part by youth unemployment, a fear exists that similar issues could affect stability in the EU. Despite an aging population, certain EU member states are currently facing social unrest due to disaffected youth and youth unemployment, e.g. the Indignados movement in Spain and the rioting that took place across the UK last August. Social unrest could affect economic stability within the EU, causing stagnation and weakening political legitimacy.

Revitalising the Bretton Woods institutions

Discussion focused, to a large extent, on the broad issue of global economic governance. Existing global mechanisms came under scrutiny, especially their role and structure post-crisis. The shift of power from West to East is seen as a major factor for more resilient and stable economic and social development.

First and foremost, participants agreed that trust is needed in the political system to be able to reform the Bretton Woods system. The next step is to correct the global imbalances, partially caused by weak global governance and an overreliance on the financial realm over the real economy. Lastly, participants pointed out that a major factor that will likely impact any future revitalisation of the Bretton Woods system, will be the shifts in the rebalancing between world regions, with the US and EU dominance in terms of capital and intellectual property ceding ground to Asia.

In preparing a successor to the Bretton Woods system for a post-crisis landscape, the most pressing concern is to create, as soon as possible, a stable and resilient international monetary system. According to the experts' discussions, the future of the Bretton Woods system lies in the East, as a resurgent and resilient Asia continues to call for more action from faltering Western economies. It was recommended that Asian and European leaders formally begin the process of reforming international economic governance mechanisms to install a post-crisis revitalized Bretton Woods system. This reform would cover issues such as: the international payments and reserve system; exchange rate arrangements and rules; improved mechanisms of surveillance and policy co-ordination including a review of existing mechanisms[9]; regulatory coordination and harmonization of International capital markets; mechanisms for crisis and debt resolution; mechanisms for financing development.

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9 International Monetary Fund (IMF), World Bank, World Trade Organisation (WTO), Financial Stability Board (FSB);

How these reforms would affect future developments were central to the discussions and the groups explored a number of scenarios: The reform of the Bretton Woods system was discussed as part of the "Harmonious Globalisation" scenario, especially with the prospect of widening and deepening this current era of globalisation. In this view, national governments would need to possess added capabilities to provide clear rules for co-operative solutions to shared problems and potential crises. A functioning system of global governance would provide these capabilities and greater global stability.

In the 'Global Meltdown' scenario global recession persists with unemployment (especially among the youth) and protectionism takes hold as national governments seek short-term solutions. In this scenario, political will to reform the Bretton Woods system is lacking and without a functioning system, a "beggar-thy-neighbour" environment prevails.

Finally, when discussing the issue of reforming the Bretton Woods system, a number of points need to be acknowledged. Firstly, the system must play an instrumental role in improving stability and prosperity. Another key point is the essential link between the consistency of national policies with regional and global financial cooperation. That said a major question remains: Is deepened regional integration a stepping-stone or a stumbling block for global institutions? Given the experience of the tense negotiations between the (IMF) and the European Central Bank (ECB) during the Irish bailout, it seems the latter could be the case.

Providing an effective link: finance and the real economy

There is a palpable need to create a strong, consistent link between the financial sector and the real economy. The system of finance-based globalization has resulted in the boom and bust nature of the global economic system. Imbalances exist due to an over-reliance on finance rather than the exchange of products that are central to the health of the real economy. Financial innovation has revealed the incapacity and inadequacy of existing regulatory frameworks and their implementation and an opaque relationship between the state and the financial sector, which continues despite major taxpayer bailouts and support.

When trying to come to terms with the scale of the over-reliance on the financial sector and the subsequent imbalances in terms of the real economic, a number of factors should be considered. First, it is important to ask what is necessary to build national capacities to promote real sector-based growth. The next question is how societies can build properly working financial services that serve to create a socially functional finance sector.

The 'Harmonious Globalisation' scenario illustrates the kind of impact that can be made by reinforcing the link between the real economy and the financial sector. The idea of a post-crisis world that is based on harmonious globalisation sees the process of global integration becoming wider and deeper based on effective and comprehensive global economic and financial governance. In this scenario, finance-based globalization is replaced by an international financial system that is regulated to serve the real economy, facilitating output growth and employment.

Regulation

Apart from structural/systemic causes a major factor underlying the ongoing global economic crisis is the under-regulation and inefficient implementation of existing finance sector instruments as a whole. Regulatory frameworks are deemed inadequate to respond to the depth and speed of the crisis due to their inability to assess the increased risk posed by financial innovations and new financial instruments.

A number of new approaches and instruments are needed in order to create a fully functioning regulatory net, from national to global regulatory bodies. A key necessity at the moment is to regain the trust and political will. This is needed to rein in the business and financial sectors. The participants were largely in support of the notion that over-reliance on the financial sector needs effective re-balancing through stronger regulation.

Looking specifically at mature economies—those most affected by the economic crisis—more complex national regulatory systems, but also regional and global rules for finance is an essential element of a post-global financial crisis international architecture. Greater convergence is needed among emerging (maturing) as well as advanced markets towards a more intensive set of regulations at different levels. Overall, closer international co-ordination and harmonization, spearheaded by institutions such as the Financial Stability Board (FSB), is required to fill regulatory gaps in order to offset the potentially negative consequences of financial innovation and shadow banking practices.

In discussing global and national regulations, a number of cross cutting issues were discussed within the three potential scenarios. In the positive, 'Harmonious Globalisation' scenario, international regulatory frameworks are robust enough to tackle the issue of unregulated flows of capital used for tax evasion, the funding of terrorism and drug trafficking. Keeping this utopian scenario in mind, we must ask the question: Can financial regulation be coordinated internationally to provide effective control of international capital flows? Global financial coordination will need strong political will, public buy-in, and, in the short term, better decision making to prevent a further slide in this crisis.

With the fear of further escalations in mind, it was recommended that global co-ordination for regulating finance—especially sophisticated financial innovation—should be strengthened. Ensuring that regulation keeps pace with new financial products, instruments and cross-border financial institutions is essential in preventing further financial crises. A large proportion of the blame for the ongoing global financial crisis landed on the poor regulation of derivatives trading, or "financial weapons of mass destruction" as claimed by renowned investor Warren Buffett. It is essential that any reformed regulatory frameworks be agile and adapt to financial innovations to reduce further vulnerability.

Asian Co-operation

One of the most dominant issues raised during the workshop was the progress of and future prospects for Asian co-operation. The increased speed and level of integration in Asia is expected to contribute to resilience and stability of regional and global economies, and, in turn, to ensuring sustainable development. When considering the rapid rise of the People's Republic of China (PRC), the possible internationalisation of the Yuan, and the potential growth of Asian markets, it is evident that Asian economic co-operation will play a major role in the post-crisis system. Workshop participants suggested that Europe and North America should react positively to improvements in Asian economic and financial integration.

Asian economic co-operation is given momentum by the rise of the PRC the dynamism of the Korean economy, as well as the progress of economies belonging to the Association of Southeast Asian Nations (ASEAN). A driving factor in Asian cooperation is the legitimacy and support of Asian governments to work in their mutual interest to support economic development. An obvious and important driving factor is global rebalancing. The rise of Asia has shifted capital eastward and will continue to do so for some time. According to OECD figures, the PRC is expected to run a current account surplus to GDP ratio of 4.5% for 2011[10]. Recent PRC figures claim this has shrunk to 4% for 2011 but foreign direct investment (FDI) remains "robust". Looking at South East Asian economic growth trends, capital inflows in major ASEAN economies such as Indonesia and Malaysia have recently been increasing with high foreign ownership of Government Bonds (30% and 20%, respectively)[11]. These capital inflows to Asia will likely continue to rise while they may stagnate in the US and EU

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[10] Yu Yongding. Macro-Management in the post crisis period. http://www.asef.org/index.php/projects/themes/economy/2225-learning-from-the-crisis

[11] Noritaka Akamatsu Global financial crisis and regional integration. http://www.asef.org/index.php/projects/themes/economy/2225-learning-from-the-crisis

Another major driving factor is the marked shift in Asia's focus towards regional demand, driven to a large extent by the rise in domestic demand in the PRC. Recent analysis revealed that the final demand of Asian products in 2009 originating from within the region accounted for only 28.9%, of the total, with the remaining 71.1%[12] destined other regions (predominantly the US and Europe). The fallout of the global financial crisis will likely imply, however, less spending power outside of Asia, which is expected to contribute to the rebalancing of global real and financial trends, prompted by such increases in national and regional divers of growth.

With the continued development of the PRC and the potential presented by regional cooperation among Asian economies, the future path the region will take will undoubtedly affect major shifts in the global architecture. In terms of scenarios, enhanced Asian cooperation and its global impact offer interesting opportunities. The 'regional isolation' scenario sees Asian co-operation intensifying out of necessity, as a consequence of the breakdown of globalization. In this scenario, a major setback in the European integration project and rising US-China tensions is expected to trigger Asian countries to look internally within the region and to integrate rapidly among themselves to sustain economic growth and stability. In a world focused on regions, protectionism will however prevail and the G20 will prove ineffective in breaking the deadlock between regions to kick start global growth. With weakened global growth, youth unemployment will continue to burden western but also other economies and emerge as a major cause of social unrest. Moreover, the control over, and access to, resources will undoubtedly raise tensions between regions and within regions. The outlier factor of rogue states will raise its head (though their impact may be contained within regions) and continue to be troublesome, raising fears of military conflict.

The idea of heightened Asian co-operation and integration is also evidenced in the 'Harmonious Globalisation' scenario. In this scenario, Asia builds the capacity to accept its growing responsibility for an orderly management of the global economy. Under this scenario, US-Chinese tensions over currency exchange rates are resolved and an effective system of global economic governance is put in place to redress global imbalances. This scenario sees Asian integration speed up both in terms of greater inter-dependency to sustain growth and its stronger position in the re-balanced global system. The 'Harmonious Globalisation' scenario sees a resilient and stable global economic system taking place and this, in turn, will help create a positive environment for reducing conflicts and improving geo-political stability. Eventually, under this scenario, sustained global growth will allow Western economies to tackle unemployment issues.

In considering the implications of the emergence of these different scenarios, a number of key reflections need to be made. Firstly, it is evident that power is shifting from West to East, though the speed and scale of this shift is not fully known. One key reflection the workshop participants wanted to stress is the US-China relationship which will greatly contribute to shaping the post-global crisis world. A harmonious US-China relationship will ensure stability and resilient actions in the face of future crises. A key factor is Asia's ability to co-operate. Regional investment is also going to be a key driver in Asia's development, as ASEAN members refocus their efforts to support Chinese domestic demand and improve their share of the region's market for goods. This gradual shifting away from the US and EU towards the PRC as a destination of final goods, will drive Asia closer together as economies become more interdependent.

A number of uncertainties are, however, also emerging. A first question is how can the PRC be further integrated into the global economy? Answering this question implies answering a number of related puzzles. What does the PRC need to do to further open up its economy more effectively? Is there the internal political will to achieve this? How can other major powers entice the PRC's entry into the global system? And, is such an increase in the power of the PRC in everyone's interest, or is the status quo more appealing?

In terms of regional supply being driven by regional demand, uncertainties exist about whether Asia can re-direct its production to be the destination of final demand. For this to happen, a number of questions need to be answered. Firstly, what policies need to be put in place? Will Asian internal demand be sufficient to refocus attention away from the lucrative European and US markets?

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[12] Ibid.

It appeared evident during the workshop that the prospect of an integrated and functioning Asian region would create a major impact of the global financial system and would inevitably play a more proactive role in global economic decision-making. For Asia to rise as an integrated region, a number of policy adjustments need to be made. First and foremost, the PRC will need to take its share of responsibility to ensure global financial stability. The internationalisation of the Yuan will provide greater opportunities for investment in Asia but will also result in greater risks, while rapid and rigorous reforms will be required.

Internationalisation of the RMB and Exchange rate co-operation

The internationalisation of the Yuan and exchange rate co-operation is expected to play a major role in global financial stability and defining the route out of the economic crisis. The idea of the Yuan playing a stronger role in the global currency system opens up a larger debate on what such a system will look like.

The 'Regional Isolation' scenario put forward the idea of a tri-polar global currency system including the US dollar, the euro and an East Asian currency (most likely the Yuan, but not discounting the Yen or a combined regional currency). It was projected that the leading currency of the three would be the US dollar given its current dominance and the interest of China to ensure the strength of its dollar reserves. This scenario presents many questions: (i) what impact will a tri-polar global currency system have on regional and global financial integration? (ii) Will this scenario push countries into a harmonious balanced global economic system or will the three-currency system push rivalries and intra-regional tensions? (iii) What impact has the uncertainty of the Eurozone crisis on monetary integration efforts in other regions?

The internationalisation of the Yuan will likely result in the PRC opening its capital markets to the outside world. This greater openness will bring, however, greater vulnerability. To avoid excessive risk-taking, workshop participants suggested that the PRC will need to take a cautious step-by-step approach to capital account liberalisation, similar to the one undertaken by Japan in the 1970s and 1980s.

In order for the internationalisation of the Yuan to take place and for the seeds of a dominant Asian currency to be sewn, numerous structural reforms are needed. Mechanisms of regulation and accountability seem to be needed in the PRC along with speeding up the process of interest rate liberalization and prepare the domestic banking sector to the structural change. With China taking more responsibility in the global finance system and the pushing ahead with the internationalization of the Yuan, the PRC needs to be aware that the risk of a sharp depreciation of the Yuan would likely lead to a further deepening of the crisis in the short term.

Interestingly, the Yuan is already playing its role in a tri-polar global currency system according to the ECB. A recent working paper claims that the International system is already tri-polar as the RMB has become a key driver of currency movements in emerging Asia since the mid-2000s. The report displays evidence of "PRC's dominance hypothesis" with the Yuan influencing exchange rates and monetary policy across the region.[13]

Conclusion

Of the six issues outlined above, the most pressing one is undoubtedly the Eurozone crisis. In deciding what action to take to overcome this crisis "the choice for the EU is simple – reform or decline"[14]. The intensity and depth of the crisis requires swift and decisive policy action, it is important that EU leaders have the political will and legitimacy to make these tough reforms.

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[13] M Fratzscher, & A. Mehl. China's dominance, hypothesis and the emergence of a tri-polar global currency system, European Central Bank (ECB), Working Paper Series, no 1392 / October 2011, Available at: http://www.ecb.de/pub/pdf/scpwps/ecbwp1392.pdf(accessed on 27/10/2011)

[14] Reflection Group on the future of the EU 2030. PROJECT EUROPE 2030: Challenges and Opportunities - A report to the European Council by the Reflection Group on the Future of the EU 2030,pg. 12,
Available at: http://www.reflectiongroup.eu/wp-content/uploads/2010/05/reflection_en_web.pdf[last accessed 27/10/2011]

Similarly, it is very important for Asian leaders to display strong and effective leadership to ensure regional integration can continue unabated to support the rate of growth and development in Asia. It is important that existing mechanisms and initiatives in the region are supported and expanded, namely, the Chiang Mai Initiative Multi-Lateralisation (CMIM), Asian Bond Market Initiative, ASEAN+3 Macroeconomic Research Office, and the ASEAN Economic Community. Workshop participants agreed that sustaining effective regional mechanisms will improve Asia's ability to deal with future shocks and create the opportunity for further economic and financial integration within the region and with the rest of the world.

Facing an uncertain future, the EU must further integrate and create policies to improve existing mechanisms to overcome the current quagmire and cope with future shocks. Asia, on the other hand, is experiencing very different challenges as the global economy rebalances, with capital flowing from West to East and priorities shifting to creating safe measures to improve regional financial integration and access to capital for investment.

The re-balancing of the global economy presents a number of opportunities for Asia to play a more proactive role in global economic governance. Capital has flowed from West to East and with it global political power is also shifting. As indicated by the workshop participants, the Internationalisation of the Yuan may bring about a major shift in the international currency system provided the right reforms and financial structures are put in place. With Asia's role rising and the strength of the Asia-Europe relationship, participants called on the leaders of Asia and Europe to begin the process of revitalising the Bretton Woods system to deal with the challenges of the post crisis world. It was recommended that the initial steps could be the commissioning of studies and a review to outline the developments needed for a robust system, reflective of the current challenges facing the global economy.

The global financial and economic crisis has plunged the world into an era of intense uncertainty. As nations and regions try to weave their path through the crisis and create measures to handle future crises, it is clear that the actions made now will form the basis of a viable post-global economic crisis world. With this in mind, the participants agreed on a common question to be answered: "How can global and regional financial integration contribute to shaping a more resilient and stable economic and social development?" Workshop participants recommended that financial integration, global and regional, should be accelerated. This improved integration should provide the structures and coping mechanisms to ensure that future crises are managed effectively at a national, regional and global level. With mechanisms in place, the post-crisis global financial governance system will need to provide the necessary stability and resilience to safeguard from future crises.

SECTION III: SETTING THE AGENDA FOR THE 10TH ASEM FINANCE MINISTERIAL MEETING IN 2012

A core objective of the project was to channel the findings of the Ljubljana workshop to the ASEM Finance Ministerial Meeting (FinMM) process. Started in 1997, the ASEM FinMM is a regular gathering of Finance Ministers and high level finance officials from ASEM partners. The 9th ASEM Fin MM was held on the 17th and 18th of April 2010 in Madrid, Spain. The next meeting is planned to take place in 2012, before the ASEM Leaders Meeting is held in the Lao People's Democratic Republic in December 2012, but to date no ASEM country has been confirmed to host the meeting.

The participants of the workshop put forward the proposition for Slovenia to take the lead and host the meeting. The below document is the proposed concept and agenda for the 10th ASEM Finance Ministers' Meeting to be held in Ljubljana, Slovenia.

PROPOSAL

10^{TH} ASIA-EUROPE FINANCE MINISTERS' MEETING (ASEM FINMM) LJUBLJANA, BETWEEN MAY AND SEPTEMBER 2012

CONCEPT

(1) With confidence in the international economic and financial system continuing to suffer, financial co-operation between the governments of Asia and Europe is more urgent than ever. Through the ASEM process, Asian and European leaders can play a vital role in creating the mechanisms that deliver a path through the ongoing global economic and financial crisis and ensure stability in the years ahead. ASEM offers the platform for dialogue to create the robust policy options needed to see us into a resilient post-crisis world.

(2) In this greater climate of global interdependence, Asia and Europe in partnership needs to play a more proactive role in setting the agenda for achieving global economic stability and growth. The ASEM Finance Ministers' Meeting provides a unique opportunity ahead of the Leaders' Summit to strengthen this partnership and seek progress on other initiatives of Intraregional cooperation.

(3) The agenda as recommended by the workshop participants could focus on:

a. Regulation
How could Asian and European leaders strengthen global coordination for financial regulation keeping pace with new financial products, instruments and cross-border financial institutions to prevent further financial crises? The closing of regulation gaps between mature and maturing financial systems is needed, especially for greater Asia-Europe co-operation.

b. Revitalising the Bretton Woods Institutions
Asian and European leaders could consider contributing to the process of reforming international economic governance mechanisms to install a post-crisis revitalised Bretton Woods system. The reform agenda may cover issues such as: (i) the international payments and reserve system; (ii) exchange rate arrangements and rules; (iii) review of surveillance mechanisms and policy coordination, regulatory coordination and harmonization of international capital markets; mechanisms for crisis and debt resolution; mechanisms for financing development.

c. Eurozone crisis and Asia
European leaders are encouraged to explore the feasibility of a European-specific Sovereign Debt Restructuring Mechanism (SDRM) to improve fiscal policy discipline. Mechanisms should be put in place for adequate and equitable private sector burden sharing for sovereign debt restructuring. The resolution of the Eurozone crisis will be relevant to the development of robust monetary cooperation in Asia.

d. Real economy – financial system link
Asian and European leaders can create national and regional capacities to promote real sector-based growth and avoid an over-reliance on the financial sector. These initiatives should include measures for a socially functional finance sector, which ensures the rebalancing of growth drivers to improved productivity rather than an inflated finance sector.

e. Supporting East Asian Integration
As Asia continues to strengthen its regional coping mechanisms e.g. increasing funds for the Chiang Mai Initiative Multi-lateralisation (CMIM) mechanisms, regional and national mechanisms to support a stable internationalisation of the RMB could be explored.

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The Asia-Europe Foundation (ASEF) promotes greater mutual understanding between Asia and Europe through intellectual, cultural and people-to-people exchanges. Through ASEF, civil society concerns are included as a vital component of deliberations of the Asia-Europe Meeting (ASEM). ASEF was established in February 1997 by the participating governments of ASEM and has since implemented over 500 projects, engaging over 15,000 direct participants as well as reaching out to a much wider audience in Asia and Europe.

Asian Development Bank Institute (ADBI)

http://www.adbi.org

The Asian Development Bank Institute (ADBI), located in Tokyo, is a subsidiary of the Asian Development Bank (ADB). It was established in December 1997 to respond to two needs of developing member countries: identification of effective development strategies and improvement of the capacity for sound development management of agencies and organizations. As a provider of knowledge for development and a training center, ADBI serves a region stretching from the Central Asian republics to the Pacific islands.

University of Ljubljana – Faculty of Social Science

http://www.uni-lj.si/en

Established in 1961, the Faculty of Social Sciences is one of the largest members of the University of Ljubljana. It has over 5,100 students in 30 undergraduate and graduate study programs. The Institute of Social Sciences, with its 18 research centers, forms part of the Faculty of Social Sciences. The Faculty of Social Sciences is housed in a modern facility with state-of-the-art lecture rooms and provides a distinguished and creative academic setting with ample opportunities for prospective students to choose from a variety of specialized programs under expert faculty guidance.

Prospex

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Prospex is practice leader and innovator in cooperation excellence, offering services for foresight, process facilitation, negotiation, research and supporting services. Prospex often applies focussed stakeholder engagement to develop multidisciplinary perspectives, applied creativity and systemic insight. Prospex experts deliver in many languages and thrive on cultural diversity. Prospex is based near Brussels in Belgium and provides its services globally in cooperation with a network of partners around the world. Clients include many International Organisations (EU, UNEP, IEA, EEA, etc.) and companies (Novartis, Toyota, BASF, GDF Suez, etc.).

Europe-Asia Policy Forum (EUforAsia)

www.euforasia.eu

The **Europe-Asia Policy Forum** (EUforAsia) is designed to target relevant stakeholders in Asia-Europe affairs and policy-making with information on contemporary issues regarding EU-Asia. The briefing series is part of the EU-Asia Policy Forum that aims to enhance EU-Asia cooperation and awareness on issues of mutual interest such as sustainable development, regional integration, governance and other hot topics. Main partners are the International Institute of Asian Studies (IIAS), the Asia-Europe Foundation (ASEF), the Singapore Institute for International Affairs (SIIA) and the European Policy Center (EPC). The Europe-Asia Policy Forum is supported by the European Union.

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This report contains innovative ideas and informed recommendations on how to prepare for future crises, identifying vulnerabilities and activities for more extensive cooperation.

This volume features Asian and European perspectives on regional financial cooperation with the objective of fostering global integration. Specifically, issues explored relate to future monetary regimes, regional financial integration mechanisms, regulatory frameworks, fiscal policy implications, as well as setting the priorities for the next ASEM Finance Ministerial Meeting.

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